Meet the bank of the future

What SMB banking might look like by 2025

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In the race for customer primacy, banks have the right to win – all the ingredients for success are within their grasp, they just need to create the winning recipe.

This is easier said than done. Growth and innovation consultant Steve Faktor argues that the potential within incumbents often "suffocates beneath their own inertia" as they fail to build on the goldmine of assets they already have, often hoping they have more time to change than they do or relying on their entrenched position to protect them.

In the face of intense competition from digital disruptors, change is already here, reshaping markets and customer expectations.

For example, Buy Now Pay Later provider Afterpay is building out a two-sided marketplace at a global scale that rivals banks, with more than 14 million customers using its services for purchases and to access finance.

Open banking and account-to-account payments are being rolled out rapidly worldwide, while innovations for Apple and Android devices that allow them to accept card payments could disrupt the $65 billion industry for point-of-sale devices.

An increasing array of services provide integrated solutions, ranging from e-commerce providers to accountancy software companies, where customers are retained within an ecosystem and guided to a curated list of solutions and service providers that meet their broader needs (for example, QuickBooks provides payments integrations with Zettle by PayPal).

> This is an inflection moment, where **key decisions will define future success**, if strategy is guided by clarity of vision and a focus on customer needs.

But as disruptors scale to become incumbents, they risk falling prey to many of the issues that gave them a foot in the door of the markets they disrupted.

People may wonder how it would be possible to conquer Amazon, Google or Facebook, where 75% of the world's digital advertising revenue now sits, but other global brands, such as Nokia or Blackberry, were once perceived in the same way.

> "Primacy of relationship is becoming paramount."

Banks have all the assets they need to win, including distribution, scale, and access to data. The key decision to be made is how they will capture SMBs and the market position they want to take to secure relationships.

While moving at speed is an ongoing issue for large financial institutions, it is a challenge that can be overcome through the power of smart partnerships that drive digital innovation; where banks win is their infrastructure, strong culture of compliance and profitable products that disruptors need to replicate as their investors demand a return from the millions of users attracted to their platforms.

The hard yards for fintechs - and biggest costs - lie in building out a trusted product portfolio, something that banks already have.

Market sentiment is changing, with investors turning to trusted brands with a secure future as they predict tough times ahead. Banks can take the initiative, but they need focused investment instead of spread-betting on the best approach.

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There are three key strategies open to banks where their infrastructure and expertise gives them a right to play and access to global growth – Banking-as-a-Service, Platform-as-a-Service (BaaS and PaaS) and Payments-as-a-Service.

The future is here, the time is now.

A converging playing field

Banking-as-a-Service, Platform-as-a-Service and sector-centric strategies all have a place within the bank of the future.

They create clear value for banks through doubling down on their unique skillsets and access to market. For boardrooms, the key decision is identifying where they can win and with whom they need to collaborate to secure profitable growth for the next decade and beyond.

Banks still have the advantages of scale, trust, and a unique mix of business and consumer data; the next step is establishing the correct focus and finding the best partners to help set a new strategic direction.

This decision comes at a key moment for the industry. Digital disruptors have seen exponential growth in user base and transaction volume, but they are reaching a crossroads amid changing market conditions and shifting sentiments among investors. ISVs blend modern technology and a focus on specific customer segment pain points, along with a strategy of “growth above income” while they establish their niche. But as some pass their fifth anniversaries, during which they achieved significant growth, investors want to see returns. Software isn’t the solution. Profitability will come from rolling out financial services via BaaS and PaaS offerings.

Traditional banks have started at the opposite end of the scale. They already have the distribution and trust, but now need to develop solutions in data, experience and proposition.

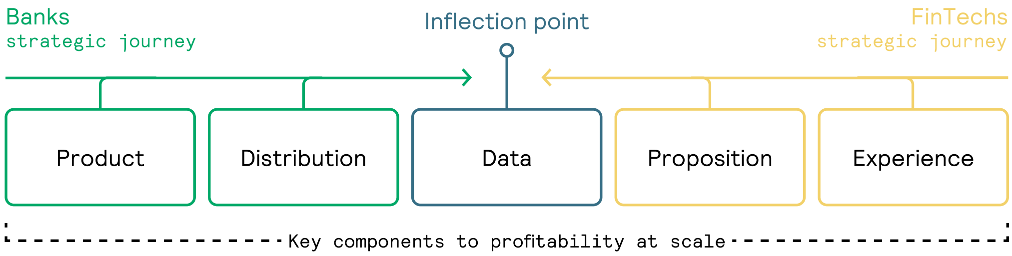
> “We have aspirations to target non-bank users, not just bank customers. I want to build something every merchant wants to engage with.”

Banks and fintechs are both working to provide the same broad set of functionality and value to customers, but their approaches are converging from opposite starting points. A key difference is that banks already have a foundation of profitability and established relationships. Disruptors have built an audience, now the hard work starts to turn interaction into profitable income.

By leveraging their strengths, banks can focus on creating a critical point of differentiation from tech-first competitors.

The market is at an inflection point

Fintechs need to create products under their digital experiences to expand from engagement towards profitable customer relationships; Banks need to build on their product and distribution advantage by delivering personalized digital experiences at scale.



Three visions of the future

BaaS – Essential but invisible

Banking-as-a-Service is the engine that will power the global growth of embedded finance. The BaaS sector is expected to reach a value of $7 trillion by 2030 as banking services become embedded in a broader range of use cases within financial and non-financial organizations.

As more non-banks adopt BaaS products they will embed services such as deposit accounts, payment services and lending tools into their offerings, which increases customer engagement and loyalty.

Key BaaS growth opportunities include:

- POS financing, including Buy Now, Pay Later
- SMB lending
- Corporate lending
- Deposit accounts and payment services, such as cards

Underpinning any launch is a successful digital transformation within the core bank as its services will need to be reliable and adapt to the different needs of individual clients and markets.

Banks will be able to maintain an essential global role in markets, driven by client growth, but at the expense of their own brand, in the same way consumers know the brand of car they are buying, but have no idea who made the tires, even though they are a critical component.

Banks already have the established infrastructure and products to address the needs of business customers, but fintechs have the data-rich experience layer that customers have come to expect. Through partnerships and adapting products for Banking as a Service, there is more opportunity to power customer experiences at scale.

> "How do you create tools that every merchant would want to access, whether they are a customer or not? That is the big dream."

PaaS – Open but owned

Through "platformification", banks can focus on better serving customer needs and being able to offer services beyond a limited portfolio.

This approach establishes the bank at the center of an ecosystem of services and suppliers, which engage with customers through its platform. The bank's services to its end-users are enhanced by a curated list of external suppliers that plug into this platform.

As a digital platform, the roles and responsibilities of the bank change. As a trusted provider of services to a network of suppliers, factors such as downtime and security are key. Furthermore, to ensure customers value the platform and remain loyal, there can be no gaps in service offerings, while any change in approved providers will need managing to reduce any disruption to customers.

Among financial providers adopting this strategy is Indian payment system Paytm. It expanded from a single service in the prepaid mobile sector to a platform that enables customers to buy airline, bus, and movie tickets, reserve hotels, and rent cars.

Deloitte research found one-third of retail bank customers in the US are interested in a platform service offered by their primary bank and half approved of a "superstore" concept which extended beyond financial services and provided a wider choice of services. Importantly, younger consumers were significantly more positive toward both concepts.

A PaaS approach exploits the bank's advantage of data, scale and trust to attract customers, but success will rely on constant platform innovation to retain a competitive edge. If customers perceive a service is static and not responding to innovation offered elsewhere (or it stops leading the market with new products) a rival offering is just a screen tap away.

Creating and operating an evolving, integrated experience is a significant undertaking that would require the support of trusted partners to deliver at scale.

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Sector specialist – Laser-like focus to lock in loyalty

Banks can drive growth by defining themselves as the go-to sector specialist with a laser-like focus on a particular area.

This may be a sector-specific play, such as construction or healthcare, for example by becoming THE bank for the world's 1 million dentists. Alternatively, it could be a particular specialist area of finance, such as being the bank for SMB access to capital.

In this way, a bank can become the Coca-Cola of capital by being known as the go-to brand in a particular area. Success creates a cycle of growth, as the brand becomes so deeply associated with a community that member referrals become a key source of marketing and customer acquisition.

North Side Bank and Trust, a $715 million asset community bank in the US, has successfully implemented this approach. The company specializes in banking services for construction contractors, but has been able to widen its customer base significantly by partnering with respected trade associations to access wider networks of construction workers.

On a broader basis, banks have an opportunity to focus on their reputation as a safe haven in a changing world for customers.

For example, the importance of security to an SMB cannot be underestimated, with 60% of SMBs failing within 6 months of a cyber-attack. These are businesses that can't risk operating with a financial services provider that doesn't make security a priority, while they will value services that protect them from harm. Products can be marketed as both innovative and secure so that risk becomes a core design principle.

How people perceive brands is important to growth; specialization is a key strategy for achieving success. A widely acknowledged, indepth understanding of a particular industry or sector drives innovation and enhances customer relationships through a much deeper understanding of their particular wants and needs, which is hard to replicate with a more generic approach to all markets. Focus can power success and growth.

> "There are some leaps of faith that banks find it difficult to take, but the conversation changes when you have partners with a common strategy. The message is stronger with more voices around the table."

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