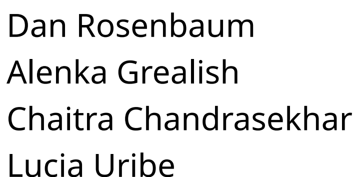
OliverWyman

WOULD YOU LIKE BETTER BANKING WITH THAT LATTE?

How major brands can use banking for competitive advantage



Dan Rosenbaum
Alenka Grealish
Chaitra Chandrasekhar
Lucia Uribe

The marketplace for banking services is about to get a lot more crowded — and much more interesting. What today is a trickle of non-bank entrants is set to become a flood in the next few years as non-bank firms learn how they can offer these services without needing to become a bank. To get ahead of the rush, companies with strong brands and large consumer or small-business franchises should make haste to explore this growing opportunity.

In today's prevailing model of banking, consumers and small businesses must go — physically or virtually — to a bank to get their banking needs met. But within the next one to two years, consumers and small businesses increasingly will be able to access banking services from non-bank brands with which they already have a trusted relationship. This will shift the engagement model of banking from one defined by the banking industry — "you need to come to our branch, bank website, or app to do your banking" — to a model defined by customers, in which they can get banking when and where they want or need it. When and where will certainly include non-banking journeys like buying a house or managing a small business's books.

The prize is big. We estimate the annual retail banking revenues up for grabs is up to $400 billion.

Hence it comes as no surprise that early signs of a rush are appearing, supported by the fast-rising trend of banking-as-a-service (see box on page 4). Several non-bank brands already have embraced this opportunity and are making banking part of their corporate strategies. In just the last 12 months, national convenience store retailers, tax preparation services, small business accounting software providers, mobile phone carriers, and e-commerce marketplaces have launched or announced plans to launch FDIC-insured deposit accounts — specifically transaction accounts — for their customers.

These companies recognize that a thoughtful, well-executed move into banking can bring them closer to the main goal of almost all business-to-consumer firms: becoming increasingly central in the lives of their customers by helping them meet their needs or solve big problems.

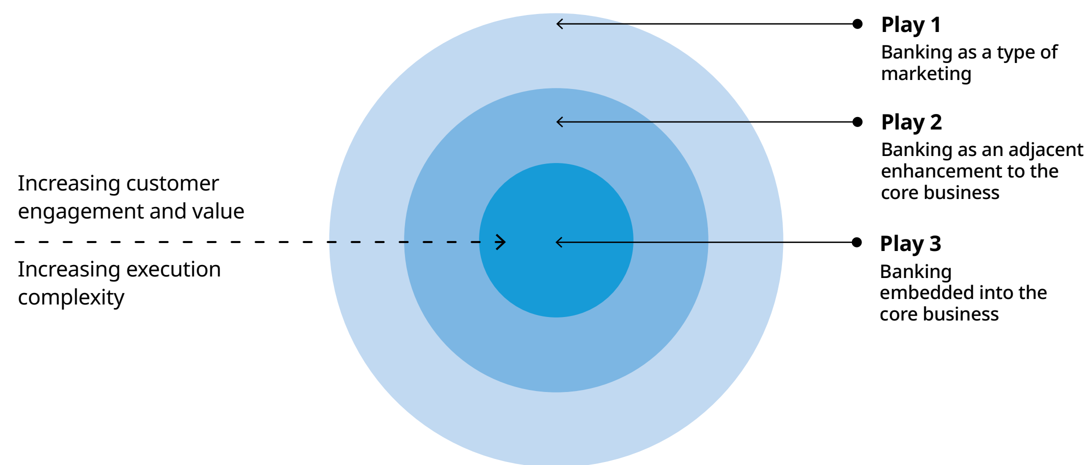
As an example of this customer-centric mindset, imagine a retailer focused on helping customers with their physical wellness also being able to help with their financial wellness by providing banking services and financial advice. Or consider an online platform that hosts the digital storefronts of small merchants also helping its customers (merchants) understand, forecast, and smooth their cash flows, all because the platform provides a business deposit account.

Many non-bank brands are exploring banking because of the meaningful strategic benefits it can provide. First, banking offers an opportunity to differentiate competitively, thereby accelerating new customer acquisition and enhancing the brand. Second, it can create new sources of revenue, like capturing a portion of interchange fees from customer debit account transactions, and create indirect financial value by slowing customer churn. For example, some brands that offer banking products alongside their core offerings find that customers with branded banking accounts attrite at a meaningfully lower rate than those without accounts, thereby creating huge spill-over value for the core business.

Third, banking allows firms to increase engagement by providing customers another way in which to interact with the company — or eliminate the need to leave the company's platform to engage with a traditional bank. Lastly, banking offerings can provide new and valuable insights into customer behavior and preferences from data flowing from banking activities, like deposit account spending.

For non-bank brands that want to explore banking, we see three potential plays with differing levels of execution complexity, customer engagement, and long-term value creation for non-banks and their customers.

Exhibit 1: Non-Bank Brands Strategic Plays in Banking



Play 1
Banking as a type of marketing

- Loose connectivity with the core business
- Free but fleeting press coverage
- Enhances the brand image
- Modest competitive differentiation
- E.g., airline rewards card

Play 2
Banking as an adjacent enhancement to the core business

- Moderate connectivity with the core business
- Can enhance loyalty and brand image
- Moderate potential for competitive differentiation
- E.g., mobile phone carrier that offers branded deposit accounts to its retail customers

Play 3
Banking embedded into the core business

- Integrated into the core business
- Increases value of the business to customers
- Significant differentiation potential
- E.g., small business accounting platform that comes with a branded deposit account built into the app

Source: Oliver Wyman

Play 1: Banking as marketing. Non-bank brands pursuing this play are looking for a new way to enhance their brand and generate some buzz without making a significant commitment to, or investment in, banking. To the customer, the non-bank's banking products, services, and experience are mostly undifferentiated from those offered by traditional banks, and therefore deliver only modest value. Here, the execution complexity and long-term value creation are moderate.

Play 2: Banking as an adjacent offering to enhance the core business. Non-bank brands pursuing this play might use banking to enhance loyalty programs that help drive the company's core business. For example, a retailer's customers might accrue bonus loyalty points for everyday-spending transactions from the retailer's branded debit account. Or a mobile phone carrier could offer better-than-market deposit account features such as higher interest rates, no fees, unlimited ATM usage, and so on — that help the non-bank attract new customers and improve retention of existing customers. Here, too, the execution complexity and long-term value creation are moderate.

Play 3: Banking embedded into the core business. Non-bank brands pursuing this play integrate their own branded banking accounts into their core non-bank offerings, thereby creating completely new value propositions for customers. These propositions become the basis for differentiation and competitive advantage. For example, an accounting software firm might meaningfully increase the convenience and speed of reconciling accounts and making/receiving payments when its small business customers adopt the firm's branded small business deposit account. The level of customer engagement with this play typically is high, as is the value customers typically receive. Here, the execution complexity is moderate to high, while the long-term value creation is high.

Non-bank brands can create value for themselves and their customers from any of these plays; however, from our experience, Play 3 — embedded banking — delivers the greatest win-win. Customers win by having an enhanced banking experience, while the non-bank wins by having higher levels of customer acquisition, engagement, and retention.

WHAT'S DRIVING THE RISE OF BANKING-AS-A-SERVICE (BAAS)?

The opportunity for non-banks to move into banking is arising from the confluence of three factors:

1. The ongoing shift of consumers and small business customers to digital channels for engagement and transacting; this long-term trend is being accelerated by the COVID-19 pandemic.

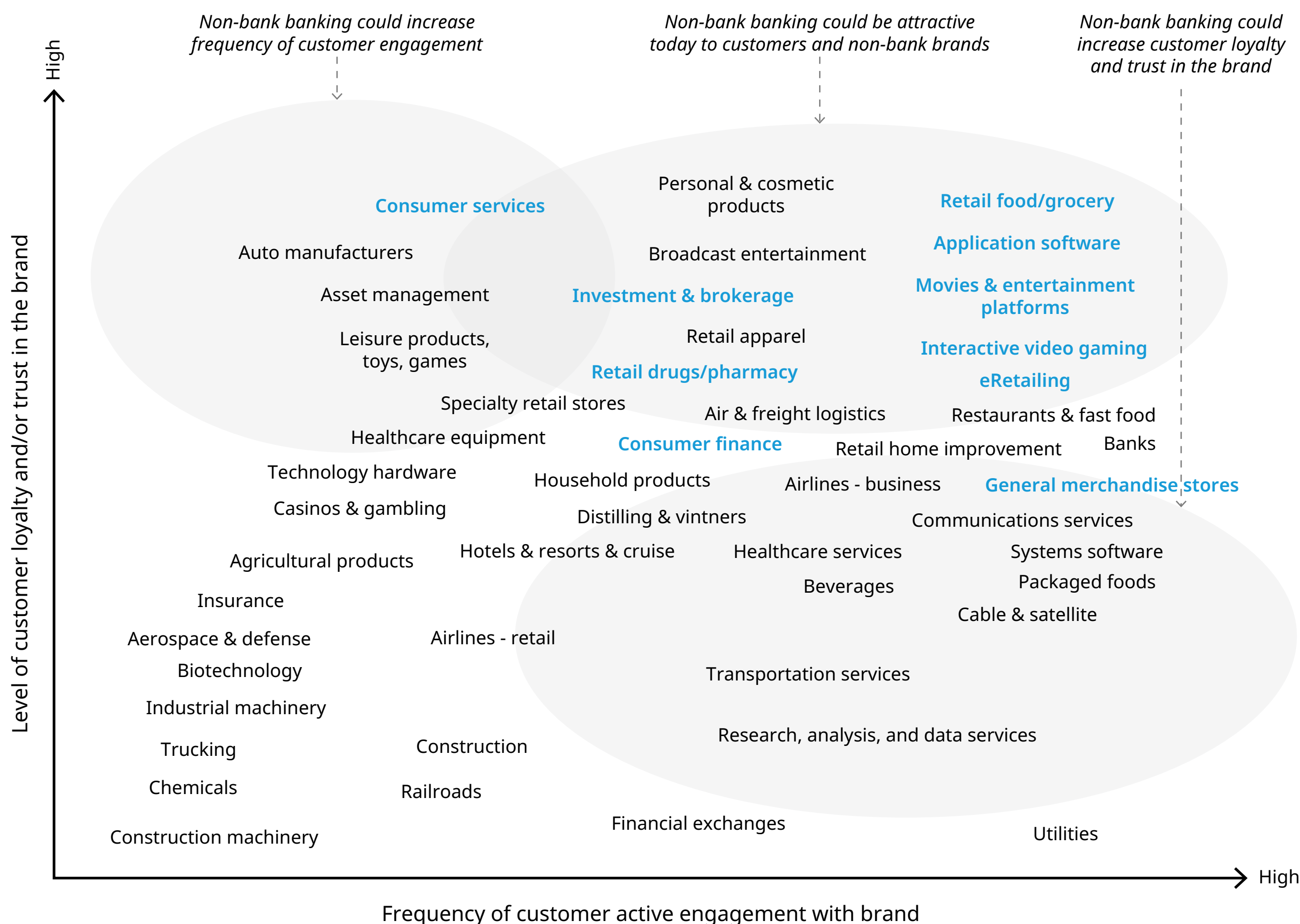
2. The emergence of a new generation of bank "partner" or "sponsor" bank built on modern IT architecture — that is willing and able to extend its banking licenses, charter, balance sheet, operations, and IT infrastructure to non-banks for a fee; this model is truly "Banking-as-a-Service," or BaaS.

3. The technological advancements of fintech infrastructure companies, some of which have streamlined and made highly accessible important banking services like payments, card issuances, and others. Some fintechs have also simplified and made accessible electronic connectivity between non-banks and partner banks — such as using modern application programming interfaces (APIs).

With each of these plays, the underlying enabler is the emergence of an ascendant model of banking: banking-as-a-service (BaaS). Just as software that once had to be purchased outright is now typically "rented" for a monthly subscription fee (that is, software-as-a-service, or SaaS), now banking is moving to a service model. The first movers were a few forward-thinking community banks that partnered for a fee with fintech marketplace lenders, helping them disrupt consumer lending, a market historically dominated by legacy banks and credit unions. Then came digital challenger banks (also known as neo-banks) that partnered with BaaS providers to disrupt the deposit-taking businesses of traditional retail and small business banks.

Now the next generation of BaaS customers is arriving: non-bank brands with large consumer or small business franchises. In each of these models, BaaS-providing banks typically supply some or all of the main components: licenses, products, regulatory-compliant operations, FDIC deposit insurance, access to US and global payments networks, and more.

Exhibit 2: Potential Attractiveness of Non-Bank Banking by Major Industry Sectors



Banking activity by non-bank brands is occurring or planned

Source: Oliver Wyman

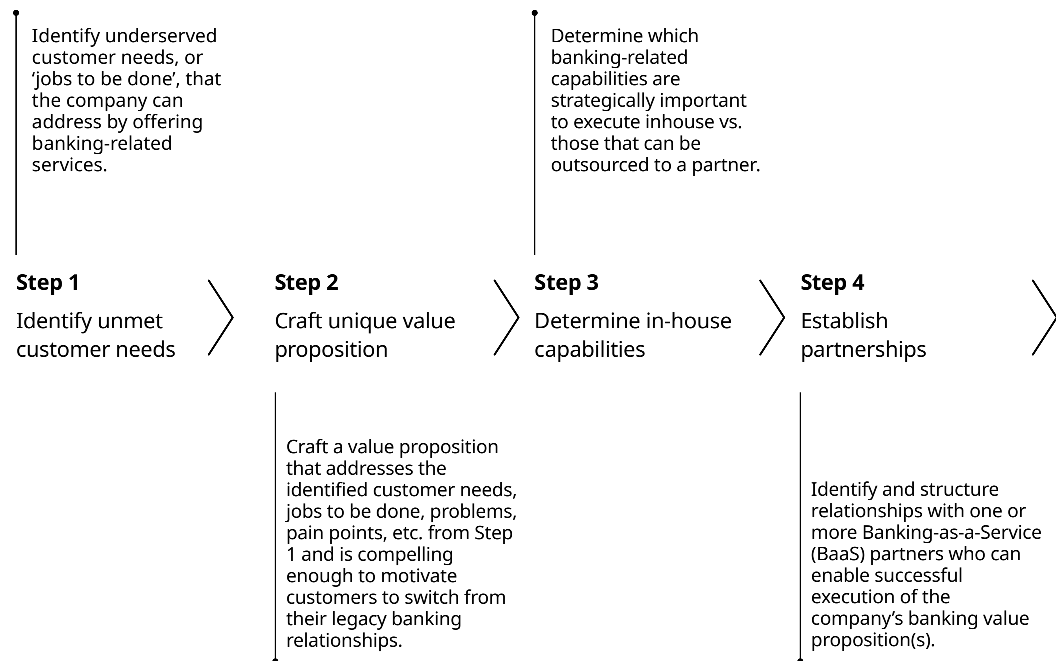
The banking opportunity varies by industry vertical. Non-bank brands that have large consumer or small business franchises, high levels of customer loyalty and trust, and high frequency of active customer engagement, are best positioned to derive meaningful value from a move into banking. We find that certain industries tend to naturally possess these traits, though the strength of these traits within an industry varies from company to company. As a result, it is no surprise that we see much of the current and announced non-bank forays into banking occurring within these industries [see Exhibit 2].

How can companies intrigued by the idea of offering banking begin their exploration? We recommend four steps:

Step 1 involves capitalizing on a major competitive shift occurring in banking that most incumbent banks have been slow to grasp: the shift from selling products to providing solutions. Providing solutions can take different forms, such as reducing pain points associated with the traditional banking experience, helping customers fulfill a need that is poorly or largely unmet by legacy banks, or providing an experience that is tailored — and highly relevant — to unique characteristics of each non-bank's customer base.

With respect to Step 2, with only about 8% to 10% of consumers and small businesses switching their banking relationships each year, and fierce competition from legacy banks for both in-motion and incumbent retail and small business customers, a non-bank's value proposition needs to be strong enough to capture a share of in-motion customers and pull other customers away from their current banking relationships.

Exhibit 3: Four Steps To Get Going in Banking

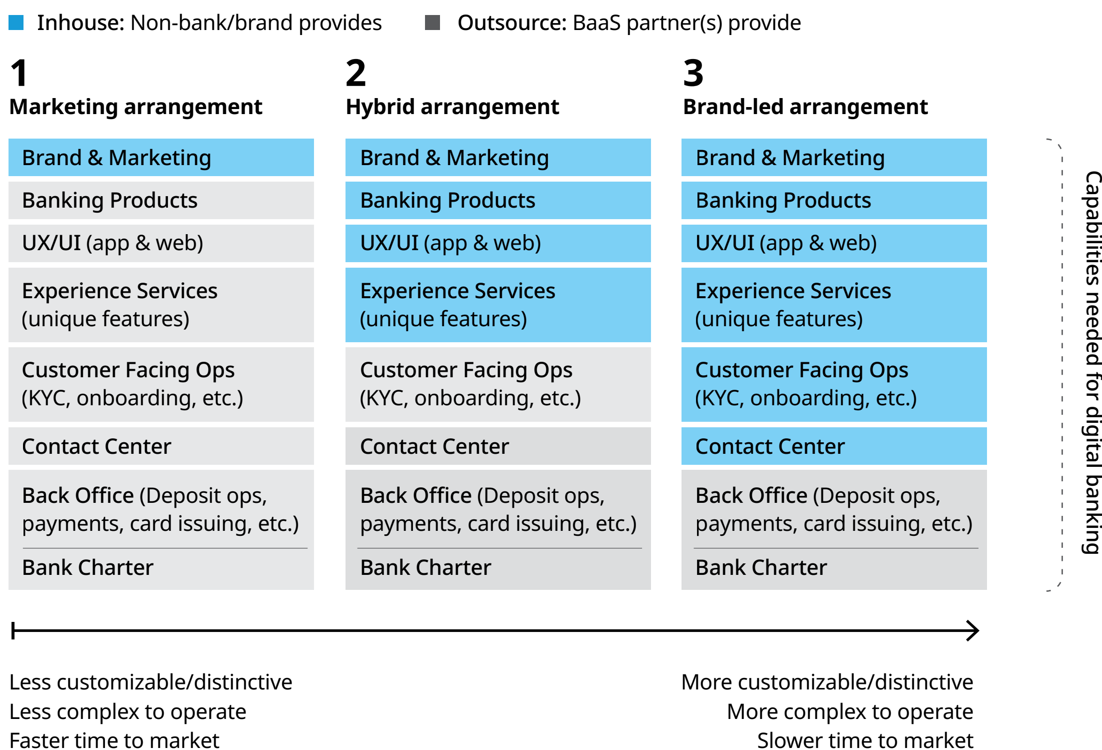


Source: Oliver Wyman

Regarding Step 3, we see three main types of in-house and outsourced arrangements for non-banks to consider [Exhibit 4] to deliver banking products and services to their customers. The most appropriate model depends on the relative importance of several factors, including the non-bank's execution capabilities, the need (or not) for speed-to-market, the need to differentiate on customer experience for the banking strategy to succeed, and others.

With respect to Step 4, while strategically important capabilities will vary from company to company, we find that many non-banks consider customer experience (user interfaces, journeys, customer service), product design and features, and customer analytics and insights to be strategically important capabilities to "own." Bank operational areas like Bank Secrecy Act and anti-money laundering monitoring, regulatory reporting, and maintenance of state and federal banking licenses are hugely important but not of great strategic importance, and therefore can be outsourced to BaaS or other third-party partners.

Exhibit 4: Three Models for Inhouse vs. Outsourced Banking Capabilities



Source: Oliver Wyman

***

Understanding whether and how to capture the opportunities created by this new banking model should be a near-term imperative for major non-bank brands that possess the characteristics outlined here. With early movers already pushing in, non-banks should explore this important strategic opportunity with a sense of urgency.

Oliver Wyman is a global leader in management consulting that combines deep industry knowledge with specialised expertise in strategy, operations, risk management, and organisation transformation.

For more information, please contact the marketing department by phone at one of the following locations:

EMEA
+44 20 7333 8333

Americas
+1 212 541 8100

Asia Pacific
+65 6510 9700

AUTHOR(S)

Dan Rosenbaum

Partner
dan.rosenbaum@oliverwyman.com

Chaitra Chandrasekhar

Partner
chaitra.chandrasekhar@oliverwyman.com

Alenka Grealish

Senior Banking Analyst, Celent
agrealish@celent.com

Lucia Uribe

Partner
lucia.uribe@oliverwyman.com

Copyright © 2022 Oliver Wyman

All rights reserved. This report may not be reproduced or redistributed, in whole or in part, without the written permission of Oliver Wyman and Oliver Wyman accepts no liability whatsoever for the actions of third parties in this respect.

The information and opinions in this report were prepared by Oliver Wyman. This report is not investment advice and should not be relied on for such advice or as a substitute for consultation with professional accountants, tax, legal or financial advisors. Oliver Wyman has made every effort to use reliable, up-to-date and comprehensive information and analysis, but all information is provided without warranty of any kind, express or implied. Oliver Wyman disclaims any responsibility to update the information or conclusions in this report. Oliver Wyman accepts no liability for any loss arising from any action taken or refrained from as a result of information contained in this report or any reports or sources of information referred to herein, or for any consequential, special or similar damages even if advised of the possibility of such damages. The report is not an offer to buy or sell securities or a solicitation of an offer to buy or sell securities. This report may not be sold without the written consent of Oliver Wyman.