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White Paper: The Future of the Financial Services Business Model

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My wife knows credit cards. She has a couple, of course, but is also the general counsel of one the world's leading credit card companies. So, it's enigmatic that were she old enough in the early 1970s to apply for a credit card herself, her bank could have, and would have, refused to issue her one. Before 1974, most banks deemed women too high a risk unless they were married and their husbands co-signed for the card.

Industries evolve in punctuated fits and starts. The pattern of corporate evolution is predictable:

1. Some technological, societal, conceptual, regulatory, or economic change makes something new possible.
2. Corporations take an often frustratingly long time to adapt. For example, the 19th Amendment to the US Constitution guaranteeing women the right to vote was ratified in 1920 and yet for 50 years banks persisted with outdated views.
3. A few pioneering firms (we call them "Outthinkers") step out of old dogmas to embrace the new reality. New York Life, for example, was the first American life insurer to offer policies to women at the same rate as men.
4. Outthinkers win, and others fall behind until, eventually, the entire industry evolves.

We are today experiencing such a leap in evolution across most sectors and, particularly acutely, in financial services. A paper contributed to by about 150 leading thinkers in finance highlighted that no less than 15 major advances in technology are opening up new possibilities for how financial service firms operate their business models:

- Mobile payments
- Next generation security
- Distributed ledger/ blockchain
- P2P transfers
- Mobile money
- Self-driving cars
- Wearable technology
- Internet of things (IoT)
- Cheaper sensors
- Biometrics
- Big data
- Connectivity technology
- Advanced analytics
- Artificial intelligence (AI)
- Advances in APIs

These technologies have the potential to restructure the business models of nearly every corner of finance: insurance, payments, investment management, capital raising, deposits, and lending.

History is repeating itself. Most incumbent firms, anchored by perspective, tradition, beliefs, imbedded processes, and systems, are reacting slowly, a view none of the large, financial institutions we work with would deny. But a few Outthinkers, large and small, are taking steps to seize an advantage out of the gap.

To make sense of how financial service business might evolve, it helps to not get fixated on the technology. An easy, but, history would say, misguided approach is to say "people are using blockchain … we should too" or "competitors are applying artificial intelligence … we should too." Such rapid-copying strategic approaches are perhaps necessary to ensure you do not get left behind. But they rarely put you ahead in the race. You must instead look at the concepts emerging around the technology that open new ways of thinking and behaving.

The technology to adopt mass-production, for example, was substantially available long before Henry Ford, having embraced a new way of thinking about industrial production, applied it. To get ahead of the future, look at the new perspectives (or at the extreme case "paradigms") that those successfully applying new technology are taking.

Financial service firms that are winning today are applying technology effectively because they are realizing approaches and objectives that emerging technologies make newly available. They are focusing on things like:

- Simplifying the consumer experience
- Streamlining the transfer of value
- Replacing intermediaries
- Adopting a sharing (v. ownership) mindset
- Creating platforms (for aggregating capital or the application of capital)
- Personalizing offerings
- Automating advice, operations, and credit evaluation
- Tapping nontraditional capital sources and customers

In summary, we see successful business models exhibiting three characteristics which are remarkably similar to how we see business models emerging in retail, media, and other sectors:

1. From stores and branches to aggregation platforms
2. From asset-heavy models that create economies of scale to asset-light models
3. From people-intensive to data-intensive approaches

The reaction of successful Outthinkers to what technology makes possible is evolving every element of the business model. You could say a business model is composed of eight elements: positioning, placement/distribution, processes, product, physical experience, pricing, promotion/sales/marketing, and people. Here is how each element may evolve.

Positioning
Strong business models begin with a unique, clear positioning. When a business clearly knows who their customer is and then adopts a brand positioning in their customers' minds that is one competitors do not want to, or at least find it difficult to, adopt, they have the potential of establishing a meaningful competitive advantage.

IKEA's competitors, for example, have long competed on durability and service. They would argue that one should not go to IKEA because IKEA's furniture is less durable and they offer inferior service. IKEA customers have to do much of the work themselves – from selecting what they want with minimal sales help, loading boxes into cars, assembling at home, and disposing of the packaging – and then must replace the furniture after a few years because it wears down. IKEA could seek to copy a durable, high-service positioning but doing so would put them in more direct competition. So instead IKEA essentially argues that doing all the work yourself is part of an empowering lifestyle. If you are someone who cleans your own home and grows some of your own vegetables, then you are an IKEA person. They argue that their furniture is not of low-quality but it is commitment free. You do not feel guilty refreshing your furniture every few years. There are enough people who want an empowering, commitment-free lifestyle that IKEA is the largest furniture retailer in the world.

Financial service institutions have nearly universally positioned themselves across similar dimensions such as trust and safety. Emerging financial winners are now finding new, more unique positions.

Simple Bank, for example, was founded in 2009 around the concept of "simple." It was less a bank than a storefront that delivered basic banking products, like checking accounts, through elegant mobile and web experiences. It substantially outsourced its true back-office operations to partners, such as The Bancorp Bank, a private-label banking and technology operator. Simple Bank's imagery is filled with stylish photos of people in everyday life situations, at coffee shops or backpacking through a city.

By focusing on attributes such as simplicity, dreams, ease, and beauty, the bank grew rapidly. The team launched their beta in 2012 and by the end of 2013 the bank was processing around 13 debit transactions per minute on average with an overall customer balance of $64 million. In February of 2014, BBVA acquired Simple Bank for $117 million, or about $1,200 per customer. The bank continues to grow and operate with reasonable freedom.

A soon-to-be-launched startup called my4 will help people invest based on their personal values. They allow you to develop a profile around your personal sustainability preferences – do you care about the environment or worker rights? – and then guide you to investments, in this case exchange traded funds (ETFs), that match your personal values.

Are you pursuing the same core customers with a similar value position as your competition? What unique core customer can you attract through a positioning that competitors would avoid copying?

Placement

Placement, or distribution, describes how you get your value proposition to your stakeholder. In most industries this means how you get product to customers. Dell disrupted the PC industry by being the first to sell customized computers directly to consumers, overpassing retailers. Salesforce.com was the first to sell software not through integrators but as service, introducing Software as a Service.

But financial businesses are fundamentally different in that they must engage not only front-end customers but back-end. Banks, for example, cannot only attract customers; they must also attract borrowers so they can put deposits to use. Investment firms must not only access investors; they must attract investments.

Crowdfunding platforms such as GoFundMe, Kickstarter, Indiegogo, and SeedInvest moved quickly onto new regulations and technology that created new ways to aggregate capital. It is estimated that by 2015, crowdfunding platforms had raised $34 billion. The World Bank expects such platforms to grow to $96 billion by 2020.

But the concept of crowdfunding is opening the door to yet more applications. CommonBond, for example, was founded in 2012 by two Wharton graduates who saw an inefficiency in the market for student loans. Students had too few options for getting loans, and alumni who had money to invest, and would get intangible value by giving loans to students of their alma maters, had no easy option to lend to students. Repayment rates on student loans are high so the returns of offering them are attractive.

Originally conceived as something like a P2P student loan platform, CommonBond quickly attracted the attention of intuitional investors. Today they have over $1 billion in loans outstanding.

Process

Process refers to the internal processes you follow to create and deliver value. In retail, Zara has enjoyed a decade-long advantage by adopting a unique design and merchandising approach. Through a sophisticated manufacturing and distribution operation, they are able to radically shrink the time from designing to manufacturing to hanging in the store. As a result, they can refresh merchandise in weeks while competitors operate in seasons. With over 2,000 stores and $16 billion dollars in revenue, Zara sustains its position as one of the fastest-growing, most profitable clothing retailers.

The most significant operational advancement in financial services is arguably the distributed ledger (also referred to as blockchain). But while blockchain is considered a technology, its future influence is better understood if one thinks of it as a new approach to ensure accountability. Instead of a central authority maintaining the record of transactions (who trades currency or anything of value with another), a distributed network of records is maintained. While someone may be able to fraudulently alter the record of one ledger, it is nearly impossible, some would say it is indeed impossible, to simultaneously alter all the ledgers. So one can easily identify fraud by checking whether the ledgers agree.

The idea that one can ensure accountability without a centralized authority opens up innumerable applications. Countless Outthinkers are applying this approach to the recording of events, tracking of medical records, records management activities, identity management, and transaction processing.

Organizations like Bitnation are even applying the approach to help refugees. When someone is forced to flee their country, they often leave behind records of their identity, education, and wealth. How can they prove they actually have earned a degree or, indeed, who they are? Through a distributed ledger, Bitnation allows people to create a "digital identity" in the cloud that follows them wherever they go.

Artificial intelligence and robotics, it is well known, are radically altering how financial firms operate. Some expect half of bank employees will be replaced by automation in the next ten years.

Alibaba is using similar technology to reinvent small business lending in China. Their platform, a sort of eBay-meets-Amazon, offers nearly a billion products and is one of the 20 most visited websites in the world. The merchants who sell on the platform sometimes need funding to grow and fulfill orders. However, the Chinese banking system is not geared well to providing small business loans. So Alibaba is filling the gap.

According to Alibaba founder and CEO Jack Ma, eight years ago, the company decided they should be a data company rather than an ecommerce company. Since they have transaction data about merchants who sell on their platform, they can use that data to make loan decisions. They implemented a program that Ma describes this way: "In three minutes, we can decide if we want to lend you money and how much. Within one second, the money will be in your account. And zero people touch [the process]. So we call it 3-1-0."

When was the last time you thought through your core processes? What can you reimagine?

Product

When we think about product, we tend to think about features such as a computer's speed and hard-drive capacity, a car's acceleration and interior, or a desk's color and design. But taking a more user-centered approach often reveals unseen opportunities.

Think about the attributes your product or value proposition delivers. A retail store, for example, delivers low or high prices, ambience, selection, etc. Then, when you know who your core customer is (see **Positioning** above), you can assess which attributes they care about. You can differentiate your product by over-delivering on what customers care about by intentionally under-delivering on what they care less about. Wal-Mart, for example, knows its customers care more about low prices than sales help. So they intentionally under-invest in sales help, putting few staff on the floor, in order to provide lower prices.

Financial service firms often think in terms of product categories (deposits, loans, insurance, retirement funds, etc.) instead of thinking about what the product does for its users (protecting capital, getting what you want without having to wait, avoiding risk, having money for retirement, etc.). Starting with the attributes people care about reveals new innovations.

TransferWise took such an approach. The two founders were friends living in different countries. Every month each had to transfer money from one country to the other. And every month they were perplexed by what banks charged them to transfer money. The amount seemed too high and it changed constantly. So they came up with a new solution. Instead of transferring money across borders, they agreed to deposit money into each other's bank accounts locally. So the one living in London would send money to his friend's UK account and vice versa. They agreed each month to apply the official interbank exchange rate.

The approach worked so well that they figured, why not make this available to other people? TransferWise was born. The idea was so good it attracted the backing of PayPal founders Max Levchin and Peter Thiel, and of Virgin founder Richard Branson. Launched in 2011, the company now has over one million customers sending more than £800 million ($1 billion) per month.

Such a "product" is not technically a transfer and would not likely have been conceived of if one started by looking at innovating transfers.

If you stopped thinking in terms of product categories and instead in terms of attributes your core customer needs, how would you design from scratch a compelling "product"?

Physical experience
Your customers only know you and your offer through their senses. They must, at a fundamental level, see, smell, hear, taste, or touch it. Companies that understand this and play at this sensory level often create innovations their competitors overlook.

Apple, for example, has long been focused on the physical experience of its products while its competitors fretted exclusively over performance. This is one reason why Apple launched Apple Stores.

Physical experiences are transforming, particularly in financial services. New advances in biometrics are making it possible to know customers (and meet "Know Your Customer" requirements) through their voice, fingerprints, and eye scans. One fintech company we came across is making advances in recognizing customers by things like how you hold your phone.

As voice recognition advances, not only can the object you're interacting with recognize customers by their voice – imagine stepping up to an ATM without a card, speaking your name and getting access to your account – but also interact in more natural ways. Amazon's Echo product – a tower that sits on a flat surface and that you interact with via voice – has proven to be an unexpected early winner in the consumer voice recognition space. In two years it sold over five million units. Sales are believed to be accelerating. Google, Apple, and others are moving assertively behind to advance us toward a seamless, natural, voice-driven experience.

As banks and financial advisors move away from physical locations (e.g., Wells Fargo recently announced it was closing 400 branches by 2018), they have an opportunity to reconceive what it means for customers to interact with them.

For complex, multi-business financial firms, the physical experience opportunity may be even larger. Many are realizing that by starting with customer experience in mind and mapping out that experience, they can find new ways to deepen and lengthen their relationships. It used to be financial firms defined themselves by a product. If they sold retirement funds, say, they interacted with customers perhaps once per year. But thinking about a customer's full "retirement journey" from their first job to first savings account all the way through to their final years, they are able to create new points of interaction. Could they offer them student loans before school, banking accounts when they start studying, and advice along the way? Such "customer-centric design thinking," which was once the domain of product designers, is finding useful application by forward-looking financial firms.

How is the physical experience of your brand and company unique? How can you rethink the experience?

Pricing

Pricing here is less about the absolute price you charge but rather about the basis of your pricing. Software has now long evolved from selling licenses to selling access. Retailers are exploring a shift from selling per unit to selling per month. Amazon and Netflix are doing the same with video content. Sectors such as hotels, automotive, and digital media are actively exploring ways to innovate through pricing.

Now financial services are waking up to the opportunity. In banking, consumers are increasingly averse to paying fees for their checking accounts, so banks have been steadily removing them. Credit card issuers have had success with pricing structures such as cash-back per transactions, and automatic savings per transaction. But such approaches are easily copied.

As financial institutions begin positioning themselves along more innovative dimensions (see **Positioning**) and become more akin to lifestyle brands, as they innovate their products (see **Product**) to meet needs rather that offer product categories, there exists an opportunity to rethink pricing. TransferWise, for example, does not make money from transactions. Instead they "only charge you a fair service fee and use the real, mid-market rate for conversion."

On what basis is your competition charging? How can you change the basis of pricing?

Promotion
Promotion relates to all activities you undertake to communicate with customers, prospects, and other key stakeholders. It encompasses marketing, sales, PR, and corporate communications.

This aspect of a business model is critical because improving the effectiveness of promotion can activate exponential growth for the business. Consider the following hypothetical. Two companies – Company A and Company B – each invest on average $2 in marketing and sales to attract one new customer. Then, Company B discovers an innovation that improves the effectiveness of its promotion effort so that it can acquire a customer for just $1.

If each company invests $2 per day, after the first day Company A will have won one customer and Company B will have earned two. The following day, Company A invests $2 but Company B can afford to invest $4, because it has twice as many customers and thereby twice as much profit. At the end of day two, Company A has won one customer (investing $2) and Company B has won four (because it has invested $4). The next day Company A wins one new customer and Company B wins eight. Each day, Company B's lead doubles.

Consumer banks have traditionally advertised higher rates to "buy" new customers. They assume that customers, being rational in deciding where to deposit their savings, will want to place their money in the bank that gives them the highest returns.

But forward-looking financial institutions are realizing there is a plethora of more interesting ways to promote. Stockpile, for example, is promoting its stock investment offering somewhere no other financial institution I am aware of has: the grocery store checkout.

The company also offers the world's first gift card for stock, making it easier to gift stock to family or friends, popular for graduations, weddings, baby gifts and the holidays. The gift cards are now available at 14,000 grocery and retail locations across the country, including Kroger, Target, Safeway/Albertsons, Wegmans, Giant Eagle, SUPERVALU, Hy-Vee, Save Mart, OfficeMax, Office Depot, Kmart, and Buehler's.

Stockpile cofounder Avi Lele is a dad who conceived of the idea when he couldn't find an easy and affordable way to gift stock to his kids, nieces and nephews a few holiday seasons ago.

"Most people have never had an opportunity to own stock in their favorite companies because it's too expensive and complicated to get started," says Avi. "You can't do anything with $25 at a traditional brokerage. Stockpile removes those barriers by using fractional shares and bringing the stock market to you. For the first time ever, you're able to walk into the supermarket and buy a gift card for, say, $25 of Apple stock right off the rack. Buy it for yourself or as a gift for family and friends."

With advisors like Don Kingsborough (founder and former CEO of Blackhawk Network) and Melanie Healey (former president of North America for Procter & Gamble), and notable investors, such as Ashton Kutcher (actor, entrepreneur and tech investor), the company has been able to expand rapidly. More importantly they have found a way to win over the elusive teen and millennial customer base that other financial institutions have been perplexed by how to attract. Sixty percent of Stockpile's user base is under 30 and 30% are kids and teens (through custodial accounts).

What promotion tactics are you currently applying to attract new customers? What more innovative approaches have you not had time to experiment with? Which low-impact tactics should you consider dropping?

People

People has to do with how you attract and retain workers, how you organize them, your incentive structures, and your values. Here again, we see a shift in thinking.

Mastercard, for example, has engineering a profound cultural transformation. Once a sleepy association of banks, the company is now known as a purpose-driven payments technology innovator, which makes the list of "most innovative companies" regularly. One key element of this transformation is Mastercard's leadership emphasis that fundamentally it is a "force for good." The more people switch from using cash to electronic payments, the less room there is for negative economic activity, such as the sale of illegal goods and other fraudulent activities. Indeed countries such as Sweden and India are pushing assertively to become cashless economies. In a cashless economy we have complete transparency and accountability.

What does this have to do with people? The focus on a compelling, social vision engages employees, particularly millennials, more powerfully. It encourages tech startups to want to collaborate with you. It engages partners and even regulators.

We also see new forms of organization emerging. The small-team, agile structures that tech firms like Google, Netflix, and Zappos have embraced are making their way through the IT departments of major financial institutions into the business.

ING, the Dutch banking group, is perhaps the leader of this movement. In 2015 the company embraced a radical organizational approach. It broke standard hierarchical groups into about 350 nine-person "squads," and then grouped these into 13 "tribes." As ING's COO, Bart Schlatmann, explained, "Customer behavior…was rapidly changing in response to new digital distribution channels, and customer expectations were being shaped by digital leaders in other industries, not just banking." So, he goes on, they adopted a new structure. "Squads are part of tribes, which have additional mechanisms such as scrums, portfolio wall planning, and daily stand-ups to ensure that product owners are aligned and that there is a real sense of belonging."

Such "agile" approaches to organization have enabled ING to accelerate time to market, increase employee engagement, and improve productivity.

Many large financial institutions we work with are exploring similar ways to better engage employees.

Beyond this we see an increased focus on building future capabilities such as data, digital, and user-centric design.

Are your people policies aligned with the future of financial services? How can you change who you hire, how you organize them, how you incentivize them, and your culture?

The concepts around technology are transforming financial services in fascinating ways, creating opportunities for those who embrace winning concepts early and laggards of those who wait. Now is the time to stop … and Outthink.