McKinsey&Company

Impact of Fintech on Retail Banking

Brussels, December 2016

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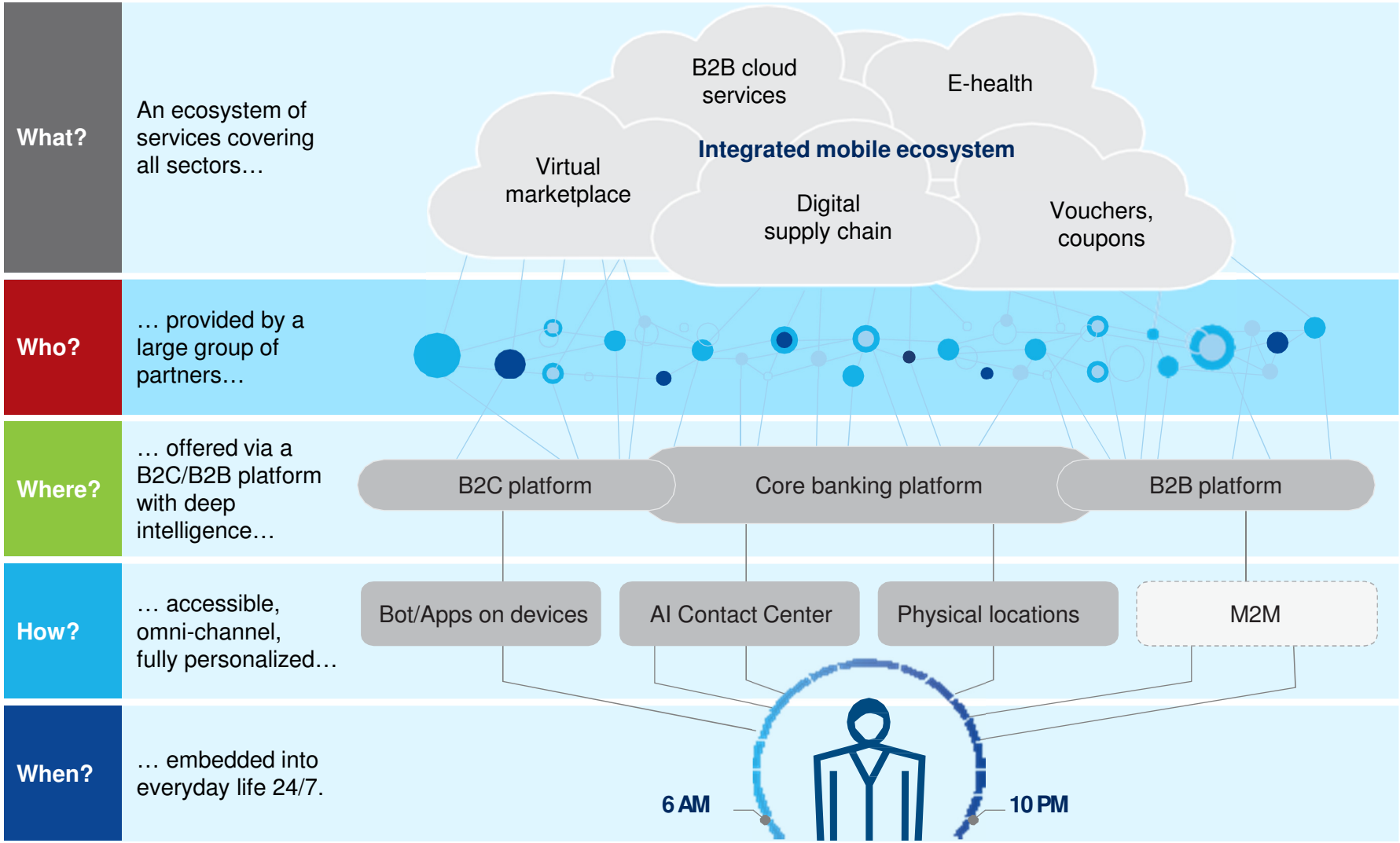
Agenda

- Fintech in Retail Banking: setting the scene
- How Fintechs shape customer expectations: Payments example
- Impact on sector economics

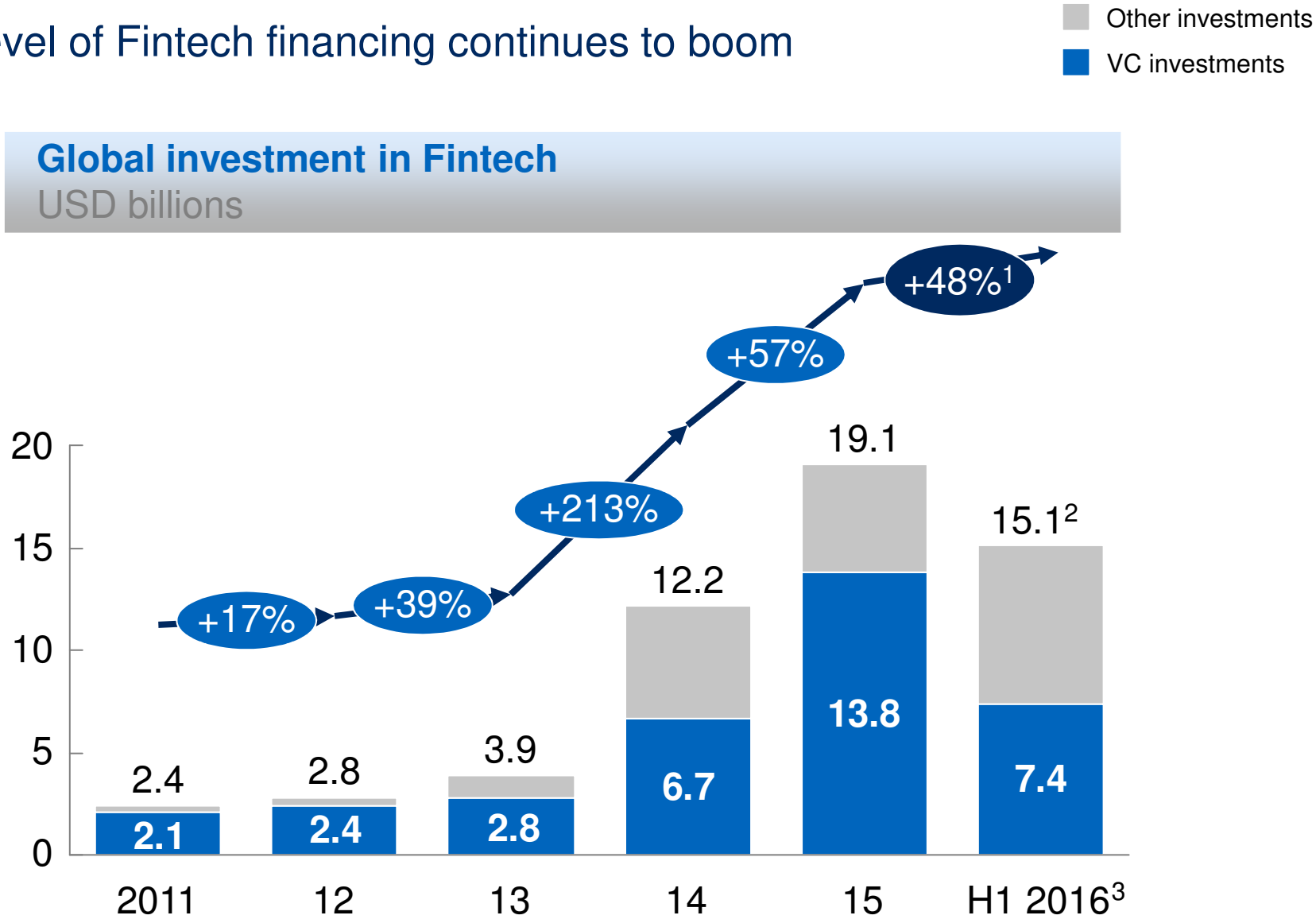
The role of Fintechs in retail banking

Customer perspective—summary of long-term business vision



SOURCE: McKinsey & Company analysis

The level of Fintech financing continues to boom



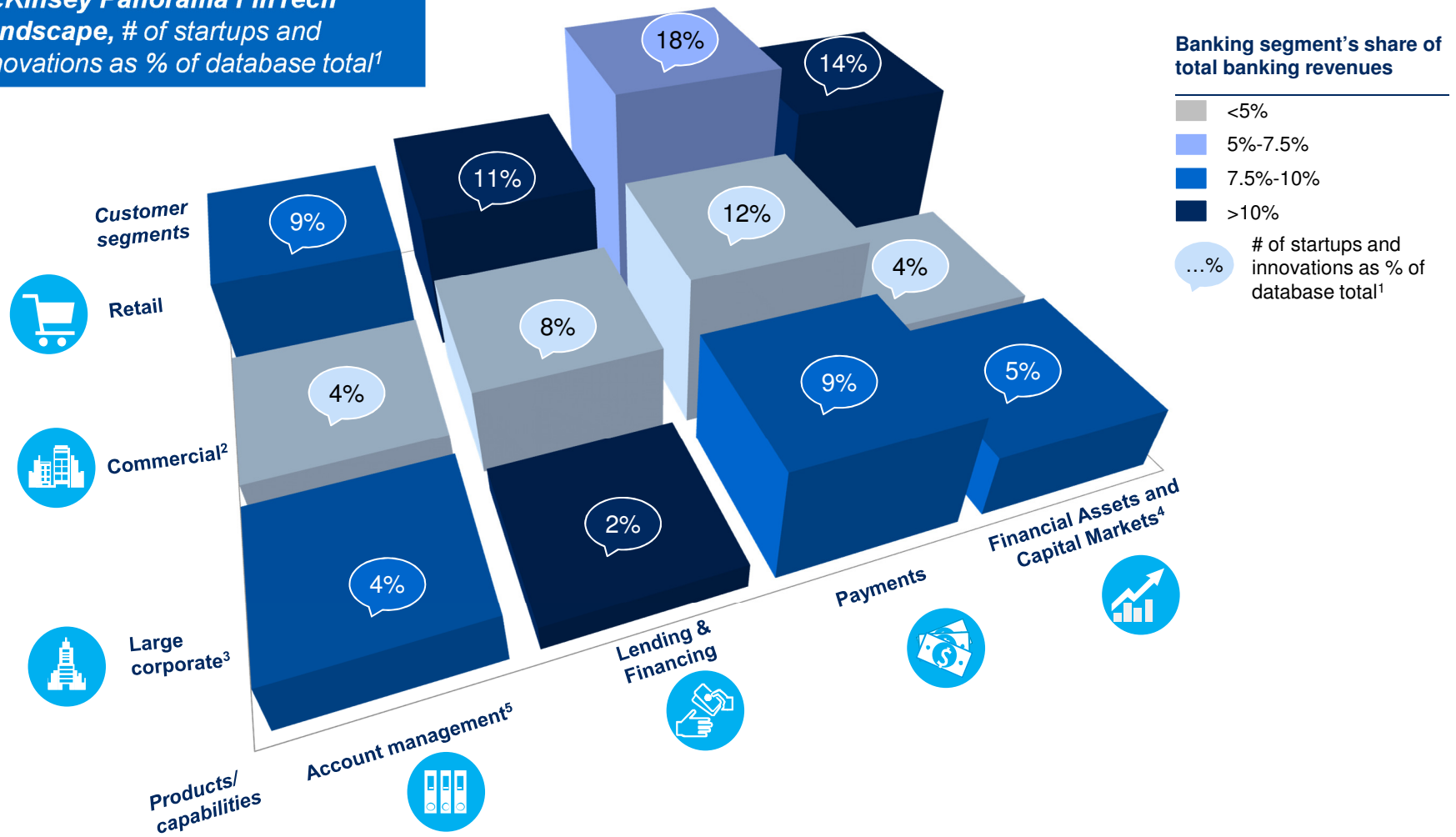
1 Growth rate calculated on half year figures H1 2015 and H1 2016
2 This figure includes $4.5bn Series B round raised by ANT Financials, which distorts the figure
3 First half of the year figures

SOURCE: CBInsights; Financial Times; McKinsey Panorama

52% of Fintech investments focus on retail banking

ESTIMATES

McKinsey Panorama FinTech Landscape, *# of startups and innovations as % of database total[1]*



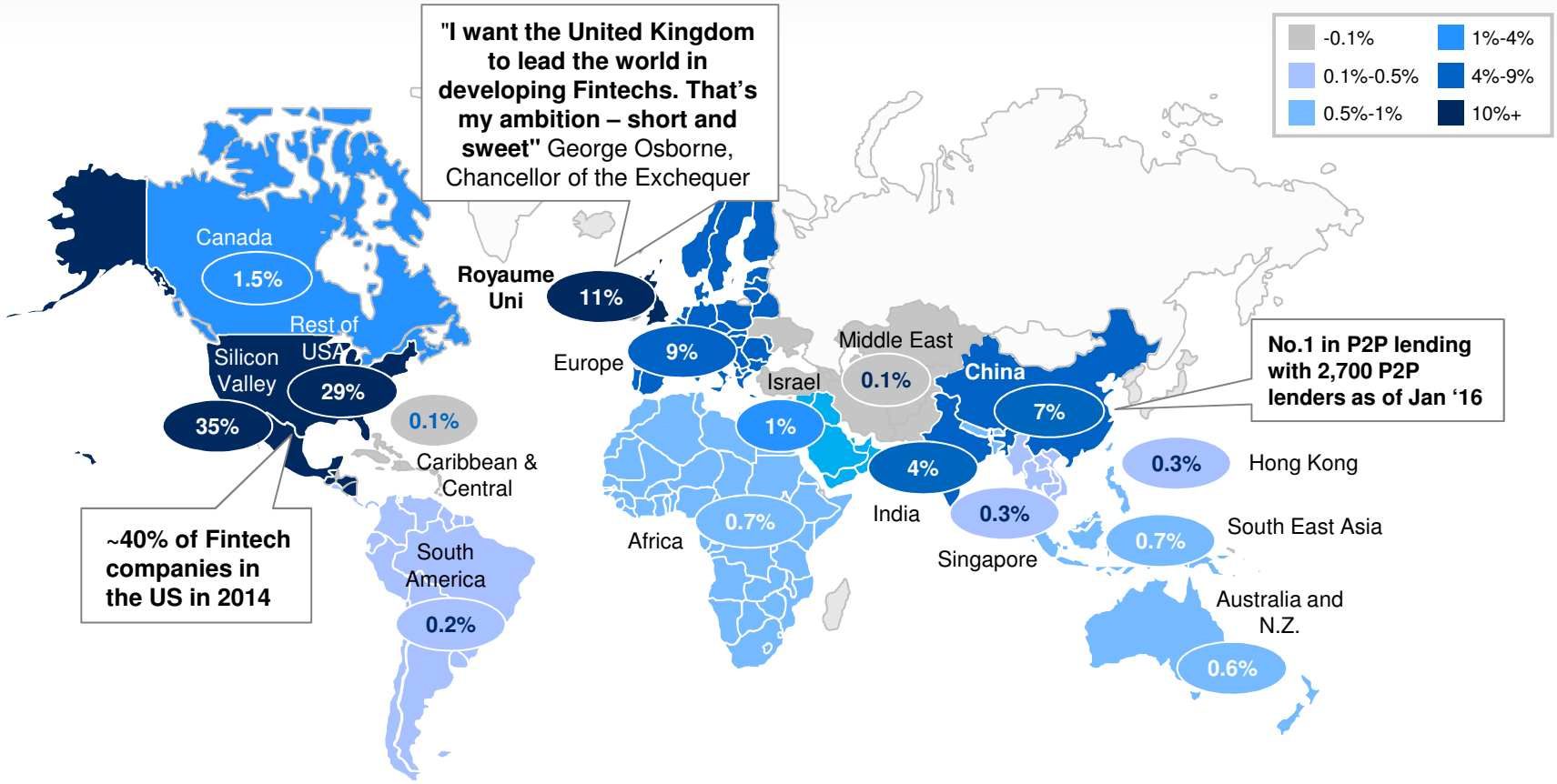
1 1,050+ commercially most well-known cases registered in the database, might not be fully representative
2 Includes Small-, and Medium Enterprises
3 Including Large corporates, Public Entities and Non-banking financial institutions deposits and asset management factory
4 Includes Investment Banking, Sales and Trading, Securities services, retail investment Non-CA
5 Includes retail CA deposit revenue and corporate CA and non-CA deposits

SOURCE: McKinsey Panorama FinTech database, Panorama Global Banking Pools

EU27 represents 9% of global Fintech Investments

Global Fintechs investment distribution (2010–2015)

Percent



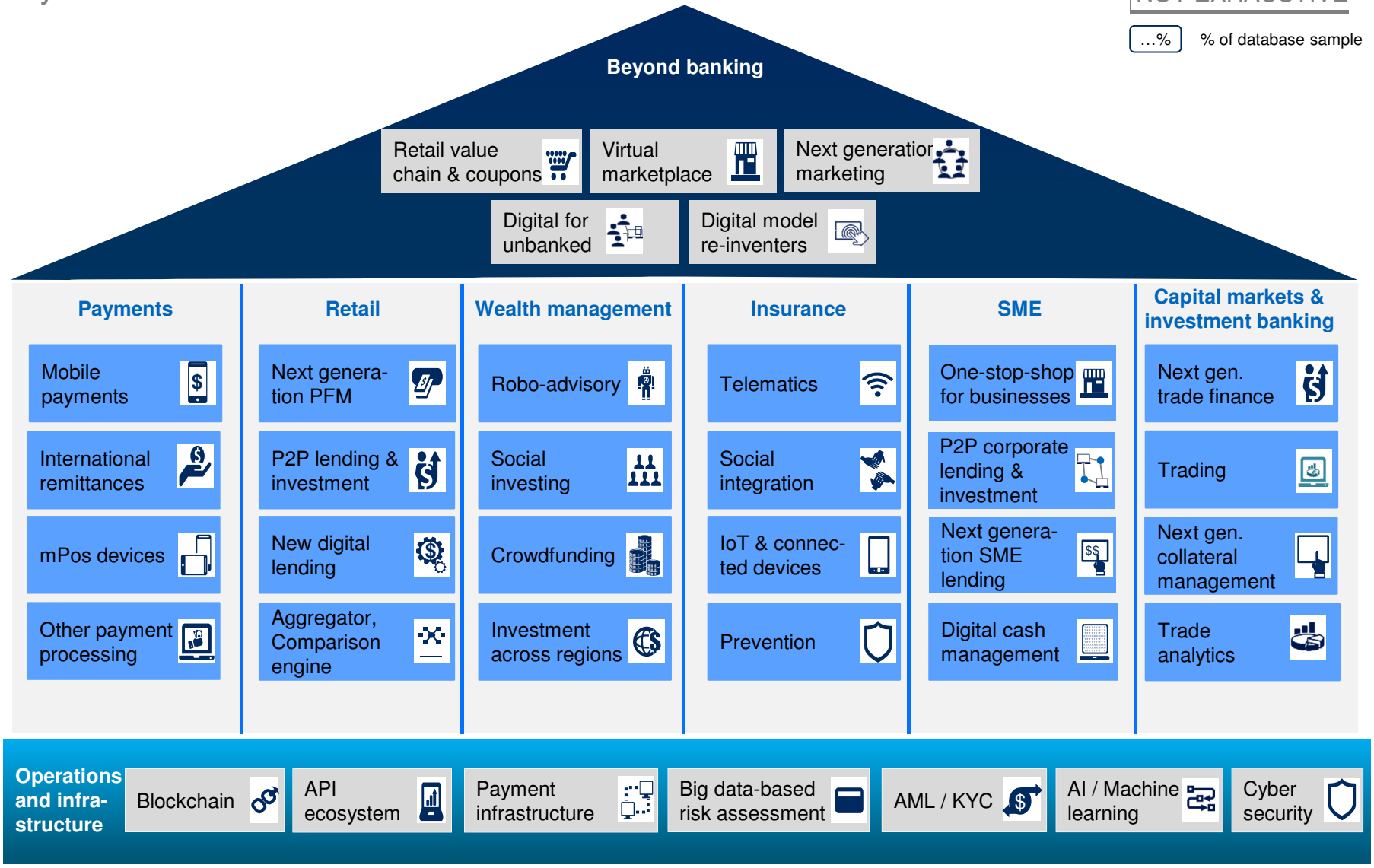
SOURCE: CB Insights, McKinsey Panorama

We see over 30 areas emerging as new norms in banking

Key Fintech trends

NOT EXHAUSTIVE

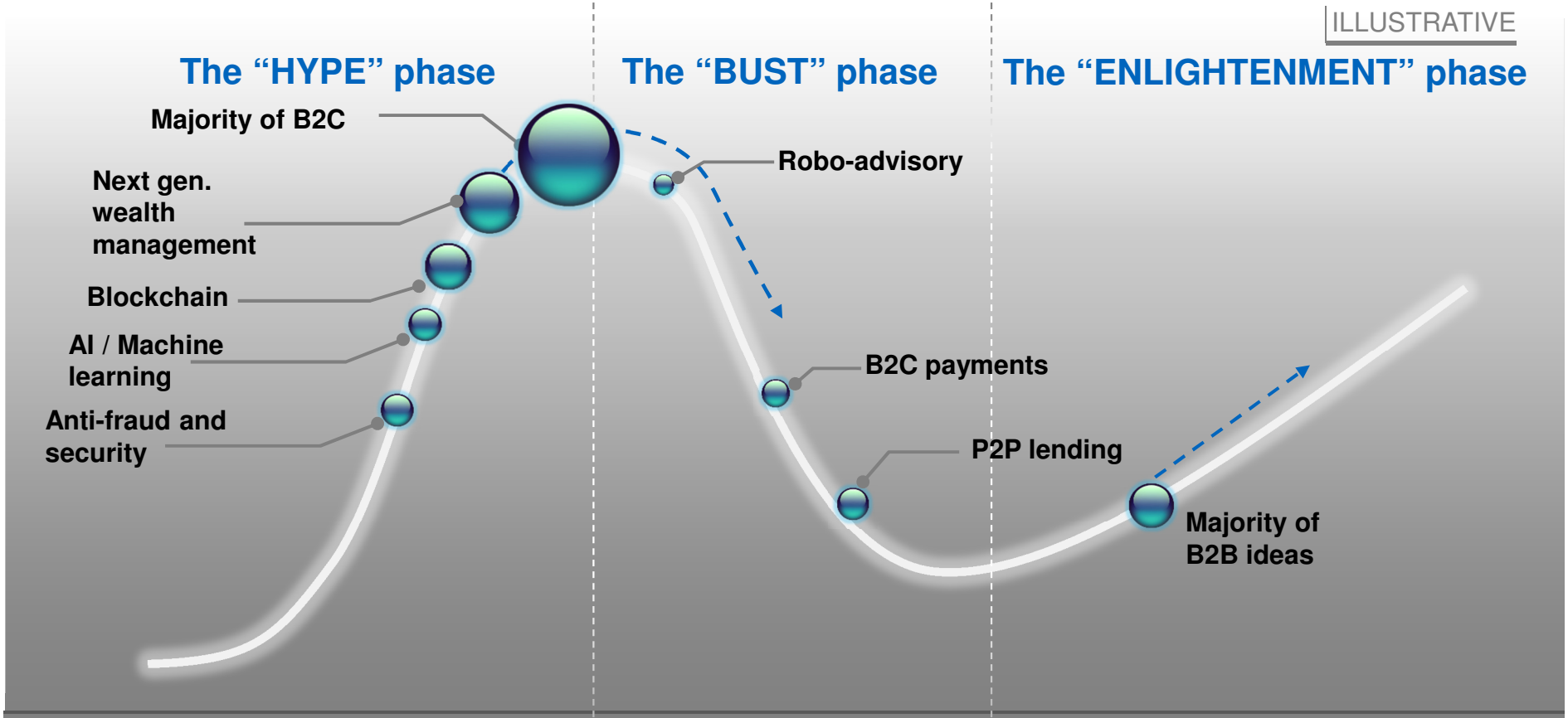
…% % of database sample



SOURCE: McKinsey Panorama

…. but where are we on the hype curve?

ILLUSTRATIVE



Examples of winning banking strategy

The "HYPE" phase	The "BUST" phase	The "ENLIGHTENMENT" phase
▪ Follow trends ▪ Make small, early bets ▪ Manage public profile, investor communication ▪ Build partnerships, but not large investments ▪ Run arm's length with innovators	▪ Pick up opportunities at the bottom ▪ Play "self-fulfilling prophecy" pipe deals ▪ Invest and divest actively ▪ Bring in top talent from failed companies	▪ Make major selected investments ▪ Deeply integrate into core operations ▪ Start second wave of acquisitions

SOURCE: McKinsey

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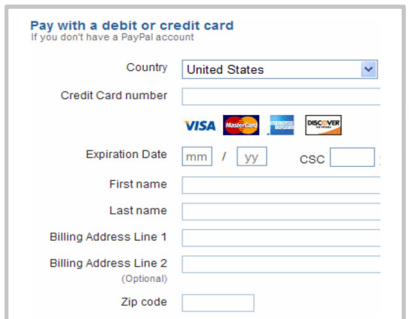
Customer expectations as to how we pay have changed radically over the last 15 years

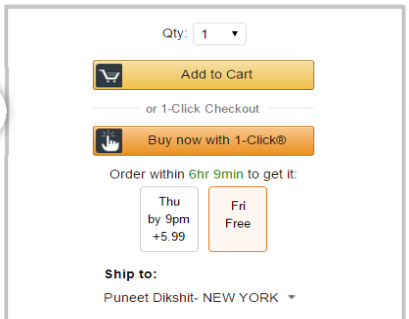
Amazon illustration

Early 2000s
Card-entry



Customers consciously chose which card to use

2010 – present
One-click checkout



Customers & merchants now prefer a "one-click" checkout experience…

Emerging since 2015
Omni-device

Digital shopping moving to non-screen based interfaces

Future outlook
Auto-purchase

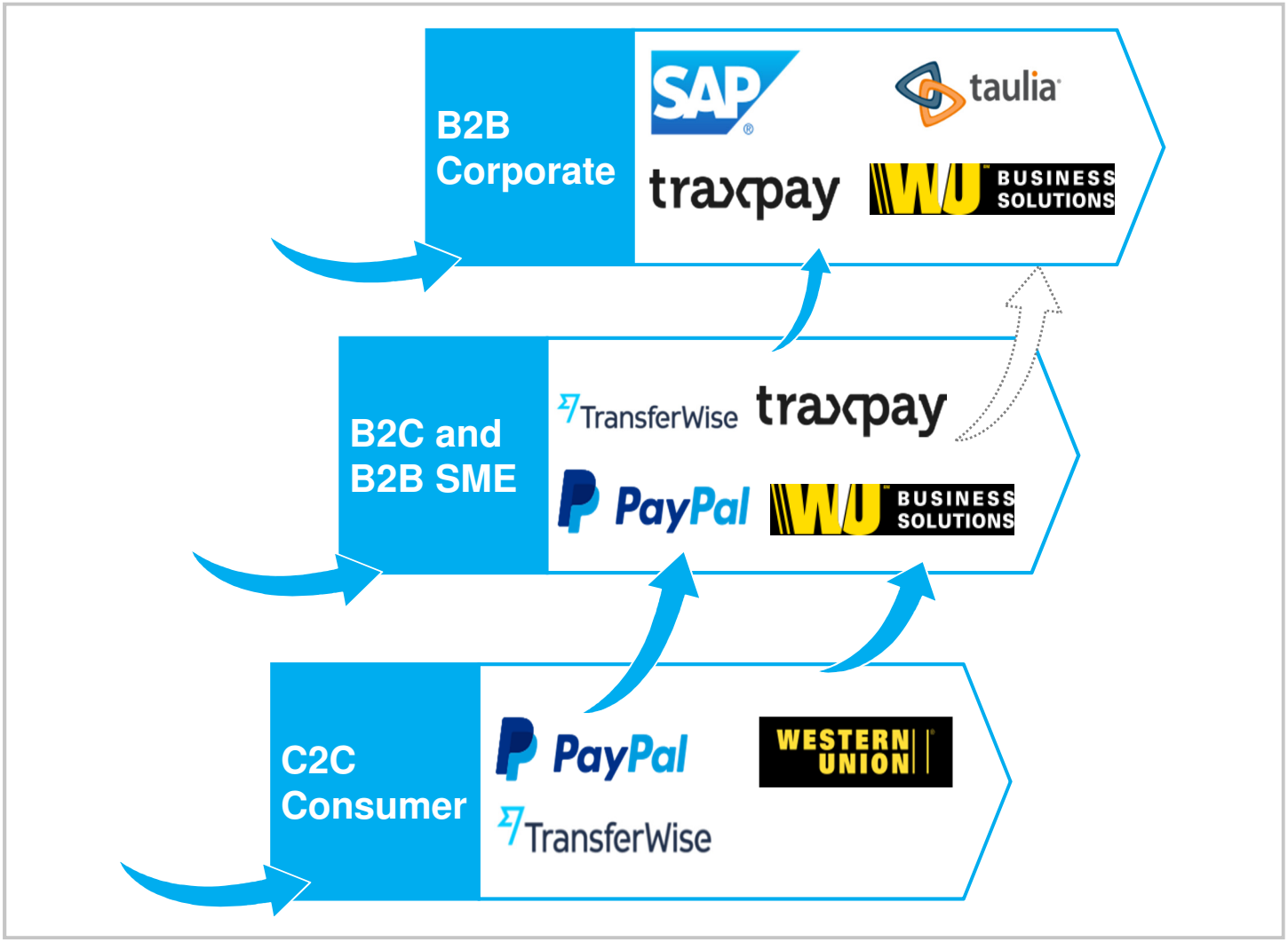
Almost entirely takes away consumer's involvement in the payment process

1 Illustration for the US

SOURCE: McKinsey Global Payments Practice

Changing face of payments is not only limited to consumer-facing space, but also rapidly creeping up to SME and corporate payments

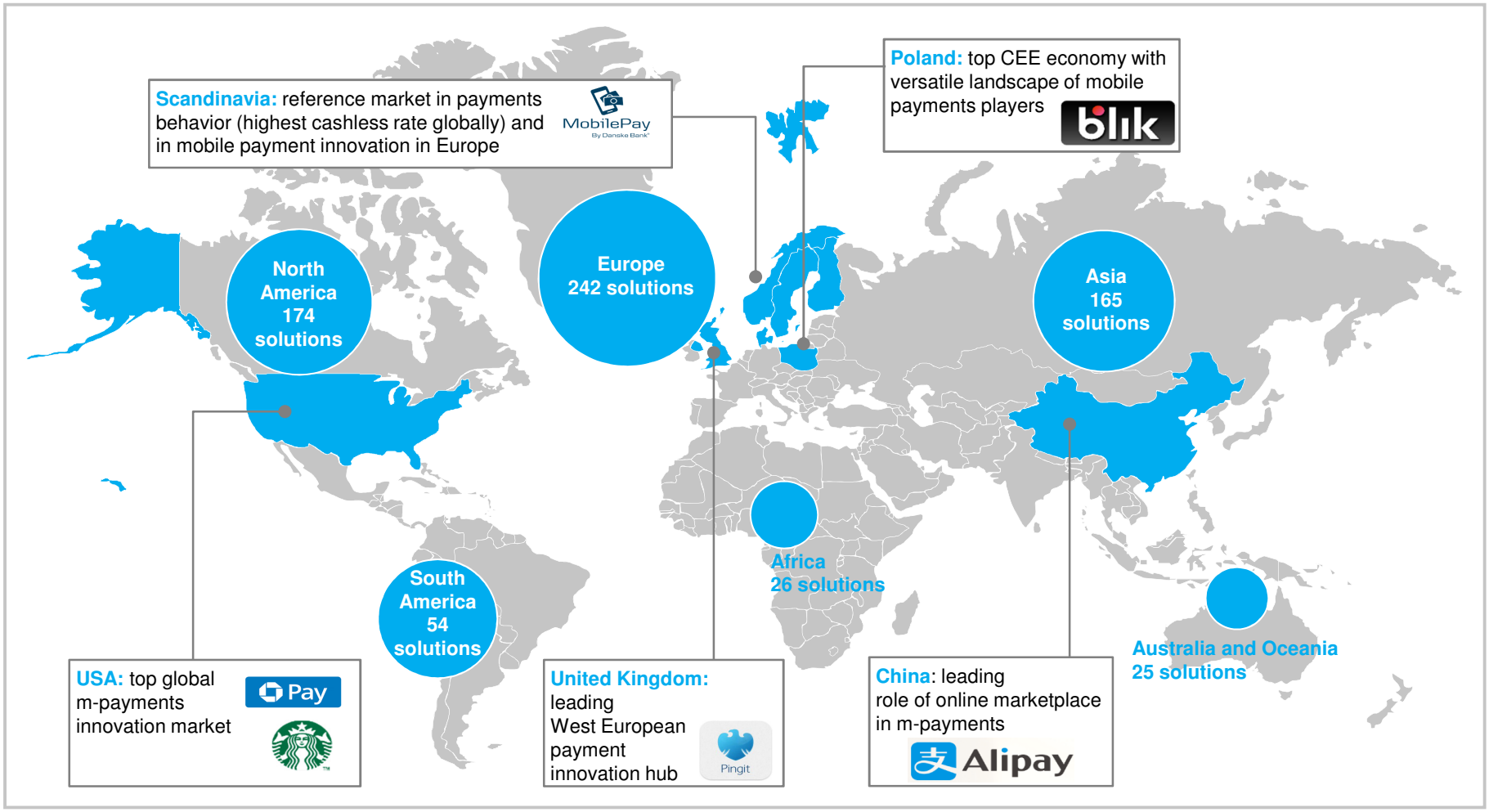
Disruption in cross-border is creeping up from C2C to SME and B2B…



Source: McKinsey Global Payments Map

~690 mobile payment Fintech attackers already identified across the Globe

Size of the bubble indicate number of m-payments solutions identified within McKinsey database



SOURCE: McKinsey Panorama Fintech, 686 m-payment solutions

Players with large customer base (e.g. GAFA) are formidable competitors

Examples of non-bank giants active in Fintechs

Started with **e-commerce** and recently moved into **payments, loans, investments, and cloud services**

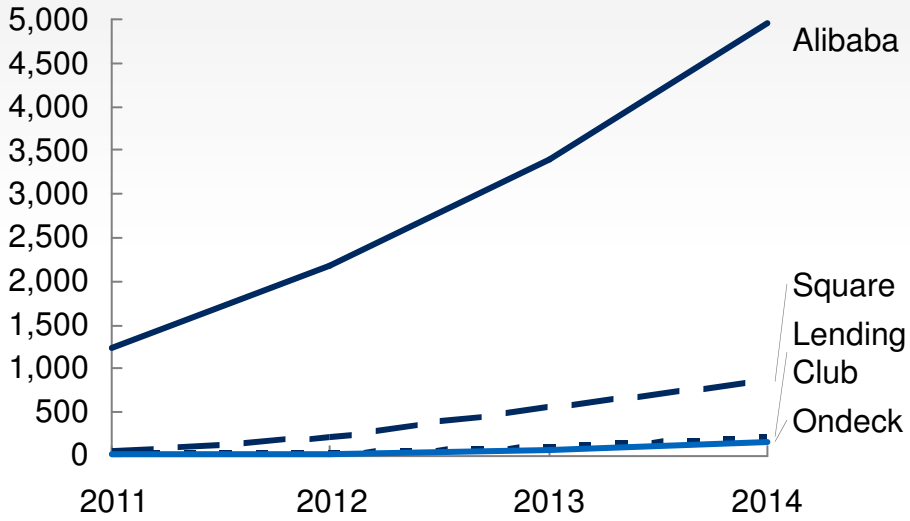
- **Disrupting:**
- **online/mobile payments**
  Dominating e-commerce payments (49% online, 73% mobile market share)
- **SME loans**
  Granting SME loans based on traffic; repayments through float money

Started with **instant messaging** and recently moved into **payments and investments**

- **Disrupting online/mobile payments,** rapidly gaining market share (19% online, 4% mobile market share within 3 years)

Financial services revenues of selected players

2011–2014, USD bn



- Revenue size and speed of growth of non-bank giants are well beyond those of startups p.ex. Alibaba is 40 times larger in financial services revenues than the median top 20 Fintechs startup
- GAFA could follow this trend and capture quickly significant market shares

1 Google, Apple, Facebook, Amazon; Microsoft may be added to the list after it took over LinkedIn

SOURCE: SNL, Quarterly and Annual Reports, Forbes, McKinsey Panorama Fintechs

… the battle for new payment solutions will however not be fought over technology, but over solutions…

A wide variety of payments technologies are emerging

Consumer payment devices

Cards

- Card details stored in electronic chip

mWallets

- Card details stored on mobile
- Bank account details stored on mobile
- Digital account details stored on mobile

Payment acceptance devices

Card terminals

- Chip reader used to access card details

mPOS card reader

- Chip reader used to access card details

Card terminals (NFC)

- NFC terminal accesses card/ account details stored on mobile phones

Other contact-less

- Terminal accesses mobile device using e.g., Bluetooth or WiFi

QR-based

- Customer generates or scans QR-code to initiate payment

In-app and cloud-based

- Transaction concluded on mobile, no terminal needed

Banks should not set on one hyped technology as solution space is increasingly fragmented and no winner has yet emerged

New commerce solutions likely to define technology requirements

New trade	Example	Changing needs
Virtual stores		A Tender-based loyalty ▪ Use transaction level data to drive marketing ▪ Level the playing field with online retailers
Social feedback		B Dynamic engagement ▪ Insert game-play to make shopping more engaging
Customi-zation		C Lead generation ▪ Partner with social networks to generate leads ▪ Minimize “showrooming” effect through real-time in-store offers
Social rewards and gamification		D Virtual shopping ▪ Enhance shopping experience through virtual stores E Mobile POS ▪ Improve in-store shopping experience by enabling self checkout or mobile POS

Broader innovations in commerce likely to influence nature of future payment solutions

SOURCE: Expert interviews, company websites, McKinsey Payments Practice

… successful new solutions in payments generally following six “winning” markers

Value step change	▪ Guaranteed satisfaction of goods to buyers
Beyond cost	▪ Targeted marketing for merchants; digital offers for consumers
Niche markets	▪ Payment mechanism for eBay marketplaces
Established infrastructure	▪ Largest cash-in / cash-out network in Kenya
Market context	▪ Online remittances via account-to-account and cash pick-up
Adjacent revenues	▪ Prepaid cards for unbanked by leveraging revenue from store traffic

SOURCE: McKinsey Payments Practice

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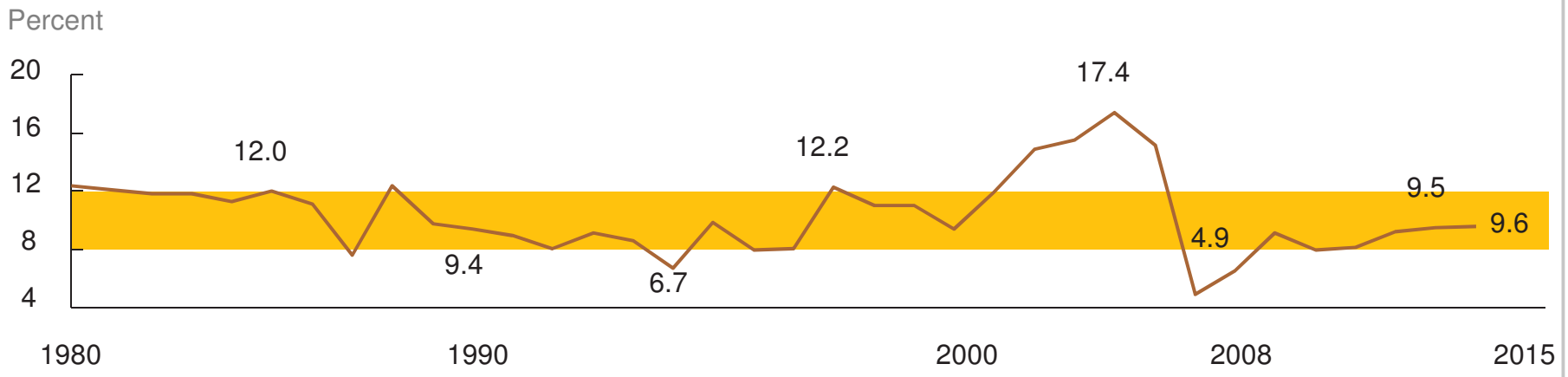
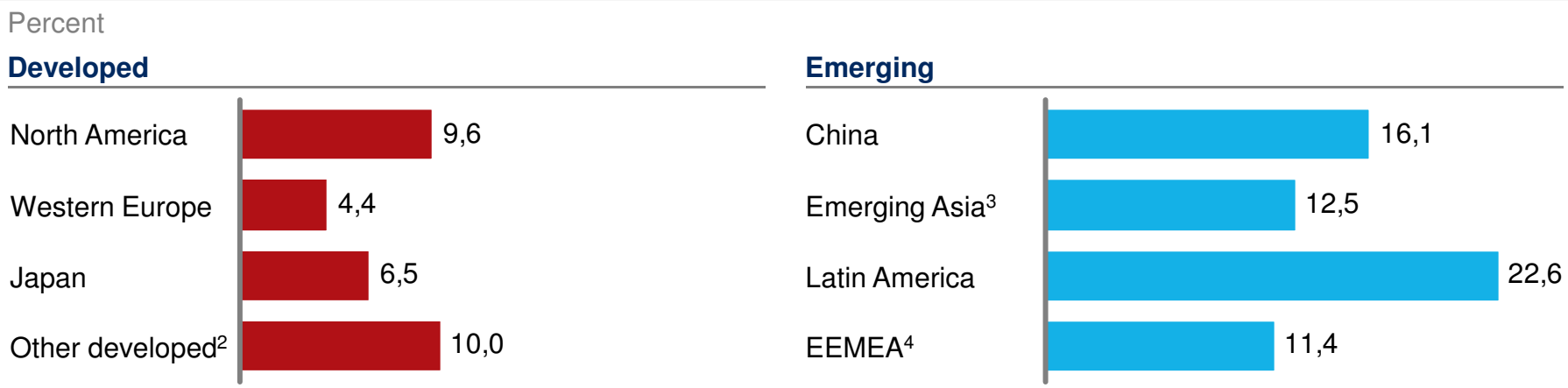
European Banking Sector has not created economic value in 2015

Global[1] banking ROE, 1980-2015



ROE by region 2015

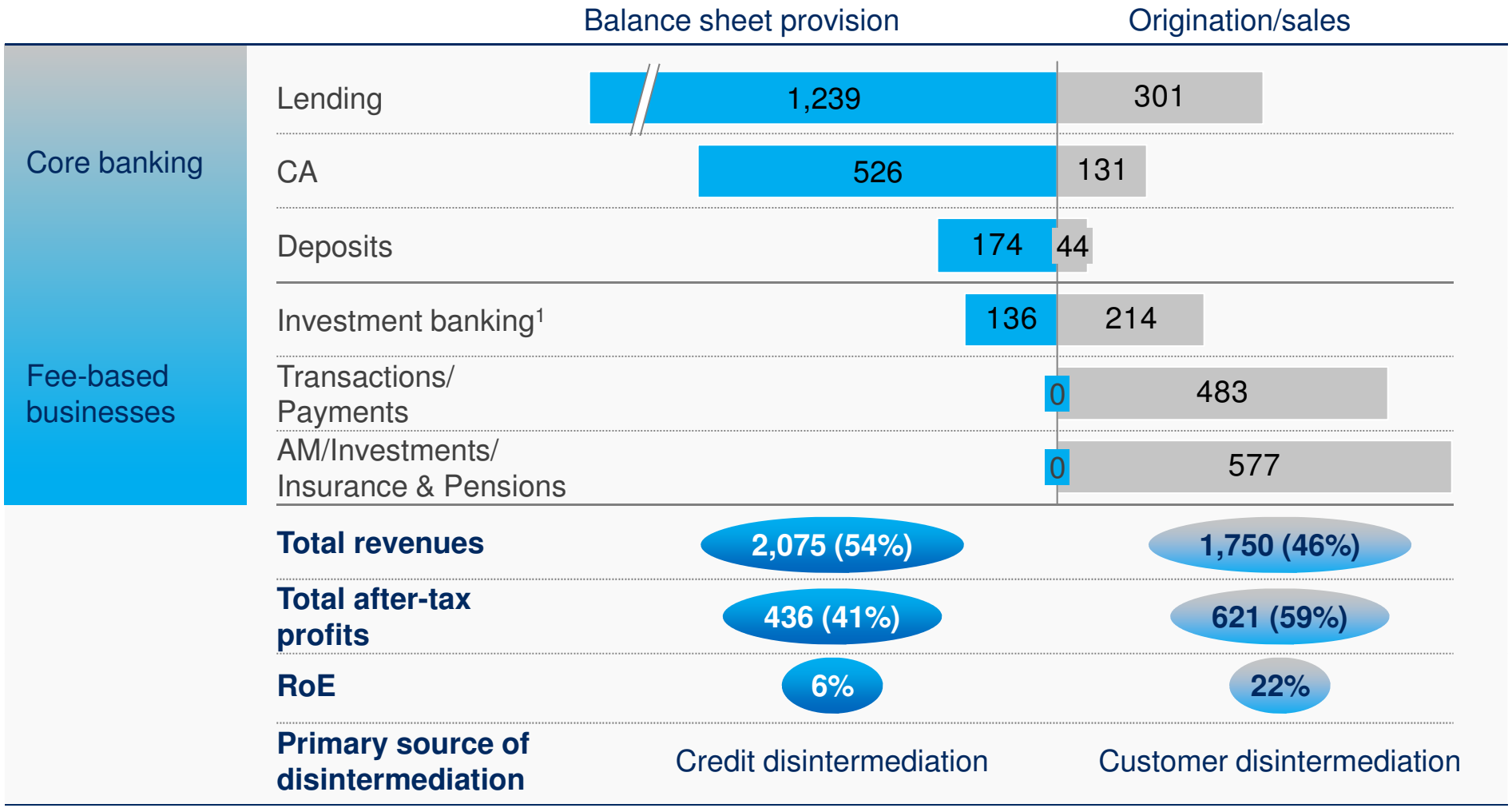


1 Based on a sample of ~1.000 largest banks in terms of assets.
2 Australia, Hong Kong, Israel, Singapore, South Korea, Taiwan.
3 Bangladesh, India, Indonesia, Kazakhstan, Malaysia, New Zealand, Pakistan, Philippines, Sri Lanka, Thailand, Vietnam.
4 Angola, Bahrain, Belarus, Egypt, Hungary, Iran, Jordan, Kuwait, Lebanon, Mauritius, Morocco, Nigeria, Oman, Poland, Qatar, Romania, Russia, Saudi Arabia, Slovenia, South Africa, Togo, Turkey, United Arab Emirates.

SOURCE: Bloomberg, Compustat, Datastream, OECD, SNL, Thomson Reuters, McKinsey Panorama – Global Banking Pools

Customer disintermediation targets the most profitable activity in banking – origination and sales account for ~60% of global banking profits

2014 revenue before risk cost, $ billion



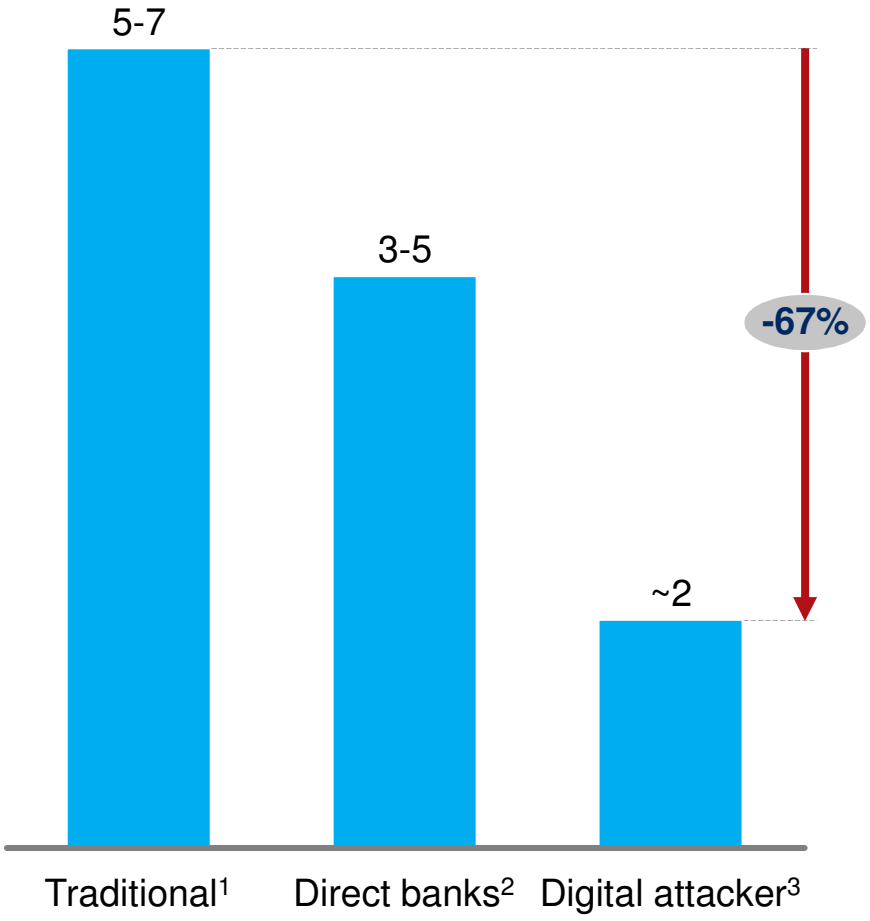
1 Corporate finance, capital markets, securities services

SOURCE: McKinsey Panorama; Expert interviews

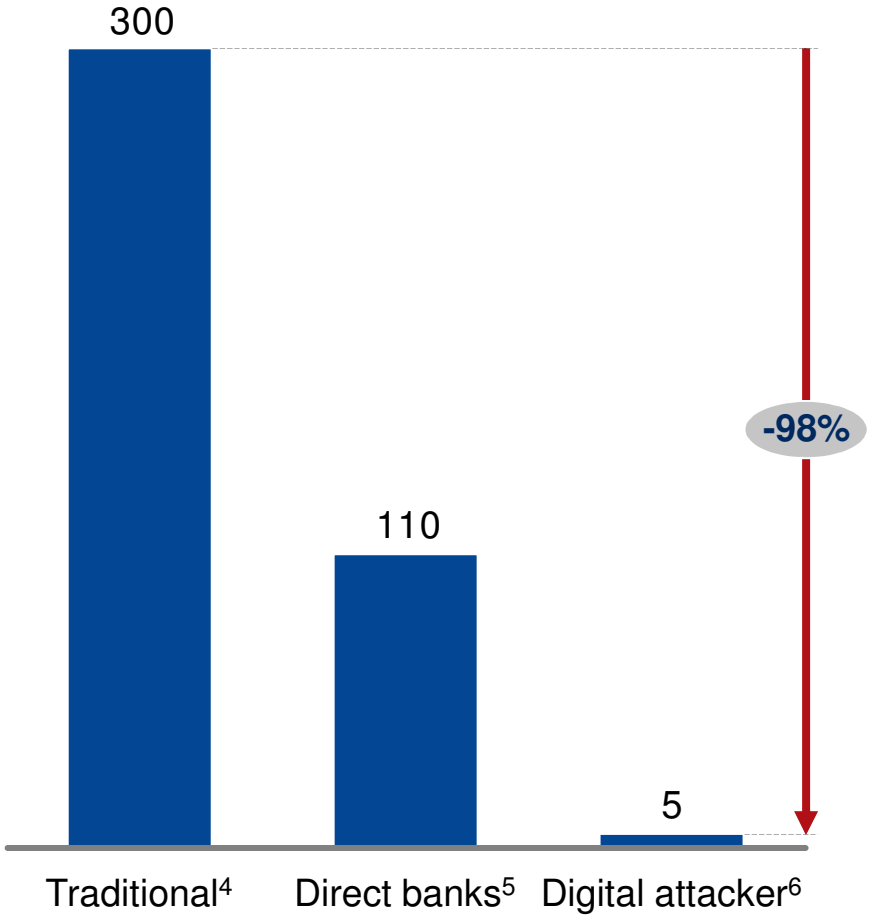
Digital attackers enjoy substantial cost advantages

Digital bank's cost advantage

Operating expense
Percent of outstanding loan balance



Customer acquisition cost (rough estimates)
$ per customer

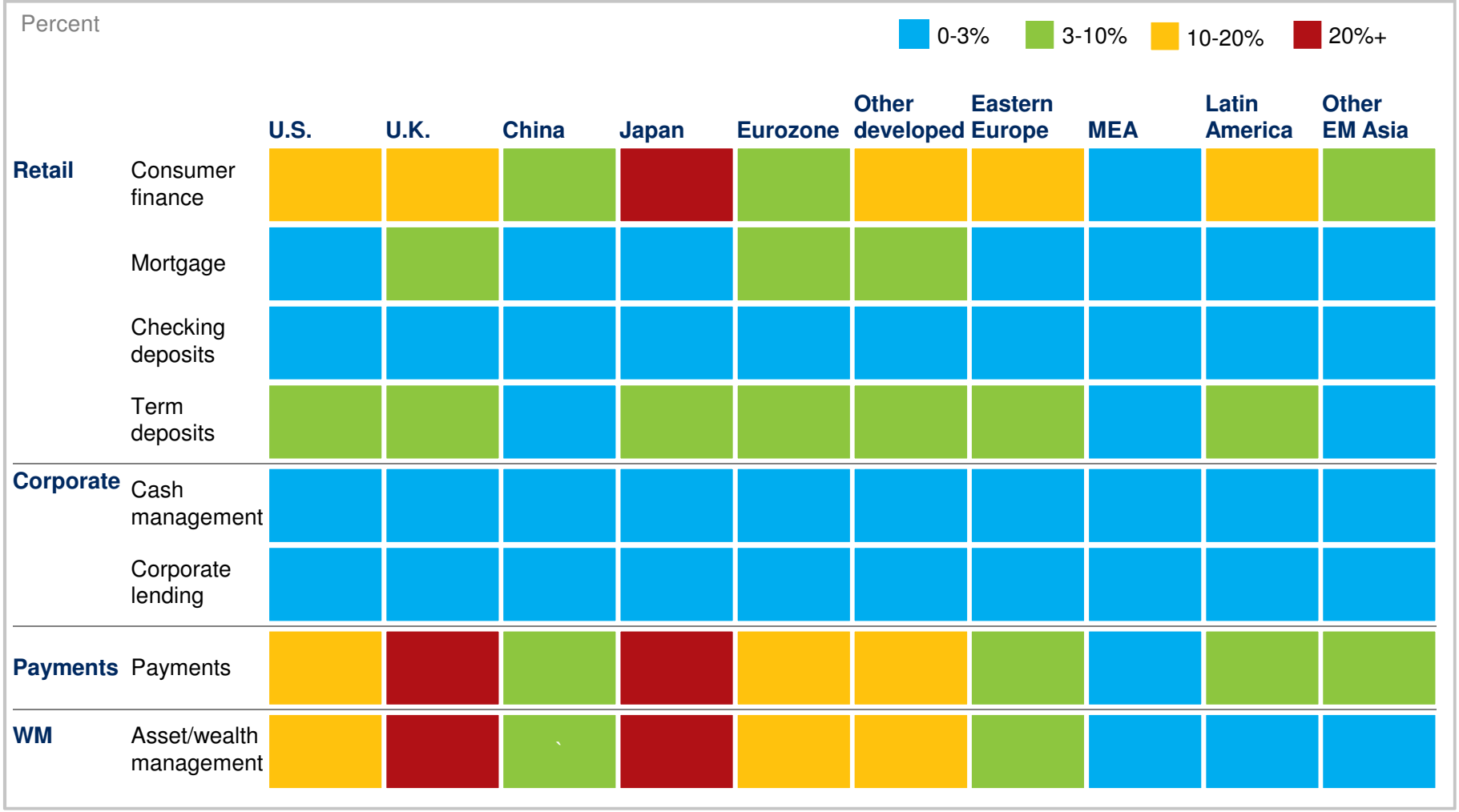


1 Traditional banks: based on sample of top 500 banks' data from Reuters.
2 Direct banks: ING DiBa, Activo, Checbaca, AirBank, mBank, Zuno (2014).
3 Lending Club First Quarter 2016 Results.
4 Foundation Capital, 2014; Lending Club based on St. Louis Fed, Federal Reserve.
5 Based on expert interviews.
6 On Deck, company presentation May 2015.

SOURCE: Annual reports, press searches, McKinsey & Company analysis

Fee-based businesses likely to experience the largest margin reductions

Fee and margin reduction in revolutionary digitization scenario

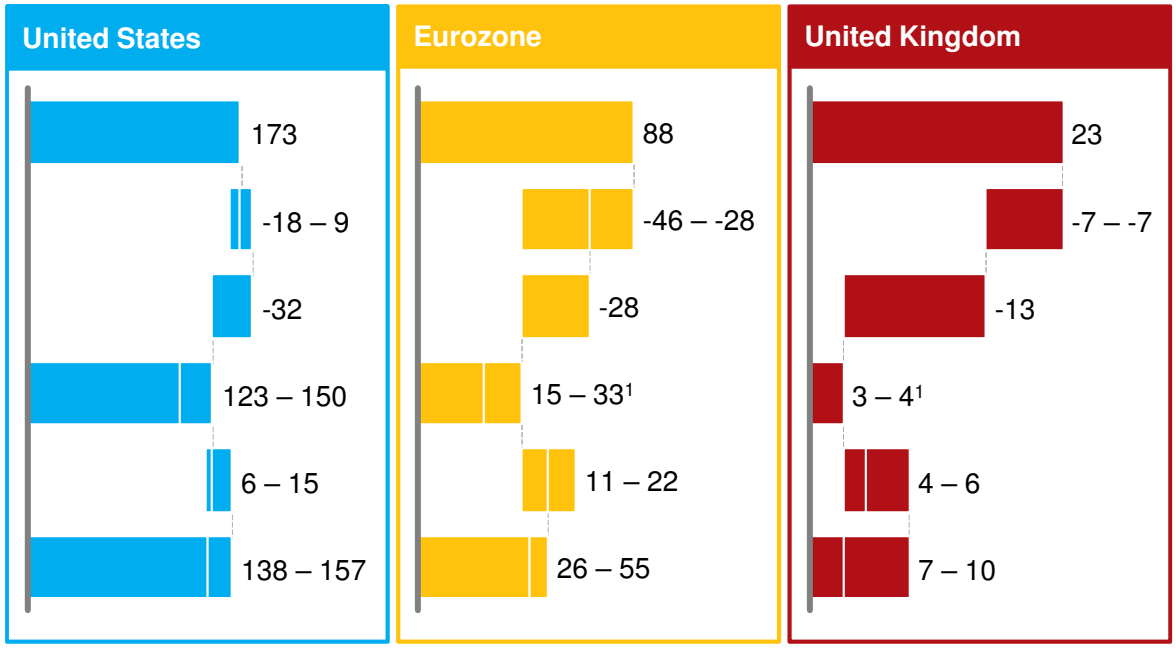


SOURCE: McKinsey Panorama – Global Banking Pools

Potential profits at risk and implied cost gaps in developed market banks

Changes in profitability from 2 secular forces, 2015-20

$ billion



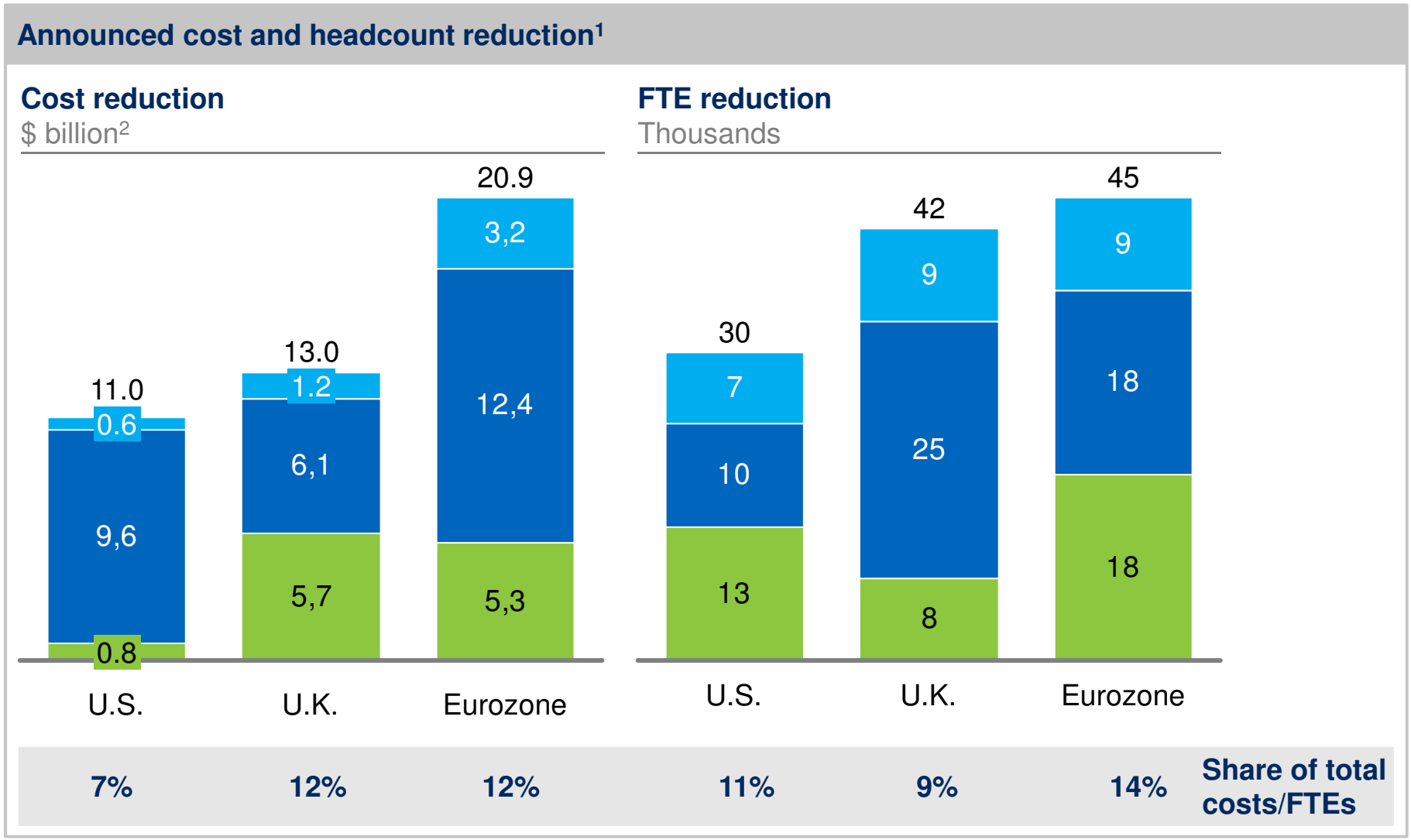
Cost gap to reach	United States Gap $ billion	United States As % OPEX	Eurozone Gap $ billion	Eurozone As % OPEX	United Kingdom Gap $ billion	United Kingdom As % OPEX
2015 profits	-35 – -16	-10 – -5	-52 – -45	-14 – -12	-16 – -14	-11 – -12
8% cost of capital	-16 – 3	-5 – 1	-132 – -139	-38 – -36	-53 – -51	-41 – -39
10% cost of capital	-54 – -35	-16 – -11	-183 – -176	-50 – -48	-68 – -66	-51 – -52

1 In consensus and flat view, including evolution to withstand the negative effects of low interest rates and digitization

2 Pro-forma 2020 profit is 2015 profit net of interest-rate and digital effects. Should profits grow strongly, banks will be better able

SOURCE: SNL, McKinsey Panorama – Global Banking Pools, McKinsey Profit Simulation Model

Banks are drastically cutting costs and pulling all levers to reach profitability targets



1 Analysis based on the largest 20 banks per YE assets (US/EU), the top 4 banks according to assets (U.K.).
2 GBP, euro and JPY converted to USD at current exchange rate (Oct 2016)

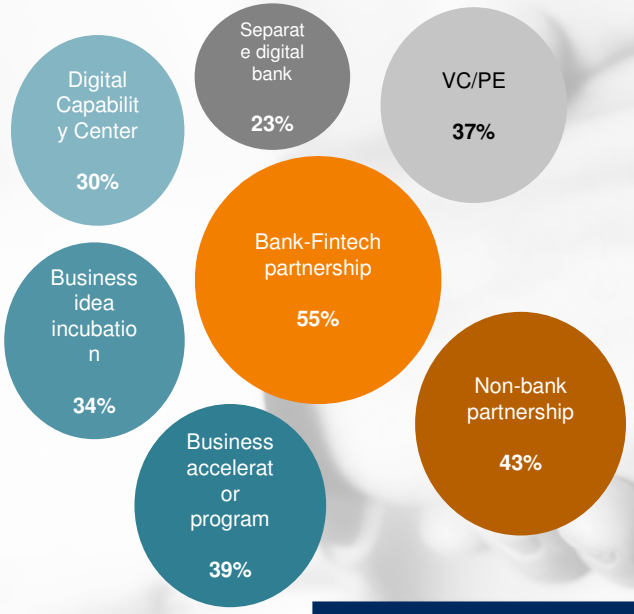
SOURCE: Bank annual reports

Fintechs and banks are increasingly moving towards working together through partnerships

Banks

52% of the top 100 banks are already in active partnership with Fintechs…

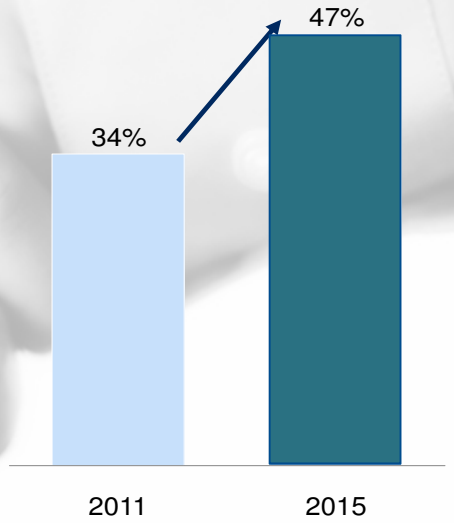
Banks by innovation solution, % of banks[1]



Fintechs

… While the share of FinTechs having a B2B business model has increased from 34% to 47%

Share of FinTechs[2] with a B2B business model



The share of B2C Fintechs working with banks has also been increasing through customer referrals and other setups

1 Based on a survey covering the top 100 banks; Percentage includes all banks that have initiatives in a certain category
2 Based on a sample of ~ 600 FinTechs included in the database

SOURCE: McKinsey Panorama FinTech