THE WINDS OF CHANGE

“Days of wine and roses”
We’re likely to look back at the pre-Crash period as a golden era for card issuers and banks.

Business looked pretty robust. Pesky upstarts (remember The Associates[1]?) had been seen off, net interest margins were fat, light-touch regulation was the rule, and returns on assets looked great. Most back-office effort went into fine-tuning a business model which had been perfected by the turn of the millennium, while marketing paid more attention to metrics than customer value.

Then came a multiple whammy: the Crash revealed business practices that stood up poorly to review, unleashing a series of regulatory changes that hammered profitability. It also provoked a public outcry for change which coincided with the emergence of technology to facilitate it.

Today, the payments industry – and financial services in general – faces more disruptive innovation than it has in decades.

Here’s a selection of the challengers.

Pay differently
There’s room for debate about when, how or even if m commerce will hit the inflexion point[2].

But one thing is quite sure: banks no longer have a monopoly hold over payments. The Internet has made it possible for a whole slew of new entrants to hover around what they see as being an industry ripe for rebuilding. And when these new entrants are as formidably well-heeled as Apple, reportedly sitting on a breathtaking cash pile of around $130 billion, they certainly have the firepower to make it happen. Most banks can only look on enviously at resources like that. And those assets aren’t just financial: Apple – and Google, and Microsoft – have huge technological smarts. Plus, they have the appetite: all of them are looking for new investment opportunities. In payments, they think they’ve found one. “I am dying to fund a disruptive bank” says legendary venture capitalist Marc Andreessen[3].

News Just In

- *At the end of April, Paym, an m-payments system developed by the UK’s Payments Council, will go live, covering most of the major UK banks and building societies*
- *Vodafone has launched M-Pesa in Europe, starting in Romania*
- *Reports say that Facebook are about to enter the payments business*

Certainly, the card industry has all the advantages of the player-in-place. But that brings with it all the baggage as well: leave aside the too-often-creaky legacy systems, banks’ relationships with merchants are at a very low ebb[4]. Retailers would jump at the chance of signing up for anything that looked remotely like a new and better deal. Sooner rather than later, the new technology will settle into a robust, secure, easy-to-use format. All that’s

[1] Taken over by Citi in 2002
[2] Though figures from the British Banking Association show that m-payments have doubled in the past 12 months: see https://www.bba.org.uk/news/reports/banking-on-the-move/#.U0KAM6hdV_g
[3] http://qz.com/175512/to-disrupt-banking-do-you-need-to-own-the-bank/
[4] Industry veterans will remember how American Express had to scramble in the mid 1980’s to repair its neglected merchant relationships

then needed is for merchants to migrate – and our bet is that that will happen faster than the banks care to think just now.

Use a new currency

Established payments players took barely-concealed pleasure in the travails of Bitcoin: an all-but-ban in China, bankruptcy petitions at Mt Gox, closure at Flexcoin, both following hacker-led thefts….the temptation to say "I told you so" was very great.

And, in truth, the scale of Bitcoin's operation is tiny: the total value of Bitcoins in circulation is around $8 billion. But a year ago, the figure was $490 million, while daily transaction volumes are up nearly 60%.[5]

Clearly, there's a demand: and it doesn't all come from radical libertarians and drug dealers. Bitcoin is arguably cheaper to use than conventional currencies because it effectively cuts out fee-charging middlemen (read, banks and FX traders). And venture capitalists, including reportedly the Winklevoss brothers of Facebook fame, claim to see in Bitcoin's ingenious platform a potential for new ways of owning and paying for assets. There also seems to be a calculation that even if Bitcoin's pioneering efforts fail, a more robust version will emerge. Poloniex, "a fast, secure exchange where you can trade Bitcoins for a variety of promising or established crypto-currencies", lists over 50 contending coinages[6]. It's even suggested that some banks have asked themselves how they can exploit the crypto-currency concept.

Bitcoin may be down just now, but the idea isn't.

Borrowers bypass banks

And not just borrowers, either: fed up with the close-to-zero returns offered on bank savings accounts, those with cash to invest are increasingly turning to P2P lending platforms. In the UK, for example, loan volumes are doubling every six months, and have just passed the £1 billion mark. In the US, Lending Club and Prosper, with 98% of the market between them, have issued $2.4 billion of loans, up from $871 million in 2012.

Let's put this in context: bank retail deposits in the UK come to £1.2 trillion. So the share is tiny, and awareness is low. What's more, given the aura of bad faith still hanging around financial services, there's understandable reluctance among many lenders to pile in to an unregulated product. In the UK, that will change on April 1 when the Financial Conduct Authority is to issue rulings. But the professional investors are convinced already: only a third of the money now flowing into P2P lending platforms now comes from retail customers; the rest increasingly comes from institutions.

Looking for a pointer? Last year, Google led a $125 million investment in Lending Club.

New banks, new banking

Some challengers have rather more familiar faces: for years now, retailers, more trusted than banks and with lots of data on their huge customer bases, have been poised to enter the consumer banking fray.

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[5] *The Economist*, 15 March 2014

[6] Unfortunately, the site this month reported that it too had been hacked, losing over 12% of its Bitcoins to digital thieves.

So far in the UK, they've only tiptoed around the edges, offering savings and insurance products and the like, but unable or unwilling to launch the core current account product. Until now, that is: on the 7th March, M&S announced detailed plans to launch a generously-featured M&S Bank Current Account this summer. Virgin Money and Tesco are also rumoured to be close to announcing similar products. Now that changing banks has been made faster and easier for UK customers with the Current Account Switch Service[7], it will be interesting to see how the much-relied-on customer inertia holds up against the expected marketing barrage. It's not clear yet whether the US fs industry is enthusiastic about enabling this particular flavour of mobile banking.

More conventional challenges come from Handelsbank and Metro Bank. The Swedish bank bases itself firmly on what it describes as "localism": a return to traditional face-to-face banking with loan decisions taken at branch level, rather than pushed upstairs to centralised algorithms. Now with over 170 UK branches and plans for more, Handelsbank is becoming a more familiar name up and down the nation's High Streets.

Not so Metro Bank: its 26 "stores" are heavily oriented to the prosperous UK South East. However, like Handelsbank, Metro also takes the view that improved banking services, including extended opening hours and weekends, are the way to capture new business from the incumbents.

Who'd be a bank boss?

Here's a sign of the times: just 3% of UK 18 to 24-year-olds want a cheque book: 25% would prefer a mobile banking app.[8]

No question, running a bank these days is tough. In payments, lending, borrowing – the heartland of financial services – the challenges just keep on coming.

And from the most surprising places: in China, Alibaba, a massive e-commerce player, recently suggested that customers of its online payment service could park any spare cash in a deposit account offering much higher returns than the banks. In six months, it has attracted $65 billion[9]. No wonder Sr. Francisco Gonzalez, CEO of BBVA, has warned[10] that banks would have to take on the likes of Amazon and Google, or die. "Banks are losing their monopoly on banking", he argued. And it rather feels as though he may be right.

Anyone remember the Kinks' old song "Thank you for the days"?

[7] According to the UK Payments Council, over 600,000 customers switched current accounts in the six months to March, a 14% increase on the previous year

[8] http://www.thinkmoney.co.uk/news-advice/Cheques-going-out-of-style-0-4243-0.htm

[9] *The Economist*, 1 March 2014

[10] http://www.ft.com/cms/s/0/bc70c9fe-4e1d-11e3-8fa5-00144feabdc0.html#axzz2wPk4AFtd

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Background

- 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.
- He is a frequent contributor to Global Reach, a VoiceAmerica programme for business leaders, and writes the monthly Expert's Corner article for NYPAY, New York's premier professional organization for payment industry leaders and innovators.
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