Battling for Buyers:
How Banks Can Combat the Threat of Fintechs

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Executive Summary:

Amazon, Netflix, Airbnb, Deliveroo. These technology start-ups have become household names and fundamentally revolutionised the way the entertainment, transport and hospitality sectors operate. The financial services industry has long anticipated that a similar step-change could be coming, but despite the array of start-ups that have taken root over the last decade, high barriers to entry and reliance on consumer trust mean that fintechs have failed to topple the established names.

So far. While the big six banks continue to dominate – holding three quarters of the cash savings market, two thirds of the personal loan market and three quarters of the mortgage market – the fintech threat is rising. Our new research shows that while overall consumer awareness of fintech banking brands is low compared to established bank brands, some are starting to cut through: quarter of people (26%) are aware of Nutmeg; one in six (14%) is aware of Atom Bank and one in 10 (11%) is aware of Moneybox.

> *Fintech is rising – but is not yet over the banking ramparts"*

This increased brand awareness is leading consumers to consider new entrants when choosing financial services products. Our research shows that, while people still largely favour established brands, and often choose their existing provider for multiple products, there is significant potential appetite from consumers for fintech's offer. More than a third of consumers would consider a fintech for a stocks and shares ISA (35%) or a mortgage (39%), while over two in five people would consider one for a personal loan (43%). And even in the savings market, where choice typically relies more heavily on brand trust than price, one in four (26%) would consider a fintech.

It is clear that fintechs represent an unambiguous and substantial threat to established banks. If these technology-driven companies can continue to build brand awareness and maintain competitive prices, then the industry will soon experience a shift in demand with almost half of consumers (49%) considering a fintech.

Some banks are responding to this threat by investing in technology and supporting start-ups themselves. But too many incumbents are relying on the low churn of customers to protect them. Our research shows that consumers switch their financial service providers infrequently – changing mortgage provider every 14 years and current account provider every 12 – but banks cannot afford to be so complacent. Fintechs are becoming more competitive and are undercutting banks across a variety of product areas, aiming to bleed the banks dry.

But it's not all doom and gloom. There are steps established banks can take to defend themselves against the fintech threat:

- **Defence is your best offence:** Focus on retaining customers by determining the factors that cause customers to switch to competitors and organise to mitigate them.
- **Pick your battles:** Focus your attention on the personal loans, savings accounts, and credit card markets.
- **Recruit the enemy:** Acquire promising fintechs and bring them in-house under the main brand to improve tech capabilities.
- **Watch your language:** Emphasise how well established and trustworthy you are in markets where consumers care about brand, and on product benefits and low pricing when brand is less important.
- **Don't drop the ball on pricing:** Stay competitive by trimming fees wherever possible.

Uprising: How is fintech disrupting the financial services market?

Technology start-ups have taken many industries by storm, and revolutionised the way businesses operate. Entertainment, hospitality, and food delivery have been fundamentally changed by the likes of Netflix, Airbnb, and Deliveroo.

Financial services are also in the line of fire of tech firms, and for good reason: with London the world's largest financial centre[i], the industry comprises 10.7% of the UK economy, contributing £176bn to GVA in 2015[ii].

Although the big six banks dominate – holding three quarters of the cash savings market, two thirds of the personal loan market and three quarters of the mortgage market[iii] – these established brands have long anticipated a technological step-change to occur in their industry. Former CEO of Barclays Antony Jenkins is so convinced that finance will be radically transformed by technology that he has launched his own start-up, 10x, to help banks adapt to the changing environment[iv].

Others predict an even darker future for banks. Research conducted by Mastercard shows that nearly 33% of millennials think banks will not be needed at all in the future[v]. Developments in decentralised banking via blockchain technology may well prove them right[vi,vii].

However, critics argue that fintech is nothing more than a mirage[viii], has been hyped up[ix], and is based on business models that simply won't work[x]. These criticisms have some merit: financial services is a complex, heavily regulated industry and requires large amounts of capital. These barriers to entry hamper the growth of new competitors. As a result, we have yet to see a comparable tech revolution in finance as has been observed in other industries.

But while fintech may have been over-hyped, it should not be ignored. Although there has not yet been a dramatic revolution, the financial services industry is experiencing a significant evolution, driven by fintechs that are not encumbered by swollen overheads and legacy IT systems.

> *"The financial services industry is experiencing a significant evolution, driven by fintechs."*

Rather than trying to overhaul the entire industry in one go, fintech firms are currently focusing on areas where banks are not competitive, building brand awareness and capturing market share. TransferWise, for example, launched in 2011 offering international money transfers that are eight to ten times cheaper than established banks[xi], and now has over a million customers. Other fintechs, such as Revolut and Monzo, recently launched current accounts to their 795,500 and 240,000 customers respectively[xii,xiii]. Fintechs are also banding together to provide comprehensive offerings to customers – Revolut has partnered with fellow fintechs Trussle and Lending Works to offer better value via smart mortgages and peer-to-peer lending[xiv].

This demonstrates the danger that fintechs pose to established companies. Every element of financial services is under scrutiny, and established players are being undercut by agile tech firms. This increase in competition may be less like Airbnb's hospitality revolution than the steady growth in e-commerce led by Amazon in the early 2000s, but the internet retailer is now one of the most valuable companies in the world[xv].

The Threat: Where does fintech represent the most risk to banks?

To understand where fintechs represent the greatest threat to established banks, we asked a representative sample of over 1,200 UK consumers about their awareness of financial services brands, their use of financial services products, and how often they switched provider. We then used a simulated price comparison website to gauge consumers' preference for established and fintech banking brands in a more realistic way.

Preference

"43% of consumers would choose a fintech for personal loans"

We presented consumers with a set of financial products from various brands for each of the six products they had experience of (Figure 1 shows an example for personal loans).

Figure 1: Simulated price comparison site setting for personal loans

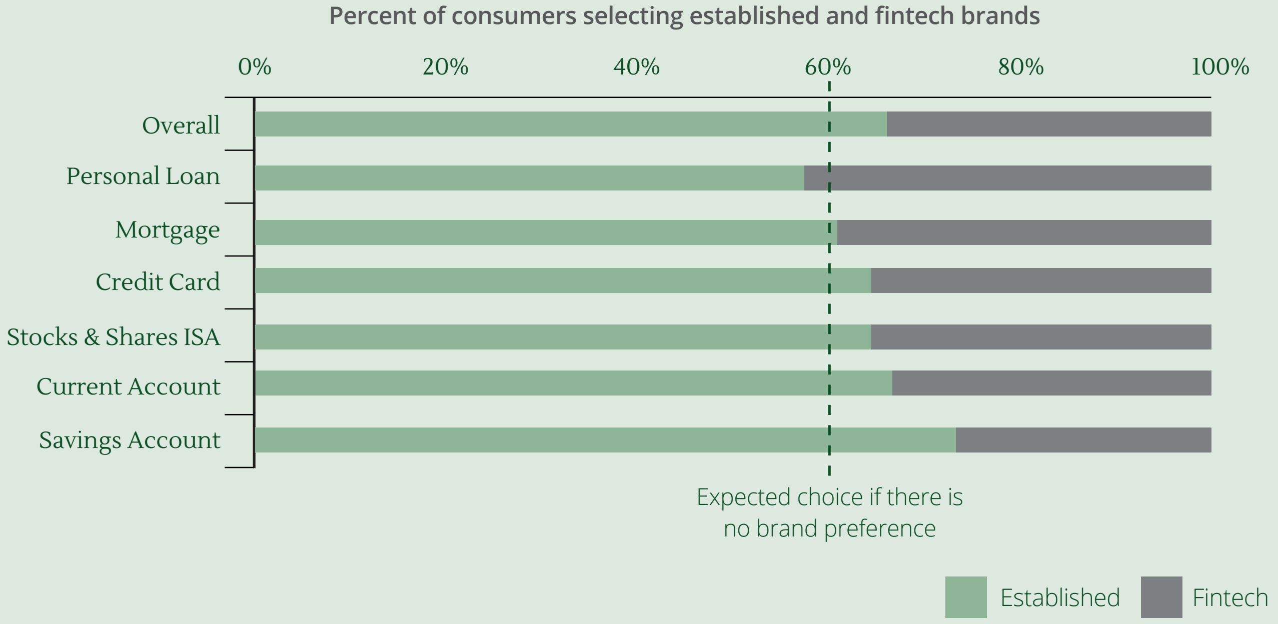
Brand	Interest Rate	Early Repayment Fee	Late Repayment Fee
LLOYDS BANK	7.0%	£100	£25
Nationwide	7.5%	£100	£15
Royal Bank of Scotland	9.6%	£200	£15
HSBC	10.4%	£50	£15
Santander	12.7%	£100	£15
BARCLAYS	14.3%	£50	£15
RateSetter	15.5%	£50	£25
lendable	16.5%	£50	£10

For each product, participants were shown a set of ten providers, six of which were established brands, four of which were fintech. Brands were shown in a randomised order: sometimes fintechs offered the best products, sometimes it was the established banks, and sometimes it was a mix. This means we can assess participants' differences in choice as a consequence of brand preference, rather than the product features.

If consumers had no brand preference, or an equal preference for established and fintech brands, we would expect 60% to select established brands and 40% to select fintech (since we listed six established brands and only four fintechs – the dotted line in Figure 2). However, we found that consumers currently prefer established brands: on average 66% of consumers selected established banks, while only 34% chose fintechs. Given the dominant market position of many of the brands we tested, this is not particularly surprising.

However, we also found that preference for fintechs varies by product, indicating that established banks should be more concerned with the threat to personal loans, mortgages, and credit cards than other financial products.

Figure 2: Consumer choice of established and fintech brands in simulated comparison task



But what causes these differences in preference? With 43% of consumers choosing a fintech for personal loans, but only 26% for savings accounts, consumers appear to approach saving and borrowing differently.

This makes sense from a psychological perspective (see 'Psychology of Brand Preference'): consumers need to balance trust and risk, so are happy to borrow money from anyone – including little-known fintechs – but are unwilling to save their own money without the security of an established bank. Additionally, there is a tendency to take greater risks when taking out a loan, and to be more risk averse when managing one's own money.

But what of stocks & shares ISAs, where 35% of consumers selected fintechs despite these being savings products? It is likely that consumers use a form of 'mental accounting' (see 'Psychology of Brand Preference') and are therefore less risk averse than they would usually be when investing. Mental accounting may also explain customers' preference for savings accounts from established brands, which are typically seen as a safer place to keep their money.

Awareness

> *"41% of consumers have heard of a fintech brand"*

Another reason for differences in fintech preference across products is the relative prevalence of the fintech brands, which we have assessed by measuring levels of brand awareness.

We found that, despite their small market share, some fintechs have relatively strong brand awareness. Of the 1,200 UK consumers we sampled, 41% had heard of a fintech. Nutmeg lead the charge, with more than one in four consumers (26%) having heard of the online investment platform. Atom Bank and Moneybox follow close behind, with one in six (14%) and one in ten (11%) having heard of these challenger brands (see Figure 3).

Awareness of each individual fintech may not seem particularly high, and they are overshadowed by the established brands – which have over 17 times the awareness of the average fintech. However, if fintech firms can bridge this gap in awareness, incumbents may find themselves forced to cut their revenues or else be steadily overcome by fintechs offering better deals.

Psychology of Brand Preference

Loss and Risk Aversion:

People feel losses more strongly than equivalent gains and are more willing to engage in risk seeking behaviour in order to avoid incurring a loss. The opposite is also true; people will engage in risk averse behaviour when seeking to make a gain[xvi]. Therefore consumers are more likely to choose an unknown fintech for loans but an established bank when saving.

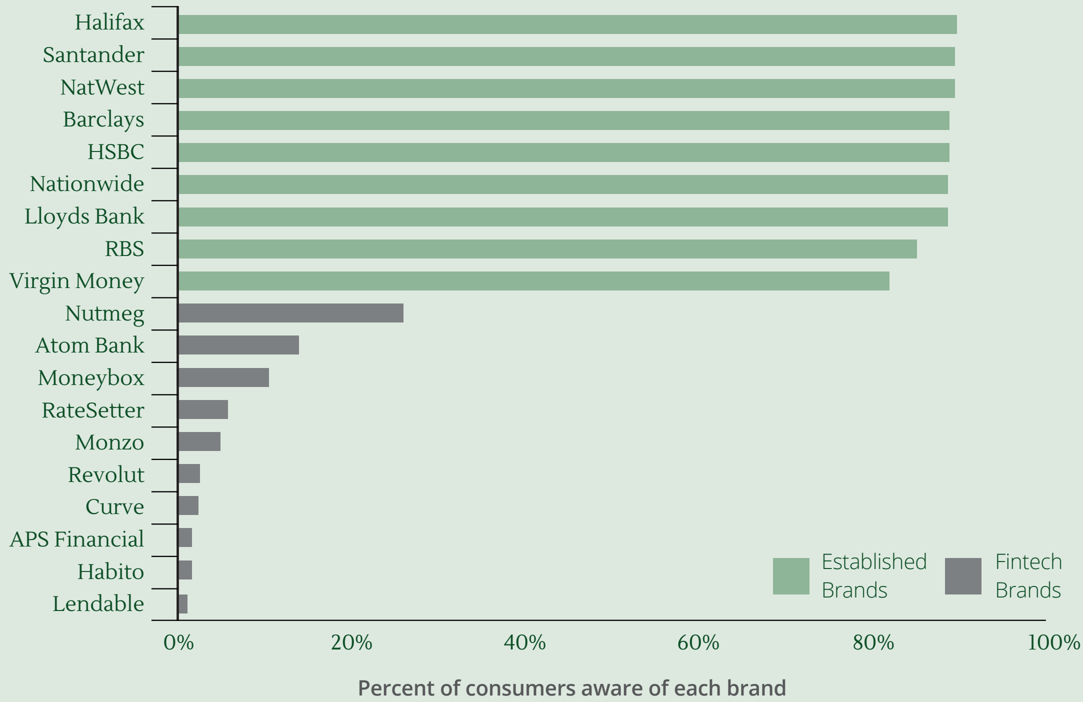
Trust:

Although banks and financial services firms suffer from 'trust gaps' where they fail to meet customers' expectations[xvii], established banks continue to reliably deliver cashpoints and other day-to-day services. By doing so, they build reserves of trust that maintain customer loyalty[xviii]. Fintechs, on the other hand, have little or no track record.

Mental Accounting:

People treat money differently, depending on factors such as the money's origin and intended use, despite all money being equal and interchangeable[xix]. Therefore people are liable to be risk averse with money saved for a rainy day, but be risk seeking with money invested for long term growth.

Figure 3: Consumer awareness of established and fintech brands



These awareness figures also demonstrate that fintech is not a niche interest. There is clearly an appetite for technology in financial services, where customers have come to expect quick and easy service through digital channels: 25 million consumers use online or mobile channels to access and manage their bank accounts, nearly twice the number using high street branches[xx]. Fintechs are well positioned to quickly take advantage of this consumer trend as it develops in the coming years.

In addition, with consistent investment in marketing it does not take long for new entrants to find their way onto customers' radars: in just five years the online-only mobile network giffgaff more than tripled its awareness from 20% to 75%, and is now a prominent thorn in the side of traditional mobile firms[xxi].

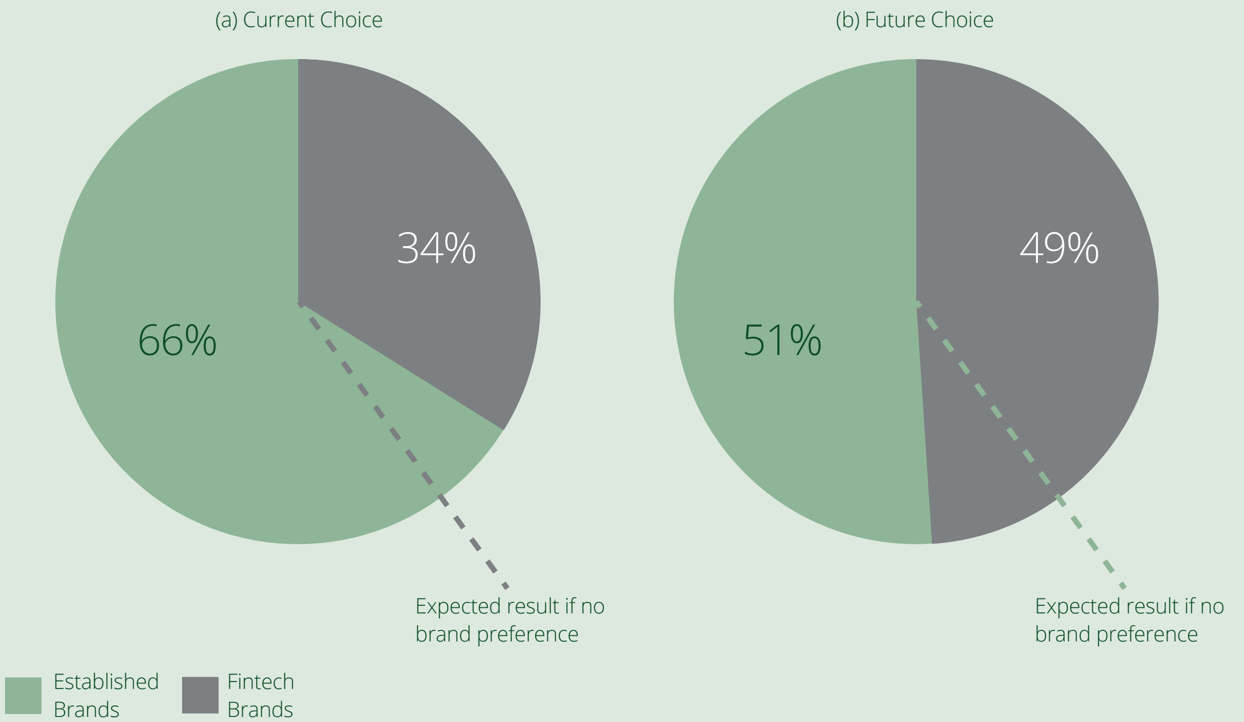
Under current conditions we found that, on average, 66% of consumers will choose an established brand – 6% more than we would expect (see Figure 4a). From this one would conclude that consumers prefer the large banks over fintechs.

But what if a similar trend emerges for fintechs as we saw for giffgaff? Our analysis indicates there would be a substantial shift in consumer choice. After brand awareness and incumbency effects have been accounted for, we see a 15% swing in preference towards fintech brands from 34% of choice to 49% (see Figure 4b).

This suggests current consumer preference for established brands is due to awareness and incumbency, rather than brand affinity. Established banks, therefore, should keep a wary eye on fintech marketing, and monitor growth in brand awareness.

> *"Half of customers likely to choose a fintech in future"*

Figure 4: Consumer choice of established and fintech brands (a) currently and (b) after fintech brand awareness grows



Churn

> *"Customers only change mortgage provider every 14 years, but change savings account provider every 7 years"*

Besides awareness and preference, the pace of customer churn also impacts the scale of the fintech threat. Switching in financial services is notoriously low. We found that, on average, people switch financial services provider no more than once every three years, and often far less frequently (see Figure 5).

Figure 5: Consumer switching in different markets

Consumers switch once every...	
Personal Loan	3.5 years
Savings Account	7.2 years
Credit Card	8.1 years
Stocks & Shares ISA	9.8 years
Current Account	12.3 years
Mortgage	13.5 years

This is good news for established banks, and helps explain why a fintech revolution has not yet occurred in finance services – customers simply do not think about who they want providing their financial services very often.

In other industries, noteworthy tech firms, such as such as Netflix, Airbnb, and Deliveroo, offer relatively simple and tangible products and services. The customer understands what's on offer, recognises a good deal, and has no difficulty engaging with these markets. As a result, new services are quickly adopted when they offer something better than what is already available.

In contrast, financial products are difficult to understand, and the impact of financial decisions is often only realised after a long delay. This has a psychological impact on consumers and dissuades them from switching (see 'Why are consumers disengaged with finance'). For many people, finance is boring, confusing, and a chore. Given this lack of engagement, it is difficult for new entrants to capture the attention of customers in order to gain market share.

However, fintech firms are working to address the lack of consumer engagement. Indeed, some fintech firms are demystifying finance and making simplicity a selling point: Nutmeg offers clear investment options, whilst Monzo makes budgeting far easier. Other finance startups, such as Finimize, seek to inform customers by making financial news clear, accessible and relevant to the less financially engaged.

In addition, established banks must remember that low levels of switching also mean that any customers lost to fintech will be difficult to regain. Incumbents cannot rest on their laurels in the face of the fintech threat, but must use the time they have to mitigate it.

Why are consumers disengaged with finance?

Psychological Inertia:
People tend to stick with the status quo and avoid making changes, particularly if they think it will be difficult[xxii]. Inertia helps explain the low rate of current account switching, despite monetary incentives to do so.

Future Discounting:
People tend to prefer smaller-sooner rewards over larger-later ones. Therefore the future benefit of making a good financial decision is perceived to be small, particularly in comparison to the immediate, tangible cost of making a difficult decision[xxiii].

Threat

> *The personal loans market is under greatest threat from fintechs"*

It's clear that fintechs pose a threat to incumbent banks. But consumer preference for established versus fintech brands vary across product areas, and different markets experience various rates of customer churn, so where are established brands at greatest risk?

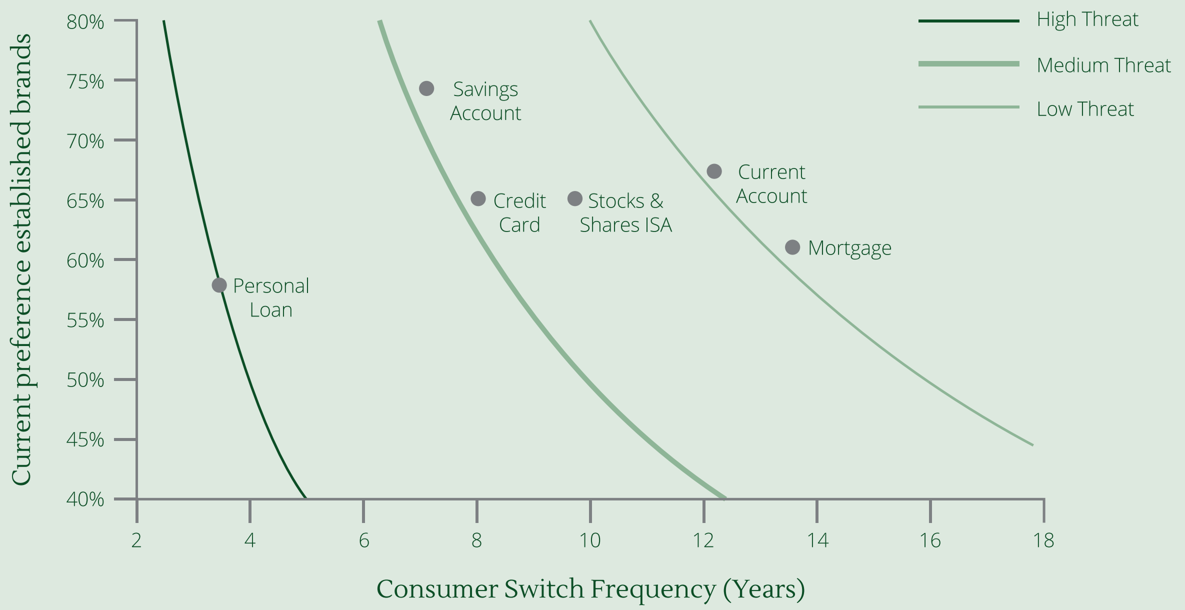
After reviewing the speed of switching, and current customer brand preferences in different markets, we found that personal loans are under the greatest threat from fintechs (see Figure 6). The typical personal loan is only held for 3.5 years, and there is already a tendency for customers to consider fintech brands, such as Ratesetter and Lendable.

Credit cards and savings accounts are under similar levels of threat from fintechs, but for different reasons. Although consumers are somewhat reluctant to trust fintechs with their hard-earned savings, the slight difference in switch frequency means that both these markets are rated medium threat level.

Stocks & Shares ISAs are not far behind. Brands like Nutmeg have already gained traction in this market, and will continue to do so as their brand awareness and customer base grows. However, since customers switch ISA providers so infrequently, established brands have some breathing space to plan their response.

Despite the intent of fintechs such as Monzo and Habito to compete on current accounts and mortgages, our research suggests that they present relatively less threat to these markets, mainly because of a very low rate of customer switching. However, established brands should remain wary, as initiatives like the current account switch guarantee may yet nudge the market to change provider more frequently.

Figure 6: Threat level by product, based on consumer switch frequency by preference for established brands. Lines indicate points of equal threat to incumbents



Fighting back: How should incumbents defend themselves?

We've seen that the traditional banks dominate financial services markets. Customers appear to prefer these established brands over the fintech challengers. But this preference is driven by brand awareness and incumbency, rather than real loyalty, and as brand awareness improves more and more consumers will choose fintechs for their financial products.

Awareness of fintechs is growing, with some brands spearheading the assault for consumers' attention, and making ground. As fintechs gain traction, there is a real risk they will steal increasingly large cuts of market share, particularly in personal loans. And while consumers are not engaged with finance, and do not switch provider often, any customers who are lost to a fintech are highly unlikely to return.

Established banks, therefore, should seek to mitigate the fintech threat while they have time to do so. We recommend the following steps:

- **Defence is your best offence: Focus on retaining customers.** The biggest brands have a strong hold across financial services, and our research shows that consumers tend to remain with their incumbent provider, with whom they are familiar. Therefore, it is vital that established banks focus their efforts on retaining customers. They should determine the factors that cause customers to switch to competitors, track their occurrence, and organise to mitigate them.

- **Pick your battles: Focus on the markets that count.** Our research shows that the greatest threat to incumbents is in personal loans, savings accounts, and credit cards. Established banks should focus their attention on understanding what really matters to customers in each of these markets, and compete with fintech where it counts.

- **Recruit the enemy: Bring fintechs in-house.** Since established banks have a strong advantage in terms of awareness and trust, they should seek to acquire promising fintechs with a view to bringing them in-house under the main brand. This is the fastest way of improving tech capabilities.

- **Watch your language: Talk about what matters.** Banks need to identify the markets where consumers care more about brand – for instance savings – and emphasise how well established and trustworthy they are in regular customer communications. In markets where consumers are less concerned about brand – such as borrowing – banks should adapt their messaging to focus on product benefits and low pricing.

- **Don't drop the ball on pricing: Stay competitive.** As fintechs enter the market with cheap offerings based on a low-overheard business model, it is crucial established banks stay competitive. A strong brand will provide some protection, but will not trounce price so it's important for incumbents to trim their fees wherever possible to ensure they remain in contention.

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Methodology

The primary research undertaken for this report was conducted online from 02/08/17 to 09/08/17, with a nationally representative sample of 1,288 UK consumers aged 18 and over.

About Decision Technology

Decision Technology specialises in helping businesses and policymakers understand and manage customer decision making, from acquisition through to retention and all the points in between. We are members of the Market Research Society and Management Consultancies Association.

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