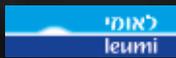


# CHANGE IN BANKING



**PEPPER.**



# WELCOME

**MICHAL KISSOS HERTZOG,  
CEO OF PEPPER**

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## WHAT IS THE FUTURE OF CONSUMER BANKING? THAT'S THE BILLION-DOLLAR QUESTION.

We're living in an increasingly on-demand world where everything from groceries to transport and entertainment are with us at the click of a button. Consumers have seen this seismic shift in the way they can live their lives more conveniently and expect the same from banking.

While the industry relentlessly chases innovation and technology giants, together with fintechs, challenge the old guard, it is accepted that the answer needs to include a more personalised, digital experience built with the customer in mind. For the UK, retail banking industry (made up of traditional institutions with a high street presence) is on shaky ground; but that's not for lack of opportunity. We all know that change is here, and more is coming. We sought to understand that change and explore how we, as an industry, should respond.

This report explores the current state of banking in the UK; both from the perspective of the consumer and retail banks themselves. We interviewed 2,000 UK banking consumers and 50 C-suite and director



level decision-makers at UK retail banks to better understand expectations and why the industry has been slow to respond.

We ask if UK retail banks have what it takes to go digital; identify what decision-makers believe are the biggest threats to the retail banking industry – spoiler, it's not fintech – and we understand how the Payments Services Directive II (PSD2), the regulation underpinning the Open Banking movement, has impacted retail banking less than a year after it was enforced.

Bank Leumi has a unique perspective. We knew that creating an 100% mobile bank was key to our survival. In 2017 we launched Pepper – a first of its kind digital banking platform, allowing customers to manage all their banking activities entirely via mobile, with no current account fees and 24/7 service. Today, approximately one year post-launch, we have hundreds of thousands of active Pepper users in Israel – many of which were banking with our traditional bank. What's more, we successfully underwent a culture change at the bank – a culture that is increasingly focused on putting customers and their banking experience at the heart of everything we do.

Today, it's clear to us that Pepper's greatest value proposition is not necessarily our innovative, simple and beautiful user experience and design, but rather the way we are utilising data for the benefit of our customers. This is combined with the fact that our Open Banking architecture allows us to collaborate with fintechs and play a significant role looking ahead.

By commissioning this research, our aim is to understand what the future of the UK banking industry looks like; the role of consumer-centric banking; and how we get there.

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# 1 WHY CHANGE IS NEEDED

At the heart of any business is **customers**.

Technology continues to play a huge role in helping banks become more consumer-centric. Since the creation of the pneumatic capsule systems in the 1830s – a system which transported cash through tubes allowing customers to withdraw money and make deposits without leaving their cars – technology has rapidly shaped the way that customers interact with their bank.

Increasing regulation and legislation, evolving customer needs and demands, and technological advancements are just some of the obstacles banks have faced on the path to creating a consumer-centric offering. When it comes to offering such services, the hurdles have been higher for traditional players. They have more customers and, ultimately, more to lose. Not to mention having to deal with clunky, less-agile legacy systems, compared to that of new fintech players with nimble back-end tech enabling them to create faster-to-market, convenient, mobile banking services. In addition to this, one of the biggest challenges retail banks face when it comes to innovation is changing the culture from within the company to focus on what really matters – the customer.

The disparity between the offer customers received from retail banks and fintechs is starkly shown: half (48%) of decision-makers at UK retail banks admit they're "three to four years" behind fintechs when it comes to offering innovative, consumer-centric services.

The majority of those leading UK retail banks are focused on innovation; not for beating the competition but for the customers' benefit with 56% of decision makers believing innovation serves to provide customers with the best possible user experience, versus 26% who said it gave them a competitive advantage against other financial players.

However, we know this consumer-centric view is not one that's shared throughout retail banks, with a third (34%) of decision-makers admitting innovation is held back by a widespread culture focused on product development and cost cutting, not customers. Artificial intelligence (AI) could be a terrific enabler of improved, end-to-end customer experiences but the top opportunity for adopting AI was "cost cutting". Again, showing that while decision-makers know that innovation is key to offering consumer-centric services, cost-cutting plays an important role in the process.

Despite this confusion, one thing is clear: retail banks know they need to become more

consumer-centric with 40% of decision-makers agreeing they were not. They also need innovate faster with 8 in 10 (82%) admitting retail banks are not innovating fast enough to meet customer demands for digital services.

For the third (36%) of Brits that bank digitally (accounts accessible via the web on laptop/desktop or mobile/tablet) convenience is a key reason. Almost half (44%) of customers banking with digital-only banks do so because it's more efficient, allowing them to manage their finances anywhere, anytime, free from restriction of branch opening times. Almost a quarter (22%) choose to bank digitally because of their easy-to-use mobile apps, a quarter (24%) said it was because they feel they have greater control over managing their money and almost a fifth (18%) said it is because of lower account costs. However, despite the convenience of 'faceless banking', even those who feel safe banking online want to be able to speak with an advisor in person.

## REASONS WHY CONSUMERS HAVE CHOSEN TO USE BANKS THAT ONLY EXIST ONLINE



It's more efficient

44%



For greater control over managing my money

24%



To get access to easy-to-use mobile apps

22%



Lower account costs

18%



For a more personalised banking service

14%

# THE NEED FOR CONVENIENCE IN BANKING'S FUTURE

Over the past decade, we have seen incremental change in banking. New fintech players have entered the market, disrupted the way customers engage with their bank and manage their money, and have grown in popularity.

The reasons Brits are holding back from going completely digital when it comes to banking are varied.

The presence of physical branches is a significant factor in consumers' trust for retail banks over digital-only banks. That might come as a surprise to decision-makers at retail banks who believe security and trust to be the key factors behind consumers' hesitation to 'go digital'. For the Brits banking with retail banks with a high street presence, 62% say that the reason why they trust retail street banks more than digital-only banks is because they have physical branches. All of this seems unsurprising when we learn two thirds (65%) of Brits admit their preferred contact with their bank is face-to-face.

Despite their desire for physical branches and face-to-face contact, convenience is the very

reason many Brits are attracted to digital-only banks. Of those customers that use retail banks, the three top things they'd hope to see their bank offering in future is the ability to:

**30%**

Open a bank account without visiting a physical bank branch

**20%**

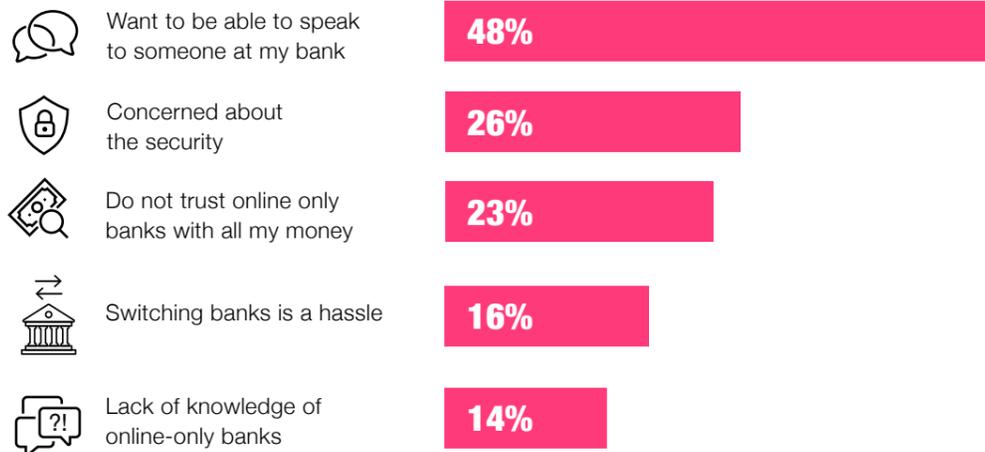
Speak with their bank via a messenger service like WhatsApp and Facebook Messenger

**24%**

Make easier and faster payments

So, we see that there's a 'convenience gap' to be filled by retail banks in order to deliver a truly consumer-centric offering.

## WHAT'S HOLDING YOU BACK FROM MOVING COMPLETELY TO AN ONLINE-ONLY BANK?



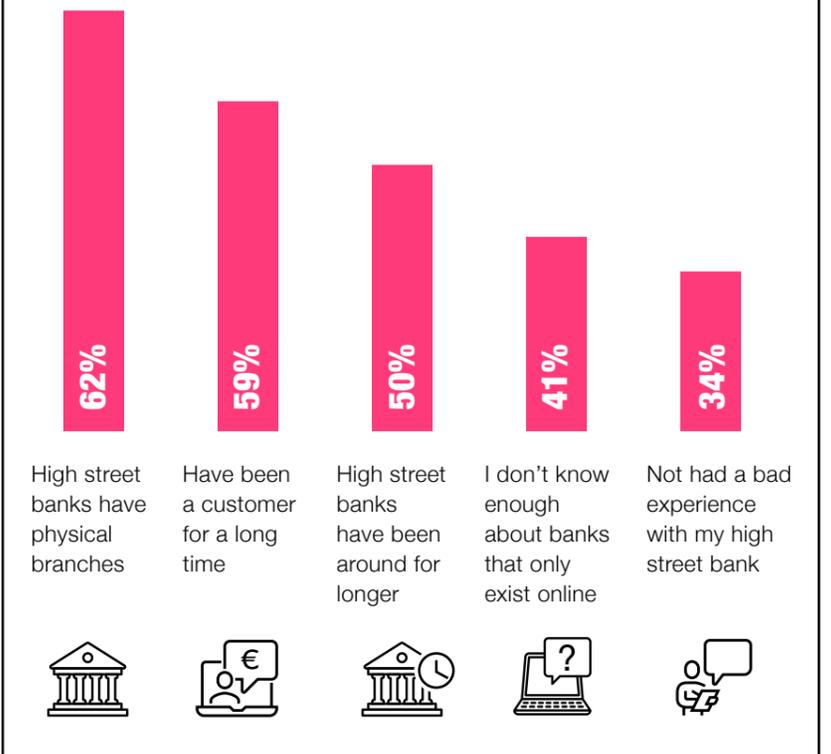
# IS THERE A FUTURE FOR THE HIGH STREET BANK?

Despite nostalgia and even a fondness for high street branches, Brits know their days are numbered. 8 in 10 (87%) Brits admit they'd be "concerned" if physical bank branches were to disappear completely from the high street in just five years' time. However, a fifth (20%) go as far to say they believe high street banks will disappear completely and be replaced by banks that only exist online by 2023.

Decision-makers at retail banks mirror this view with almost a fifth (16%) believing high street banks will disappear completely and be replaced by banks that only exist online. Over a third (34%) believe banking will split into specific services (i.e. payments, money transfers, loans, savings, etc.) leading to retail banks ceasing to exist, as they currently are, in just five years' time.



## REASONS WHY CONSUMERS TRUST HIGH STREET BANKS MORE THAN BANKS THAT ONLY EXIST ONLINE



Ilan Buganim,  
Chief Technology and Data Officer, Bank Leumi, comments,

**I PASSIONATELY BELIEVE THAT A FANTASTIC DIGITAL BANK CAN TRANSFORM A CONSUMER'S BANKING EXPERIENCE. WE'RE SEEING THIS HAPPEN EVERY DAY. BUT TO SAY THE HIGH STREET WILL LOSE ALL BRANCHES IS RADICAL IN THE EXTREME. THE FACT REMAINS THAT PEOPLE NEED SUPPORT IN THEIR BANKING AND CHOICES IN HOW THEY ACCESS THESE SERVICES. IT FALLS TO THE INDUSTRY TO MAKE THAT THOSE CHOICES AS ATTRACTIVE AS POSSIBLE.**





# 2

**IF CONVENIENCE IS THE KEY, WHAT'S THE HOLD UP?**

We know that decision-makers at retail banks believe innovation is key to providing consumers with convenient banking experiences. But why is it key to their business?

Decision-makers believe the top reasons why UK retail banks need to innovate are:

**56%**

Provide customers with the best possible user experience

**26%**

Have a competitive advantage against other financial players

**16%**

Drive customer acquisition

**46%**

Improve customer retention

So, we can confidently conclude that decision-makers are wise to the fact that innovation is for the wider benefit of the customer. In terms of getting to this point of consumer-centricity a fifth (20%) of decision-makers believe that to survive alongside new fintech players, retail banks need to create new digital-only banking brands – something which Bank Leumi has done in its creation of Pepper, the 100% mobile bank.

And while decision-makers at retail banks are aware that innovation at retail banks lags behind new fintech players for reasons that include - but aren't limited to - a culture focused on product development and cost cutting instead of innovation and customers, what else do they believe is holding them back from offering consumer-centric banking services?



# BARRIERS TO DIGITAL

Almost half (44%) of decision-makers at retail banks believe they'd have to change their business model to go 'fully digital'. This is an area fintech thought leaders [Chris Skinner](#) and [Ben Robinson](#) have been vocal about in order for retail banks to survive in an increasingly digital-focused world.

While recognising that a retail bank must change its business model to go digital is key, the importance of having directors that put innovation first is another way in which decision-makers (70%) believe the pace of

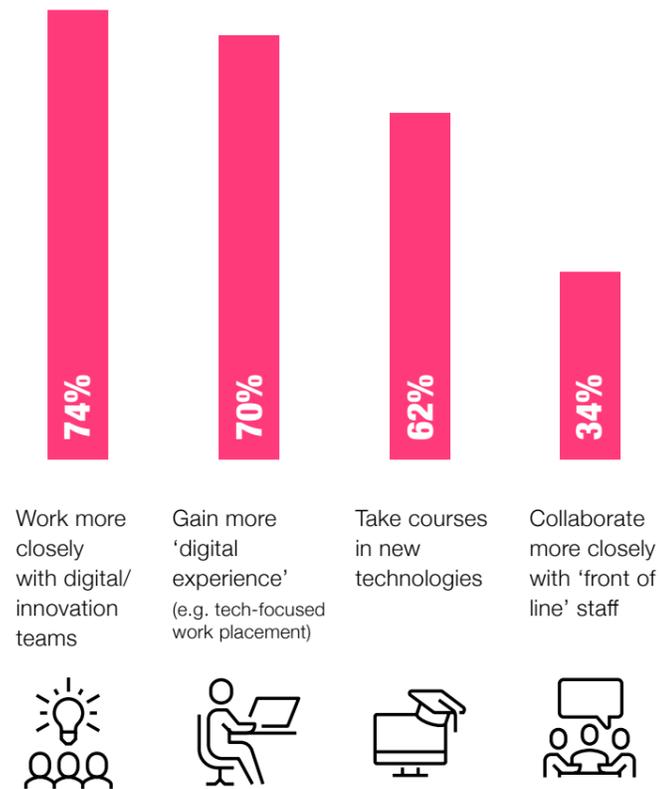
# KNOWING WHAT'S TRULY DIGITAL

This 'digital knowledge gap' is shown by the fact almost a fifth (18%) of decision-makers at banks consider any bank with a mobile app to be 'truly digital' and 1 in 10 (8%) believing banks which offer online statements to also be 'truly digital'. While three quarters (76%) of decision-makers at retail banks are right in thinking a bank created from scratch with a core digital infrastructure is truly digital, it's clear that there's confusion about what makes a digital bank truly digital.

At Bank Leumi, we saw the importance of having digital-savvy decision-makers to better understand the challenges we faced when we set out to establish Pepper. Our senior management is comprised of several digital and tech executives who have worked within and

innovation within retail banks can quicken. In addition to this, a top reason for retail banks falling behind fintech innovation is lack of in-house tech skills, knowledge and/or experience with almost half (47%) of decision-makers believing this is the case.

## WHAT DECISION-MAKERS AT UK RETAIL BANKS THINK THEY NEED TO DO IN ORDER TO BETTER MEET CUSTOMERS' DIGITAL DEMANDS



know the challenges of the industry. This has had an enormous contribution to the creation of Pepper – a digital spin off success. The learning here is about culture and willingness to change. If you want to change the experience you provide, break down the traditional structures and ways of working and be open to change at the most senior level.

# THE TECHNICAL DISJOINT

Not only is there a digital knowledge gap hindering innovation at retail banks, siloed departments in these institutions also present a huge challenge for banks looking to work together and become more consumer-centric. However, breaking out of such a structure is incredibly difficult – simply because retail banks' foundations are built on siloed departments. Half (49%) of decision-makers believe such internal silos are the reasons that UK retail banks are behind fintechs when it comes to innovation and almost a third (29%) believe that this is also

because of a lack of internal communication – specifically between decision-makers and tech/innovation/mobile teams within retail banks.

While consumer-centric banking services are key to the survival of UK retail banks, having digital-savvy decision-makers that are well connected with innovation/tech/mobile teams within the bank is essential. With digital experts at the top, that have a true understanding of what a truly digital bank is, retail banks will be better placed to harness the storm that is digital innovation.



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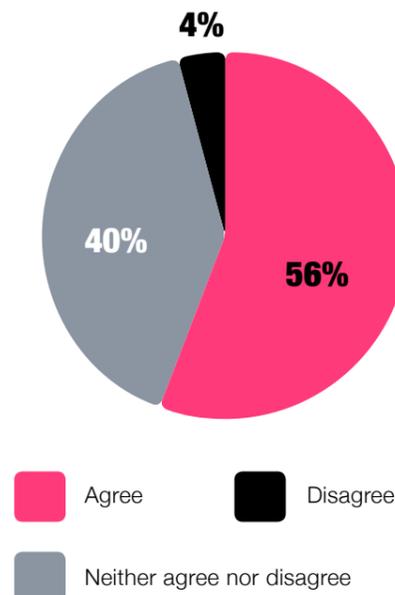
# WHAT DOES THE FUTURE LOOK LIKE?

Digital banks have many advantages. Working free from silos and not hindered by fragmented and decentralised customer data, innovation comes more easily. Digital banks also have agile core systems to keep up with changes and new regulation like the recently enforced Payment Services Directive II (PSD2 or Open Banking as we know it), or with consumer needs and demands.

Open Banking, came into force on 13th January 2018. The regulation requires banks to open their payments infrastructure and customer data assets to third parties. This means competitors beyond UK retail banks will have the data they need to offer personalised product offers, from loans to current accounts. While the regulation was presented as a way for financial players to become more consumer-centric, we know that many UK retail banking leaders believe the regulation hasn't helped them in the immediate term.

We asked decision-makers at retail banks how they felt Open Banking affected their institution. While 56% of decision-makers at banks agree that Open Banking presents an opportunity for UK retail banks to become more consumer-centric, over half (58%) admit the regulation has had a negative impact on their organisation.

## DOES OPEN BANKING PRESENT AN OPPORTUNITY FOR UK RETAIL BANKS?



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**DESPITE THE CONCERN, OPEN BANKING WON'T CULTIVATE A 'WINNER TAKES IT ALL' SCENARIO. THAT BEING SAID, THE BANKS FAILING TO SEIZE THE OPPORTUNITY MAY WELL DISAPPEAR. BUT THE OVERALL IMPACT WILL BE A BETTER, MORE CONNECTED AND CONVENIENT EXPERIENCE FOR THE CONSUMER. NOT ONLY DID WE DISRUPT OURSELVES WITH OUR OWN MOBILE-ONLY CHALLENGER BANK PEPPER, WE ALSO MADE SURE IT WAS BUILT FROM SCRATCH WITH AN OPEN BANKING-READY ARCHITECTURE SO WE CAN PLAY A ROLE IN THE BANKING ECOSYSTEM OF TOMORROW**

Ilan Buganim,  
Chief Technology and Data Officer, Bank Leumi

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The graph highlights the varied ways in which decision-makers at retail banks believe their organisation has been impacted by the PSD2, but we can see clearly that their concern for the advantage the regulation has given tech giants over retail banks is large. Surprisingly, the concern of the upper hand the regulation has given the GAFAs (Google, Amazon, Facebook, Apple) of this world exceeds the concern they have for the advantage it has given fintech companies.

There's no doubt that Open Banking poses a threat to banks as they share their once sought-after prized possession – customer data. But, there's an even bigger opportunity for those banks willing to adapt in this new digital era and build a new business model based on collaboration with outside players. However, when asked why they believe retail banks are behind innovative fintech companies, two thirds (65%) of decision-makers admit there's a reluctance to adopt external technology despite over half (54%) saying that to innovate faster, retail banks must collaborate with fintech companies.

Regulations like PSD2 herald new business models based on collaboration between banks and outside players. Collaboration is essential for every incumbent which wishes to stay relevant. It provides them with the ability to offer consumer-centric banking services and cut through the 'red tape' almost half (48%) believe Open Banking causes.

# WILL AMAZON OR GOOGLE BE THE BANKS OF TOMORROW?

The future vision of personal banking is clear when we asked decision-makers and consumers about the role they believe tech giants will play in the industry. Simply put: if retail banks don't change fast enough, they will be replaced by tech giants waiting in the wings.

Our research reveals that two in three (66%) decision-makers believe tech giants, such as Google and Amazon, will offer full banking services in the next five years in the UK and

attract many customers of retail banks and banks that only exist online (digital banks).

The opinion that tech giants' role in finance becoming ever more prevalent is mirrored by consumers, however just 29% believe they will overtake retail and digital banks. Unsurprisingly, the age group which most believes we will see tech giants offering banking services in the future is 18-24-year olds.

## CRYPTOCURRENCIES

While many technological advancements in payments such as Apple and Google Pay and the rise of contactless and card payments are helping the UK to move towards becoming a 'cashless society', the rise of cryptocurrencies is quickening this movement. Over the past five years, the conversation around alternative digital currencies has increased. However, consumer trust is still a sticking factor for alternative digital currencies, such as Bitcoin and Ethereum, becoming mainstream – with half (50%) of UK consumers viewing them as a 'gamble' and just 3% believing they will replace cash in 10 years.

According to the research, men are more likely to believe that cryptocurrencies are a

'gamble' (at 56%), compared to women (44%). Somewhat surprisingly, 43% of 18-24-year olds also think that these digital currencies are a 'gamble', compared to 25-34-year olds (at 37%).

Amongst decision-makers in the financial sector, there was no firm agreement on burgeoning cryptocurrencies. Despite over half of decision-makers (54%) thinking that cryptocurrencies are a speculative 'bubble', 28% say there will be more and more transactions made via these currencies in the future, while one in ten (14%) believe that they will fully replace cash within 10 years.



# CONCLUSION

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**WHILE UK RETAIL BANKS ARE IN A POSITION OF TREMENDOUS STRENGTH – THEY ARE, AFTER ALL, TRUSTED MORE THAN FINTECHS – IT'S CLEAR THAT THEY ARE FAILING TO HARNESS THE OPPORTUNITY THIS PRESENTS.**

They are also struggling to cope with some fundamental changes in consumer behaviour and the marketplace. For example, UK consumers are still very traditional in the way they like to communicate with their bank. The desire for tradition and convenience is a difficult path to tread for the UK banking industry. At the same time, incumbent banks are also losing their footing on customer data. Once their sole possession and advantage – customer data – is now fair game thanks to Open Banking, so retail banks must seek ways to meet customer demands using data before a competitor, be that another retail bank, fintech or tech giant. There is also a knowledge gap at the top of what it means for a bank to be 'truly digital'. Fintechs are mostly led by digital experts who understand the importance digital innovation plays in meeting consumer demands. We believe that the Bank Leumi board's commitment to 'digital' helped us understand the pain points of our customers faster as they craved a more convenient way of banking. Not only are tech-savvy board members important in giving digital direction, they are essential in cultivating a culture focused on the customer and innovation – not just cost cutting.

The task facing the industry is massive. My view is that incumbent banks need to collaborate more openly with digital players. We share the same goals. Why don't we share innovation and technology? A culture change to understand the importance of becoming more customer-centric is key to understanding that collaboration is essential to the survival of high street banks in the UK.

So, no matter what the market conditions or geography, delivering banking solutions built with the customer in mind is our shared future. UK decision-makers understand that retail banks are falling behind when it comes to digital innovation and are aware of the reason why their hands are somewhat tied to match the pace fintechs and tech giants are developing at. Perhaps the most significant finding was that decision-makers know how they can improve to meet the banking needs of consumers. Now, they just need to deliver.



**MICHAL KISSOS  
HERTZOG**  
CEO OF PEPPER

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