The Financial Services Forum

The Race to Primary Banking Relationship Status

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The UK is an internationally recognised centre of fintech excellence, yet few new fintech providers have secured primary banking relationship status with their customers. Meanwhile, many of the established banks have completed major digital transformation programmes and now offer many of the benefits fintechs were founded upon. The Financial Services Forum gathered representatives from leading fintech banks and digitally enabled established players to discuss what is holding fintechs back in the race to reach primary banking status, as the gap between the traditional and the 'new guard' closes.

Fintech Financing, Performance and Valuation in the UK

- Research across a sample of 100 established fintech start-ups (i.e. those that have received at least two rounds of financing and been founded since 2010) shows that for £4.5bn invested, £13.7bn of value has been created, with cumulative losses totalling £1.6bn.
- The 10 largest equity fundraisers in the sample are financial services businesses, accounting for 63% of total funding received.
- Once a start-up has proven its business model and can attract customers, it is relatively easy for tech starts-ups with disruptive potential to secure funding.
- Valuations are strong to date: returns on paper for first-round investors have been very high (median 71% internal rate of return from round 1), and only four companies in the 100 sampled have failed so far.
- However, the Bankingtech 'vertical' shows much higher median losses per annum than other start-ups, e.g. Insuretech or Regtech, and only six of the 100 start-ups sampled had managed to break even by their fifth year of trading.
- While many fintechs are now achieving meaningful customer numbers, few are yet generating profit or becoming cashflow positive. Achieving an exit for investors via an IPO or trade sale represents the final measure of success for these start-ups.

Measuring success: fintech market penetration and profitability

- The total addressable market is the whole UK market of 70 million accounts, and the total market penetration by fintechs currently stands at 5%. While growth is very strong, it is expected to slow at some point, so the timescale in terms of market penetration is difficult to predict.

- Fintechs consider that there is strength in numbers, as the greater the number of players, the greater the opportunity to build trust in the space. Our focus is on capturing market share collectively as a movement rather than capturing each other's market share. The flipside of this is the high risk of contagion from any negative publicity.
- 'Share of wallet' per customer is another facet of market penetration. Fintechs are well placed to increase this metric: open communication with customers is facilitated by their digital platforms and early adopters are generally keen to feedback their experiences and needs.
- In the multi-banking era where most people have more than one bank account, the idea of switching bank accounts or having primary banking relationship status with a single bank is outdated.
- Challenger banks allow customers to 'try before they buy', as it takes just five minutes to apply for an account. After a year of banking with a fintech, the average balance in a customer's account is £1,400, which is comparable with average bank balances at traditional banks.
- Fintechs have much higher start-up costs than other start-ups, owing to regulatory and banking system requirements. They can improve profitability by providing additional services over time. There is significant potential to increase revenues through cross-selling, but fintechs aim to design and offer products based on customer need and demand, rather than their potential profitability.

Measuring success: obstacles to growth

- Establishing trust is a major, complex obstacle in financial services: people do not behave logically when it comes to money, and attitudes towards money are often shaped by emotional factors.
- Challenger banks seek to address this with financial education programmes that encompass the mental health aspect of dealing with finances, and by trying to find new ways of engaging with customers using fresh vocabulary, such as 'lifestyle' rather than 'budgeting'.
- Challenger banks are helping people to manage their finances and feel in control, by helping them to compartmentalise their finances within a single account. This also helps build trust over time.
- Trust requires getting the basics right every time: avoiding the outages that have plagued traditional banks and ensuring the app always works. This is easier for fintechs owing to their technological savvy.
- Trust and awareness are also built by advertising on television and via posters rather than relying solely on digital channels, particularly outside of London. Many consumers only see companies as 'real' if they advertise on TV.

Questions and Answers

Are UK customers ready to pay for their bank accounts?

- UK customers, who are used to being able to bank for free, will pay for a premium account if it offers true value, e.g. access to certain benefits and/or additional digital features. This will become an increasingly important source of additional revenue, with fintechs able to design and offer more additional features than traditional banks. However, they must first establish which features and benefits customers want and are prepared to pay for.
- In the experience of one fintech, the take-up of premium accounts in the UK has been higher than expected. One reason for this could be that UK consumers have grown used to paying a small monthly fee for services they value, such as entertainment-streaming services.

What services have your customers asked you to provide?

- Although many fintechs offer a travel card that guarantees customers the best possible exchange rate when they travel, there is still demand among UK customers to be able to hold and make payments in other currencies, such as the euro.
- Some business customers have asked for branch access for the purpose of depositing cash; one challenger bank has partnered with the Post Office for this.
- Most fintechs offer online customer service in the app, which tends to be the preferred point of contact for individual customers. However, some customers still prefer to contact banks via call centres, staffed by real people, 24/7 and this is a service fintechs can offer

Which competitors should challenger banks be most concerned about?

- Competition from ‘big tech’ cannot be discounted; these companies hold a lot of data and have been very successful in scaling their businesses to date. However, they operate in an unregulated space; they do not understand regulatory environments, and many do not wish to be subject to regulation. Moreover, customers may have reservations about handing their financial data to companies that can already access so much of their personal data.
- Legacy banks may now offer some of the features of challenger banks, but they cannot replicate the fintech model in terms of cost base, technology or culture. Their leaders are not entrepreneurs, and they cannot match the challenger banks’ overall offering.

Have you considered using incentivisation to attract new customers?

- Fintechs want to attract customers who are engaged with their brand. They generally do not offer incentives for opening an account, preferring instead to use the money to invest in product improvements to attract new customers.

How do you maintain the culture of a start-up while growing rapidly?

- This is one of the biggest challenges for fintech start-ups. Maintaining the original culture must remain the priority when hiring and implementing processes in order to retain the original 'spark'. Clear internal communications and the establishment of a goal that everyone can buy into are essential.

What is the average age of your customer and how do you reach customers outside of London?

- Early to mid-thirties, but challenger banks are accessible to people of all ages. They can be of particular use to the less mobile or people in remote locations, as there is no need to access a branch. We work hard to avoid a London bias, as this is something that fintechs are often accused of. Outside of London we target customers via digital channels, billboards and TV advertising, or via regional offices, which are key in bringing new customers by word-of-mouth.

How does your experience with small-to-medium enterprises (SMEs) differ to your experience with individual customers?

- Fintechs currently work with the smaller end of the SME spectrum, such as sole traders and smaller companies, but we intend to provide services to bigger firms as we grow. Our SME customers tend to be more profitable than individual customers, as they transact more frequently with a greater number of vendors. In addition, they may have multiple business accounts.

How will the market evolve, and will there be consolidation?

- The nature of start-ups is that some will fail. However, given the level of financing currently available to maintain digital challenger banks, it is likely to be several years before we see any major failures. Valuations are also very high from an acquisition perspective.

Thank you to our speakers:
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