BRETT KING

BANK 3.0

WHY BANKING IS NO LONGER SOMEWHERE YOU GO, BUT SOMETHING YOU DO

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Marshall Cavendish Business

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1 The Demands of the Hyperconnected Consumer

In 2011 the Internet surpassed television and newspapers as the primary news source for the Y-Gen demographic in the US.[1] In 2011 the average time spent daily using mobile phone apps surpassed the time people spent surfing the web on their PC.[2] In the US, approximately 25 per cent of all US households have no or very limited access to financial services,[3] while there is a 103 per cent adoption rate of mobile phones and a 76 per cent adoption of the Internet.[4] In Asia, there are 1.6 billion people without a basic bank account,[5] while in the same geography there are 2.6 billion mobile phones.[6]

In June 2011, the United Nations declared Internet access a basic human right.[7] By 2016 more than half the planet will own a smartphone with Internet access, and Internet access will basically come free with your monthly contract.[8] Today more people access the Internet via a mobile device than a PC. Tablets alone will pass PC sales in the next few years.[9]

We live in a world where being connected is not only a basic right, but an expectation, a simple foundation of our day-to-day lives. Today it's not enough to just be connected. Many of us live with multiple devices simultaneously. A smartphone or two, a tablet, a PC, a gaming device connected to the Internet, a web-enabled TV to stream content, and more. We live in a hyperconnected world.

My kids who are three, nine and twelve (at time of press) will never live in a world without a mobile phone or an Internet connection. They won't be able to conceptualise a world that never had "always on" messaging, social networks, multitouch tablets and other such technologies. They won't perceive of these technologies as unique, new, advanced or "alternative" channels. They'll simply expect the world to work in that context. If you don't—you're irrelevant.

With Facebook set to exceed one billion connected individuals in 2012,[10] it's likely that we'll soon have trouble finding even one of our friends who isn't on Facebook. Remember those holdouts who said they'd never ever use an ATM, have an email account, or use a mobile phone? There are those same responses to Facebook today, too. Now admittedly, Facebook might run out of steam (in terms of adoption) somewhere north of one billion users, but fewer than the estimated two billion users who already have an Internet connection—but that hardly makes Facebook a demonstrable failure now, does it?

The fact is that the Internet, mobile apps, social media and other such innovations of the last 20 years are not special anymore. They might have been in 1999 to those of us who remember a time without them, but they are not new to anyone born after 2000. They just are part of the fabric of everyday life.

So when you are looking at your strategy for your bank and figuring out how quickly or holistically to integrate these technologies into your channel strategy, think about this. *This is the way banking will be done from this day forward, without exception. We're never going back to a world without internet banking access, mobile phones, social media and multitouch.* Thus, it just doesn't make sense to put off investment in these most basic of technologies that lay the foundation for the very future of banking. It's not like you can avoid the investment sometime in the future, or that you shouldn't take every opportunity to learn about them now, because they're absolutely critical for future revenue and engagement.

Now some might argue that it's not going to make that much of a difference delaying investment in digital. They'd be dead wrong. If the sceptics looked at every major industry that has been massively disrupted in recent times (books, music, newspapers, etc.), they would be certain to see that the businesses that believed in the status quo or didn't invest fast enough were the first casualties in the digital shift.

Clearly the expectation of the average consumer today is that you will simply provide access via this technology, just as you would via an

ATM or a branch. You *have* to do this, you have no choice. As you'll see from this book, there's not even a choice of *when* you invest anymore—if you're not already heavily investing in all these technologies, you are well behind the behaviour and expectation curve, and you will be disrupted. In all likelihood, banks will be predominantly IT or technology companies in the near future, with banking simply the utility provided through that technology.

The average individual is spending 94 minutes or so a day using apps, checking emails and texting up to 100 times per day.[11] We're logging on to mobile banking 20–30 times per month[12] and internet banking around 7–10 times per month,[13] but visiting a branch only a few times a year.[14] We're shopping online and via mobile with increasing voracity, and we're even using our phone in-store to check prices of comparative goods we see on the shelf with others available online or around the corner. Amazon has even used this behavioural strategy specifically against the likes of Best Buy in the US. These are not novel experiences for the average consumer anymore, they are just the way we live our lives in the 21st century.

Being "always on" or hyperconnected presents its own challenges. Many users of such pervasive technologies are finding it increasingly difficult to detach themselves from such "always on" access and service, either because of demands from their employers/clients for uninterrupted access, or worse, because of addictions to connectivity. This almost compulsive need to stay connected is just one of the side effects of the Information Age.[15]

The customers of the Information Age have been empowered by greater choice, greater access, and better, faster, more efficient modes of delivery and service. To understand why resistance to technology investment is futile, we must recognise the underlying forces at work.

There are two major factors creating behavioural change, namely the ***psychological impact*** of the Information Age and the associated innovations, and the ***process of diffusion*** (of innovations). Each of these factors contributes to create a paradigm shift in the way financial institutions need to think about service and engagement of customers. There are ***four phases of disruption*** that constitute this behavioural paradigm shift with respect to consumers. These have serious long-term implications for banks and financial institutions.

Psychological Impact

To understand the core psychological drivers at work in the modern, hyperconnected consumer, we need to revisit one of the foundational pieces of work in respect of the theory of motivation—that of Maslow's hierarchy of needs.[16] Abraham Maslow studied exemplary people of his era such as Albert Einstein, Jane Addams, Eleanor Roosevelt, and Frederick Douglass, and determined the hierarchical progression of the individual—essentially what amounts to a theory of positive motivation and personal development.

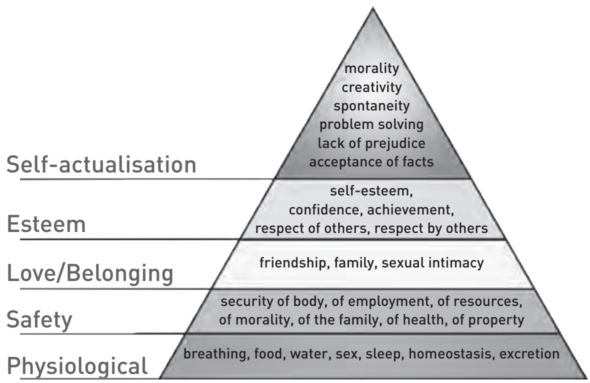

Figure 1.1: Maslow's hierarchy of needs (c. 1943)
(Credit: Wikipedia Creative Commons)

The growth of technology and more efficient service paths and ways to meet our self-actualisation needs have shifted the way we value our time, set expectations and perceive ourselves in our environment. For example, we understand through the introduction of new communications channels that if we can do something via phone or online, we are essentially wasting our time by persisting with a traditional interaction that is far less time-efficient. This, in turn, increases our self-esteem because we are using our time more wisely. Secondly, the execution of a transaction or a purchase *without* the assistance of a person, as long as it works well, gives us a feeling of control and self-achievement that cannot be achieved in a traditional interaction. Let me illustrate…

Take a mortgage proposition from the 1970s in middle America. Let's say I wanted to purchase a family home, but needed a mortgage from the bank to accomplish that. In those days, I would need to drive down to the local bank, make an appointment with the manager, and then prepare myself for an intense grovelling session to see if I could possibly convince the bank manager to give me his approval. If the bank manager liked me, or knew my family, or my business was strategic to the bank, then I might get an offer, but I had zero control of rates, fees and such as the bank was totally in control. This might have led me as a customer to feel helpless, especially if the application was rejected.

Banks at the time began to believe it was ok to reject their customers and effectively started saying to them: “If you’re lucky, if we approve your application, we might just let you be our customer.” These days, the customer has much greater control over this type of interaction and is not dependent on a limited set of providers, and so he is empowered.

In 2008 the biggest seller of home loans in the United States was Countrywide, acquired by Bank of America in 2009 for US$4.1 billion in stock. Now before you start with the fact that the Department of Justice went after Countrywide, and they had massive losses associated with sub-prime, remember that none of this has anything at all to do with the fact that Countrywide proved repeatedly that you could sell a complex mortgage product online, that you didn’t need a face-to-face interaction. I hear time and again from supporters of the branch that you need branches to sell mortgages, but that is simply not correct. Countrywide had more than nine million home mortgages on its books which originated online[17] at the time of the sale.

This is not specific behaviour for a younger demographic of first home buyers either. Generation X (born 1964–75) and baby boomers (born 1946–63) are the most likely candidates to research mortgages online.[18] Savings from online mortgage offerings also abound.[19] MyRate, a successful Australian online mortgage provider backed by ING, claims it can save borrowers about A$80,000 on a A$300,000, 30-year loan because of the savings the online channel produces. Mortgagebot reported in 2010 that 88 per cent of people who completed online mortgage applications were between 19 and 59 years of age.[20]

Google Finance Australia reported that 88 per cent of Internet users in Australia start their search looking for a mortgage online, and spend between six and 11 hours researching the mortgage before they select a potential provider and reach out to them.[21] When they do contact a mortgage provider, increasingly it will be via the website, rather than by walking into a branch or phoning the call centre. In the UK and the US results parallel this behaviourally. The myth that customers require a branch to buy a mortgage is just that, a myth. It is more than likely that the majority of mortgages sold today were actually selected by the customer online, and the branch was just a step in the application process.

Rather than feel threatened by this, traditional lenders should be buoyed by the fact that one of their most profitable products is so easily enabled through low-cost, digital channels. In fact, in the US alone, close to 50 per cent of lenders take 25 per cent or more of their mortgage applications online, and 61 per cent of all the loans that were submitted through third-party underwriting engines were approved online, according to the Mortgagebot study mentioned earlier. This is simply mainstream behaviour now. It's not new, it's not emerging—it's how the mass market behaves.

So let's get back to the psychological influences that these technology and competitive choices give me as an individual. **I am in control** and if the mortgage provider's offer doesn't meet my expectations—I walk away. I have an abundance of choices, and **I am better informed** because of access to extensive informational resources. **I get better deals** because service providers have to work harder to get my business, and **I save money** because the margins have been squeezed through better delivery methods and more competition. **I get a better-quality solution** because mortgage products fit my needs much more precisely than the one-size-fits-all solutions that I was restricted to previously.

How do I feel about this environment as a consumer, compared with the consumer of the 1970s example? In terms of Maslow's hierarchy, I associate these positive changes as personal development and an improvement in the perception of self. I am more motivated and feel better about myself, I am happier and **in control**.

Over time my overall expectations of my service providers in the finance sector have been lifted to where I now *expect* an element of self-control, efficiency and choice that I didn't have available to me previously. This then moves from being a nice *change of pace* to becoming a driver of choice and selection, and I penalise providers who aren't able to offer me this flexibility and level of control/empowerment.

Process of Diffusion

We'll talk more about this in later chapters, but the other key factor in the shifting behaviour of customers is the increasing acceptance of technology and innovation in our daily lives. At the start of the 20th century, several fundamental new technologies were coming or had recently emerged onto the scene, namely the automobile (1886), electricity (1873), radio (1906), the telephone, and, in 1903, the aeroplane. This was the dawn of a new age in industrialisation and innovation that caused leaders of the world to claim these improvements would usher in a new age of peace and prosperity. However, we do share in common with our brothers of the 19th century the inevitable sceptics who could not envisage a world that was changing as a result of technological improvement:

> "Lee DeForest has said in many newspapers and over his signature that it would be possible to transmit the human voice across the Atlantic before many years. Based on these absurd and deliberately misleading statements, the misguided public … has been persuaded to purchase stock in his company…"
>
> *— A US District Attorney, prosecuting DeForest for selling stock fraudulently via US Mail for his Radio Telephone Company in 1913*

New technologies that emerged in one geography took a lot longer to cross the seas in those days. Mass production was only just starting at the turn of the 20th century so getting products out of the factory and into the hands of distributors was a lot more difficult. There were not the large, mass retail brands and businesses that we have today; retail was often limited to the independently owned corner store or high street location. All these factors limited distribution and mass adoption.

By the late 1960s, Moore's Law had kicked into gear, and miniaturisation and the "'tronics" fad were leading to an increasing appetite for new gadgets and devices. In the late 60s, TV commercials and print advertisements often touted a science fiction-like future for consumers that was just decades away. Technology and innovation were capturing the imagination of society.

In 1975 IBM invented the personal computer. It wouldn't be launched until a few years later, but it just showed how far technology had come in the three decades since 1943 when the chairman of IBM had envisaged that there would be a total market globally for only five computers.

Introduced in 1977, the Apple II[22] became one of the most successful mass-produced microcomputer products of all time, based on market share. The Apple II line continued to be sold until 1993.

> "I think there is a world market for maybe five computers."
>
> —*Thomas Watson, Chairman of IBM, 1943*

Within 10 years of the launch of the IBM PC and the Apple II, terms such as DOS, mouse, keyboard, disk drive and dot matrix were in the common vernacular. By 1995, when Microsoft launched Windows 95, the desktop computer was already a global phenomenon accessible to more than 90 per cent of the world's population and with adoption rates of more than 25 per cent in most of the developed economies of the world. The launch of the cellphone in 1983 by Motorola set the pace at which consumers were being bombarded with new and revolutionary technologies.

Then in 1991 the Internet burst onto the world scene. The web was commercialised by 1994 and reached the dizzy heights of the dot-com bubble in 1999. I say dizzy heights, but the fact is that Internet adoption actually accelerated after the dot-com period, and did not slow down until around 2006 in most developed economies. History bears witness that the dot-com bubble collapse was not a collapse in Internet or technology adoption by any measure.

The rate of diffusion is the speed at which a new idea spreads from one consumer to the next. Adoption is similar to diffusion except that

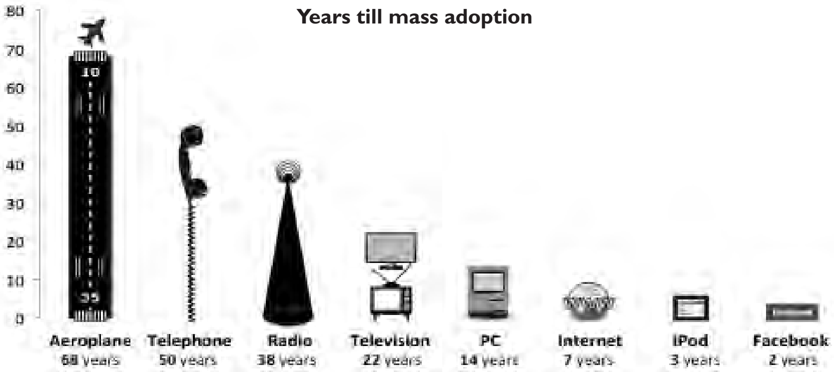

Figure 1.2: Technology adoption rates over the last 100 years

it also deals with the psychological processes an individual goes through, rather than an aggregate market process. What has been steadily happening since the late 1800s is that the rates of technology adoption and diffusion into society have both been getting faster. While the telephone took approximately 50 years to reach critical mass,[23] television took just half that (around 22–25 years), mobile or cellular phones and PCs about 12–14 years (half again), and then the Internet took just seven years (half again).

Ultimately new technologies and initiatives such as the iPod and Facebook are now being adopted by consumers *en masse* in a period measuring months, not years. To illustrate this shift, Apple sold more iOS devices in 2011 alone than all the Macs it had ever sold in the 28 years prior.

> *"This 55m [iPads sold to-date] is something no one would have guessed. Including us. To put it in context, it took us 22 years to sell 55 million Macs. It took us about 5 years to sell 22 million iPods, and it took us about 3 years to sell that many iPhones. And so, this thing is, as you said, it's on a trajectory that's off the charts..."*
>
> *—Tim Cook, Apple CEO during February 2012 reporting call*

Apple then sold more iPhone 4S devices in fiscal Q1 of 2012 than in the preceding 12 months.

As we become more used to technology and innovation, it is taking us less time to adopt these technologies in our lives, and this further encourages innovation and thus increases the impact on business (which has less time to adapt).

Simply put: If you aren't introducing innovations into the customer experience at the same rate at which customers are adopting these new technologies, you are at a considerable disadvantage and risk losing your customers as more agile intermediaries and third parties capture the benefit of the innovation. Justifying your slow innovation because you are "the Bank", "we're a heavily regulated industry", or your legacy system/processes won't allow it just doesn't cut it anymore.

The core problem is that consumer behaviour is shifting with technology at the centre of that shift, but largely the "bank" is staying the same in respect of behaviour around onboarding, application processes and channel biases. This creates a significant behavioural gap between the consumer and the institution—one that is now being filled rapidly by better-positioned non-bank competitors like PayPal, Square, Apple, Starbucks, P2P lenders and many more.

For those of you who are thinking your organisation needs to watch for ROI (Return on Investment) to be demonstrated first or that maybe you'll be a fast follower, think of this. If it takes just months now for new emergent technologies to insert themselves into the mainstream and change behaviour, and if you've got a 12–24 month development and deployment cycle (typical of most banks' IT departments)—you'll be at least three to four years behind if you wait to see someone else's ROI demonstrated before you commit. Three to four years is the time it took Facebook to go from nowhere to half a billion users.

Here's how Jeff Bezos puts it:

> "I am emphasizing the self-service nature of these platforms because it's important for a reason I think is somewhat non-obvious: even well-meaning gatekeepers slow innovation. When a platform is self-service, even the improbable ideas can get tried, because there's no expert gatekeeper ready to say "that will never work!" And guess what—many of those improbable ideas do work, and society is the beneficiary of that diversity."
>
> —*Amazon Form 8-K filing, Amazon.com Inc, 13 April 2012*

You could be dead in three years with a fast-follower approach. That's more than enough time for a disruptive business to take a big chunk of your customers, for your revenue to disappear, or for the remaining margin you have to be hammered into non-existence.

If you're not constantly adapting and moving, you may as well just resign now, because you're already a dinosaur, and someone is trying to disrupt your ar… architecture?

The Four Phases of Behavioural Disruption

There are four stages or phases to the disruption occurring within retail financial services and each stage is disruptive enough to be a "game changer". However, by the time the third phase impacts retail banking, the changes will be complete and irreversible, resulting in a fracturing of the commercial banking business as we know it today.

The *first phase* occurred with the **arrival of the Internet**, and was amplified by social media. While many banks denied it at the time of the dot-com bubble, the Internet changed forever the way customers accessed their bank and their money. As we discussed in the psychology of customer behaviour, this gave them *control* and *choice* that were not available previously. Suddenly, customers were thrust into an environment where they could access their money as they wished, when they wished. As internet banking capability improved, the drive to visit the branch started to diminish, and customers began to rely on the new channel as their *primary* access point with the bank for day-to-day transactions. Within just 10 short years, we've gone from 50–60 per cent of transactions done over the counter at the branch to 95 per cent of our day-to-day transactions now going through the mobile, Internet, call centre and ATM.[24] Game changing…

In the later part of this first phase, in parallel to the start of the second phase, was the emergence of social media. Social media is a sort of theme running contiguously throughout each of the four phases, but it was enabled by the Internet (obviously). The key to understanding the disruption of social media can be seen not only in base crusades such as the Occupy Movement, but in the fundamental shift in power within the customer value exchange (see Chapter 5).

In retail banking previously, banks had the enviable position of being able to "reject" customers because they were too risky, or not profitable enough. Customers would come to the bank, jump through all these hoops called "KYC" (Know-Your-Customer), and if the bank didn't like them, sorry—they didn't qualify. Some of my banker friends refer to this as the "lucky to be a customer" philosophy. Banks got complacent enough to think that they could summarily reject customers on the basis of risk because that would lead to better profitability. This, of course, flies in the face of the perceived role of banks in society, where they are seen to provide a basic social right. In turn, over time this has led to a very cynical view by the public of the inequality of the bank-customer relationship.

The flip side of this in the social media age is that today, customers are assessing bank brands with a social lens that now lets them reject stupid bank policies, or the entire brand, based on recommendations from the "crowd". Essentially, the power of my friends and network is such that if the crowd tells me your bank sucks, there is no amount of advertising spend you can leverage that will bring me back to your brand. In the age of social media, the balance of "value" has tipped back in favour of the consumer, and has weakened the value proposition of the average bank brand.

No longer do banks have the luxury of being able to deal with customers unilaterally and without respect for the crowd, as Bank of America recently found out when it raised basic checking account fees as a result of the Durbin Amendment. It took just weeks of public pressure via social media to push them to reverse this decision. Trust is no longer a given in the social exposed world. I'll trust your brand when you engage with me openly and honestly, with a real commitment to service.

The *second phase* is occurring right now. The emergence of the **smart device** or **app phone,** such as the iPhone and Google Android-enabled phone, is a driver for portable or mobile banking. This has extended into the world of tablets and generic device "screens" that enable web or app access. While there's debate over the security and ROI (Return on Investment) of these screens, customers don't make that distinction—they just adopt. Already many banks are deploying what amounts to a cashless

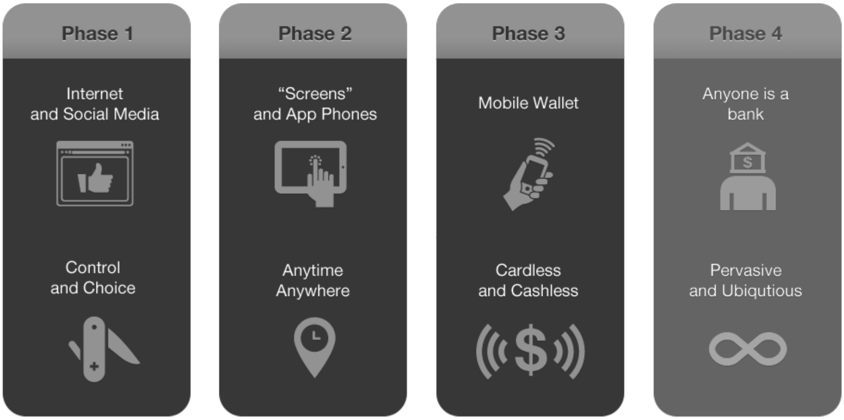

Figure 1.3: Four phases of behavioural disruption (Illustration: Sebastian Gard)

ATM on a mobile application platform—yes, you can do everything on a mobile phone that you can do on an ATM, *except* withdraw or deposit cash. You can even deposit cheques via remote deposit capture technology.

Here are a few statistics that support the second-phase disruptive model:

- The US has a more than 100 per cent adoption rate of mobile phones (some people have more than one), and one-third of households in the US are mobile-only now.[25]
- China has more than 950 million mobile users, almost three times that of the US,[26] and the number is growing at the rate of 20 per cent annually over the last decade. It has over 500 million Internet users—that's twice what the US has.
- China Mobile is deploying one million WiFi hot spots around China for ad-supported, free wireless access.
- The US population sends over two trillion text messages annually. It's estimated that more than 15 billion text messages were sent in China in just the first two days of Chinese New Year, contributing to the three trillion text messages expected in 2012.
- As of December 2011, smartphone users spend on average 94 minutes a day using apps, compared with 72 minutes using the web on browsers.[27]

- 99 per cent of mobile banking users view balances, 90 per cent view transaction details; about $10 billion of funds have been moved via mobile transfers/bill pay; 15 million location-based searches are being performed (annual run rate).
- More than 50 per cent of iPhone users have used mobile banking in the past 30 days, according to Javelin Strategy; 32 million Americans access mobile banking on their smartphone as of June 2011—a 45 per cent increase since 2010.
- 33 per cent of mobile banking users monitor accounts daily, 80 per cent weekly, also according to Javelin Strategy.

So if we didn't need physical cash or a plastic card, what would happen then? This is the *third phase*—when we move to **mobile payments** on a broad scale. NFC-based (Near-Field Contactless) mobile wallets and stored value card micropayments are already here, but more is to come. The third phase also involves the convergence of our mobile phone and our credit/debit card, which is a logical technical step in the next five years. When these changes occur, our need for cash will reduce rapidly, and the disruption will be far-reaching.

In the UK 43 per cent of payments is done by debit card, and 23 per cent by credit card.[28] Cash still makes up 32 per cent of retail payments, but as a percentage of the whole, it is expected to reduce by a further 20 per cent over the next five years. Cheques make up just over 2 per cent of payments these days, so it is not hard to see these disappear entirely in the UK within three to five years. As the growth of debit cards swells further and other mobile payments such person-to-person (P2P) are enabled on our phones, this will further reduce legacy payment methods.

It is not unimaginable to see 85–90 per cent of UK retail payments done by mobile/card in the next five years. In markets such as Japan, Korea, and Hong Kong, the requirement for cash may be even less compared with mobile payments.

While cash is not going to disappear overnight like cheques are, the fact is that mobile payments will accelerate the already declining use of hard currency. Between 2007 and 2010 in Australia, cash as a payment method at the retail point of sale declined from 40 per cent to 30 per cent,[29] the fastest decline in cash use we've ever seen anywhere. US consumers' use of cash is predicted to decline by 17 per cent between 2010 and 2015.[30] In the UK, cash was seen in 73 per cent of retail transactions in 2000, but will be a fraction of that by 2018.[31]

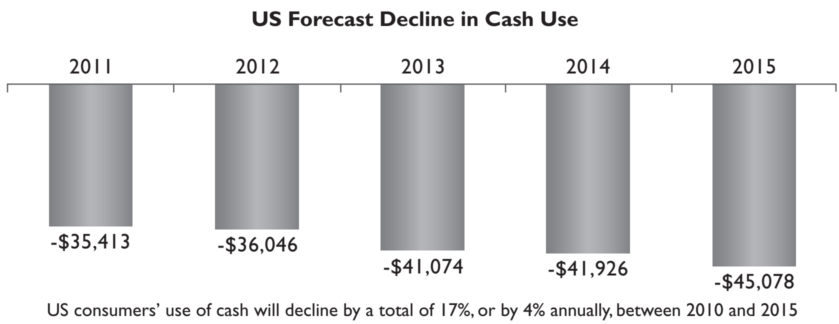

Figure 1.4: Decline in Cash Use—US Forecast (Source: Aité Group)

There are the great unbanked who don't yet have a bank account and who currently rely heavily on cash and prepaid debit cards, but as we will see with M-Pesa and G-Cash (Chapter 6), this is hardly a hurdle for mobile cash and payments. The success of the Octopus card in Hong Kong, T-Money in Korea, Edy and Suica in Japan, and other emerging technologies already prove the concept. What would quickly kill the need for cash in its entirety is a technical standard for mobile money that could be adopted globally by network operators and device manufacturers.

Even if only 50 per cent of cash transactions are replaced by electronic stored value cards, debit cards and mobile wallets in the next five to ten years, the current ATM and branch infrastructure that supports cash becomes untenable from a cost-burden perspective. If we no longer need to go to the ATM to withdraw physical cash or currency, then pretty much everything we do on the ATM today can be done on our mobile app phones. If branches no longer need to deal with cash, then a large part of the reason for their existence disappears.

In 2000, 59.5 per cent of retail payments in the United States were made via cheque. **That number plummeted to just 4.3 per cent in 2010.**[32] In Australia this decline has been even more severe. In 1995, 80 per cent of non-cash retail payments were made by cheque. **That number was just 3.3 per cent in 2010.**[33] In 1990, 11 million cheques a day were written in Britain. This number ballooned to 36 million cheques a day by 2003. According to the UK Payments Council report mentioned earlier**, fewer than one million cheques per day** will pass through the system in the UK **in 2012**, but more significantly, **by 2018 cheques will make up less than 0.8 per cent of personal payments.**[34] Regardless of UK Payments Council edicts, this translates to the death of cheques in short order.

Traditionalists might argue that the value of cheques still in the system is high, and thus more likely a part of business transactions and other such payments that are unlikely to shift to cards or other mechanisms in the near term. To balance out this claim, bear in mind this simple and undeniable fact. There is not a single economy or banking system in the world today where cheque usage is trending against a decline—not one. There is no use talking about saving cheques—these antiquated artefacts are in their death throes. The mobile wallet and person-to-person payments will simply accelerate the demise.

As we'll see in Chapter 12, every man and his dog wants a part of the mobile wallet—from Google, PayPal, mobile operators, handset manufacturers, mobile OS creators, app developers, start-ups, and banks. Phase Three is not just about the death of cheques and cash, it is about the loss of physicality. It is where we no longer need physical interactions with a bank for basic, day-to-day banking.

So what happens when Phase Three hits? From that point on the battle for the basic bank account will be on. The likely outcome is that for the great unbanked (approximately 61–64 per cent of the planet[35]), the phone will become the day-to-day bank account of the near future. While the average banker might dismiss this as immaterial to his traditional business, the unhinging of the bank account from the bank spells massive disruption for the financial services industry. It means that eventually the bank account will just be a value store commodity. While some form of e-money licensing, such as that in the UK, is likely to regulate and protect consumers, the taking of a deposit will no longer require a full banking licence.

Think of this. What's the difference between a balance on an Oyster, Octopus or a prepaid MetroCard, and a deposit in a CASA (Checking Account/Savings Account) account? How would we explain the difference in deposit taking mechanisms for a basic bank account, prepaid debit card and a prepaid telephone contract? What if our prepaid telephone account allowed us to pay at a point of sale using an NFC-enabled phone?

This is where the *fourth phase* emerges. If you think a banking licence restricts everyone except banks from taking deposits, you just haven't been paying very much attention, have you? When banks lose the basic day-to-day bank account to the mobile phone or commodity value store, the rest of banking is down to specialist banking products, investment management, and the movement of funds.

Phase Four is about banking no longer being somewhere we go, but something we just do. It is the realisation that the best way to deliver banking products and services is *pervasively*, wherever and whenever a customer needs the utility of a bank. The fact that banks simply don't have the ubiquitous coverage to deliver these products and services in the new world, and that a whole slew of partnerships will be required to ensure the product or service gets to the customer at the point he needs that banking utility will be a revelation to many. This is where retail distribution becomes unhinged from product manufacturing and risk mitigation. It's a time when you won't need to be a bank at all to provide what we've traditionally called banking, and it's already happening.

Customers will go about their daily lives with banking embedded into processes that require financial products or transactional support. The home-buying experience will integrate the mortgage sale, and we won't need to see a mortgage officer. Travel websites will not only integrate products such as travel insurance but will allow us to take a loan for our trip instead of using a debit card or credit card to pay for the flight. A car dealer sells us a leasing deal for that new car we bought. A retailer gives us a line of credit for that furniture we bought using our mobile wallet. Someone else owns the customer, banks become the manufacturers, networks and processes that support the utility of banking.

Phase Four will produce a fundamental split between banking as a distribution business and banking as a product-manufacturing or creditprovisioning capability, with banking never to be the same again. Banks can either own the product, transaction and payment platforms, integrate the technology, and embrace broad partnerships OR protest with their last dying gasp of breath that things are not really going to change. "The branch is back", "Cash is king", "Cheques will bounce back"—yeah, ok, and let's bring back vinyl records, telexes, VCRs and cassette tapes while we're at it!

Retail Banking Disruption and the Debanked

These changes, both in regard to psychology and consumer adoption cycles, have empowered and liberated customers, but represent a real threat to the industry. As Evans and Wurster first posited in their book, *Blown to Bits* (2000), the threat for traditional intermediaries is that their business faces potential deconstruction if they cannot encapsulate their place in the value chain in new ways by utilising technology and innovation. This is increasingly why traditional intermediaries such as travel agents and stock brokers are facing an impossible task of maintaining margins and restricting churn[36] or loss.

Online stock trading, first embraced by Charles Schwab and the likes of E*Trade, was phenomenally successful in the early days of the commercial World Wide Web, and still is. But there was significant resistance from the likes of traditional players such as Merrill Lynch, which regarded e-trading as a threat to its traditional brokerage model.

The difference in approach between the Charles Schwabs of the world and the Merrills of the world is perhaps the essence in identifying how an organisation copes with challenges presented by innovative technologies in the customer experience.

> "The do-it-yourself model of investing, centered on Internet trading, should be regarded as a serious threat to Americans' financial lives."
>
> —*John "Launny" Steffens, Merrill Lynch vice-chairman, September 1998*[37]

One reaction is to resist the change because it is uncomfortable and potentially "breaks" your traditional view of the world, while the alternative reaction is to realise that this is simply the inevitability of momentum and you need to figure out how to capitaliseon it, or benefit from it. Occasionally such new technologies turn out to be failures (not fads), like 8-Track, BETA video and WAP. This is due to the fact that, more often than not, the new technology is surpassed by something better. The lessons we learn in the first generation of the technology, however, are typically invaluable for future applications.

Today the Korean Stock Exchange owes 90 per cent[38] of its volume to internet trades, NASDAQ sees more than 60 per cent of its daily trading volume come from ECN (Electronic Communications Networks), and regional exchanges such as the CME (Chicago Mercantile Exchange) achieve more than 80 per cent of their volume from electronic trades. Between 2006 and 2007 the New York Mercantile Exchange observed an increase in electronic trading volume of 86 per cent,[39] leading to an overall increase in trading volume of 38 per cent. Today that figure is well above 70 per cent. It would appear by any measure that the online trading experience has been successful.

In Hong Kong, HSBC launched its online trading platform in 2001. Today, more than one million trades each month are completed on that platform. If this facility were to be shut down, there is no way the traditional channels of HSBC could cope with even half of this volume of transactions. Meanwhile, the more than 280 brokerage firms that were present in Hong Kong during the late 90s have dwindled to fewer than 80 players.[40] Indeed, internet trading was a *serious threat*—but not to consumers, only to traditional brokerage firms that weren't ready to adapt.

The more advantageous of these transformations have empowered customers in ways that a 1950s bank manager could only have had nightmares about. To illustrate, below is a list of retail banking products and the average approval times for applications, comparing 1980 and 2008.

Table 1.1: Comparison of Product Application Approval Times

Product	1980	2008
Credit Card	14 days	Instant approval
Personal Loan	7–14 days	Pre-approved, or 24 hours
Home Mortgage	30 days+	24 hours[41]

These product application approval times are indicative of the pressure on financial service providers to adapt to the changing expectations of customers, and the need to stay competitive. Barriers to entry are lowering, and new innovations in business models are creating pseudo banking services streamed right to our desktop, supermarket or corner 7-Eleven store.

Here's how I articulated this disruption for bankers in my last book, *Branch Today, Gone Tomorrow*:

> "Everything about retail financial services that relies on outmoded physical artefacts, proprietary and outdated networks, and processes that are complex and unwieldy—all lend themselves to disruption. If you can think of a better way to do your banking, then you already realize that the current status quo is not sustainable. In today's environment, if you can imagine it, then someone is probably building it.
>
> "If you are an incumbent player you might argue, for example, that NFC requires critical mass to reach adoption, but so did the Internet, so did music downloads, so did Wikipedia and electronic stock trading. The question is, do you wait until the disruption takes place to start planning for the new reality?"

The new value is not being a "bank". The new value is understanding the context banking products and services play in the life of the consumer, and delivering those products and services on that basis. The customer will expect and demand this type of integration. He will have no patience for a bank that insists he comes to its "place" before he can have access to banking.

There are two big threats to retail financial services distribution strategies today. The first is simply changing behaviour with respect to where and how the consumer shops for financial service products. The second is the proliferation of alternatives to traditional financial service organisations.

There's a growing group of consumers in the United States who have no checking or savings account, and they number in the tens of millions.[42]

This group of unbanked or underbanked is increasing in size instead of decreasing, as conventional wisdom would dictate. Ron Shevlin from Aité Research Group aptly coined the word "de-banked" to describe the behaviour of this growing group of hyperconnected consumers who are abandoning traditional banking relationships. So how can they survive without a bank account?

This is where the fastest growing form of payments in the US comes into play today, namely prepaid debit cards. As an industry, this business has grown from $2.7 billion in 2005 to $202 billion in 2012. In November 2011, the Center for Financial Services Innovation (CFSI) released new data about the 2010 underbanked market. The research found that:

- Underbanked consumers in the US generated approximately $45 billion in fee and interest revenue for financial services providers in 2010.
- The total dollar volume of the underbanked marketplace in 2010 was approximately $455 billion in principal borrowed, dollars transacted, and deposits held.
- The market has shown strong growth in certain segments: payment services grew by 6 per cent from 2009 to 2010; credit services grew by 2 per cent in the same period.
- Approximately half of this group have college education, and close to 25 per cent of the underbanked segment are prime credit rated.

Several individual products witnessed very high revenue growth rates between 2009 and 2010: Internet-based payday lending (35 per cent), general purpose reloadable (GPR) prepaid cards (33 per cent), and payroll cards (25 per cent).

This appears to be a global phenomenon too. In China the prepaid debit card market came very close to $250 billion in 2011, and is growing at close to 30 per cent per year. Programme managers of prepaid debit cards can be any organisation—supermarket chains, private companies, telecoms companies, retailers, sporting clubs and memberships. There's a whole lot of non-bank organisations providing basic bank accounts today.

Niche payment solutions such as iTunes and other loyalty cards are also becoming increasingly commonplace for day-to-day transactions. *The Wall Street Journal* reports that the Starbucks Card sees more transaction volume than any in-store loyalty card of its kind.[43] A total of $2.2 billion was loaded onto Starbucks Cards in the year through to September 2011, up 151 per cent from the same period of 2006. Reportedly 25 per cent of in-store purchases at Starbucks are now made via their Starbucks Card Mobile App, accounting for 27 per cent of US domestic retail revenue.[44]

The bank account is becoming unhinged from the bank. Mobile is the ultimate disruptor in this shift. Once we can pay with our phone, and it is connected to a value store—this is a far better banking utility than a basic checking account. A bank still issuing chequebooks simply doesn't provide a competitive platform to compete with a mobile wallet, and as we've already seen, businesses don't need a banking licence to power a value store on a wallet.

So how does this affect the future of banking? As value stores begin to abound and the mobile wallet gets hooked into everything from the iTunes store to Facebook credits, to loyalty cards, transport systems, and beyond, the basic bank account becomes impossible to differentiate, and will be the ultimate commodity. In the UK and markets such as Hong Kong, the regulators have responded to this increasing pressure by creating a sort of subsidiary banking structure for "e-money" or, in the case of Hong Kong, for basic deposit taking.

The problem for banks is that the ability to store a balance or take deposits is no longer the sole domain of "banks" that have a full-blown banking licence. The cost of this is significant. In 2011 almost $40 billion in deposits was freed from traditional banks to credit unions and the like, along with an additional $200 billion in prepaid cards, resulting in the loss of approximately $12 billion in revenue (including overdraft fees, monthly fees, lending fees, and interchange) for the incumbents. Again, look to de-banked consumers as an emerging group effecting this change.

The problem for banks is that increasingly this group of de-banked customers who use non-bank value stores to power purchasing are not the poor underprivileged struggling with unemployment and with dismal credit ratings (as banks imagine they might be). Increasingly these are technology-enabled professionals, university graduates with prime credit ratings. Valuable future customers for sure, but hardly unattractive today either.

You might argue that the most profitable high-net-worth customers or mortgage holders are hardly going to unhinge themselves entirely from the banking system. You'd be correct. But the problem with the unhinging of the bank account is not that you'll lose the high-end, investment-class business. The problem is that you lose the day-to-day connection with the customer.

The key to really understanding the fourth phase of disruption is that we all need the utility of banking, but increasingly we don't need a bank to provide that utility. Understanding that utility is the core value of a banked relationship, and not the "bank" itself, is a harsh realisation that most bankers will not be able to deal with philosophically. Those bankers are the targets for disruptors, as the bookstore was for Amazon.

The disruption that is occurring in the customer experience is all about removing friction in outmoded or outdated processes for customers. Whenever you tell a customer he needs to fill out manual paperwork, or visit a physical location, you're increasingly going to get kickback from a growing segment of the market. While many will argue passionately for the role of a face-to-face interaction and the "richness" of the branch experience, the reality is that there are two reasons most customers will baulk at that.

Firstly, they don't have the time or they perceive it is faster to go an alternative route—convenience was always a key driver for disruptors such as Amazon and iTunes. Secondly, we're being trained that we can open pretty much any non-bank relationship completely digitally today—so KYC (Know-Your-Customer) issues aside, the push is for rapid, digital onboarding of customers. In usability terms we call the latter a design pattern and it ends up driving consumer's expectations because it is an entrenched behavioural expectation.

Digital natives won't be able to figure out why they can sign up for Facebook, iTunes, PayPal and other relationships completely electronically, but your bank still requires a signature. It defies logic for the modern consumer, and no amount of arguing regulation will overcome that basic expectation. This is also why this generation is getting de-banked.

The end result of this is that banks, being the slow, calculated, and risk-averse organisations they are, will likely allow disruptors the opportunity to come into the space between the bank and the consumer as a "friction-eliminator".

Utility and Service are the New Differentiators

As the four phases of disruption occur, the old differentiators of banks evaporate.

In the past, retail financial institutions held that **Product, Rate** and **Location/Network** were the mechanisms by which they competed. But in a transparent, open world where information flows freely—products are just a commodity. In a low-interest-rate environment, a 25-basis-point differential is hardly something to write home about. And if I never visit your branch except once or twice a year, it's hardly going to be the linchpin in my choosing your bank over a competitor.

It's far more likely that your mobile capability, your internet banking support, and the ease of use in onboarding and day-to-day problem resolution will drive my decision to commit to your bank. Ultimately, I'm not going to stay your customer in the hyperconnected age unless you provide me with great total-channel service.

Think of it this way. If you're dependent on me visiting a physical location to get a great customer experience or service from your brand, you're seriously disadvantaged against a brand that has contact with me 10 times a week through a digital channel. If you are relying on the branch to keep me happy, you've already lost the battle for the customer of today.

What all this is teaching customers is that they can have control, and they have choice. No longer will customers stay with a bank just because it is the first bank they ever took a deposit account with, or because it appears too hard to change. Those protections will no longer be afforded to a service organisation that doesn't *serve* its customers.

As I move my day-to-day relationship to a mobile wallet hinged to a bunch of value stores that give me the functionality of a basic bank account—but none of the KYC hassles—the banking sector loses a vital platform for relationship development. As a consumer I get all the utility of payments, and basic banking (cash withdrawal, online payment, bill payment, etc.) without the need for a specific banking relationship.

Why do I go to a bank ultimately? There are three core expectations—my money is safe, and I get access when/where I need it, and, as my financial behaviour becomes more sophisticated, the bank can facilitate my financial life through access to credit and advisory services.

I want to be in control, and when I need it, I expect rapid and seamless delivery. Don't ask me to fill out an application form with all the same details you've already asked from me four times in the past three years—I am not here to work for you, you are here to work for me. Don't ask me to wait, I am impatient. Don't dictate to me that I have to go to the branch to do this because I now know that is simply not necessary for a progressive financial services provider with the right systems in place. Understand me, so that you will know what I need before I do—you're the experts—you tell me. When you recommend a solution to me, don't treat me like a novice—be prepared for me to be well-informed and know more about the alternatives than your staff. Tell me why you are recommending this product, and how it fits my needs.

Deliver to my criteria. I'm the customer. It's my total ***experience*** that matters.

KEY LESSONS

Customer behaviour is rapidly changing due to two key factors, namely the psychology of self-actualisation, and technology innovation and adoption—otherwise known as diffusion.

Banks can either try to reinforce traditional mechanisms and behaviour, or they can anticipate changing behaviour and build accordingly.

The pace and rate of behavioural change is speeding up, not slowing down. Thus institutions get less time to react and anticipate the impact of such changes on their business. The longer institutions wait, the bigger the gap between customer expectations and service capability becomes.

There are four key phases to these behavioural changes and we are already at the third phase, and it is the game changer—the loss of physicality and the mobilisation of payments. The fourth phase, the unhinging of the basic bank account from the bank, will occur gradually over the next decade, and banking will never be the same again because banking will be everywhere, and anyone can provide the utility of a bank. The rise of the "de-banked" is evidence of the growing trend of consumers who value the utility of banking over banks themselves.

When the world's bank account is a mobile phone—who exactly is the bank?

Keywords: Countrywide, MyRate, Merrill Lynch, Charles Schwab, KOSDAQ, HKEX, Lead Generation, Psychology, Customer Experience

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"BANK 2.0 will change the way you think about banking in the future. Audacious, provocative and sometimes controversial, Brett King redefines the paradigm of consumer banking. This compelling book is guaranteed to send your pulse racing and your mind searching for a new strategy for your bank."

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"Creating more value for customers is a hallmark of successful and growing organisations. But the field of competitive battle has changed. What customers value today is different from what they appreciated years ago, and will be very different once again in the rapidly unfolding future. BANK 2.0 brings together Brett King's incomparable view of technology, strategy, customer value and delivering superior service. His insights are a "must read" for anyone who wants to attract and keep customers in the incredible years ahead."

Ron Kaufman,
author and founder of UP Your Service! College

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