Future trends in UK banking

Analysis and projections

A Cebr report for Fiserv

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Executive Summary

The key points in this report are given below:

- **UK Internet banking use** is projected to rise significantly by the end of the decade, from 53% of Brits in 2014 to **66% by 2020**. This **represents an increase of almost 7.5 million internet banking users** – presenting a significant opportunity for new banking entrants. Weekly values moving through internet banking are projected to rise to £9.4 billion by 2020, from £5.8 billion in 2013.
- **UK Mobile banking** is expected to see an even more rapid rise, to **32.6 million users in 2020**, up from 17.8 million 2014. The rapid expansion of the mobile banking market also gives significant opportunity to new entrants to gain market share. The **total value being moved through mobile apps is projected to reach £3.4 billion a week in 2020**, up from £1.7 billion a week in 2014.
- Users of bank mobile apps report being more satisfied with their banking provider than those that don't use the software. In addition, costs are significantly lower to the bank per online and mobile transaction compared to in branch or over the telephone.
- Significant changes are also taking place in payment channels. Non-cash, non-card payments are expected to be used for more than a fifth of transactions by 2020, up from virtually nothing at the start of the decade. The rise of people using their mobile to make transactions in-store is expected to be a key driver of this trend.
- Almost a quarter of banking users expect to be banking with an alternative payment provider (e.g. PayPal) within two years, highlighting the threat to incumbents not just from new challenger banks but also from other, less traditional avenues.

* Where UK data is unavailable, figures from the US have been used for illustration throughout this report.

1 Introduction

This Cebr report, commissioned in late 2014 by Fiserv, looks at changing trends in the UK banking sector, and the ways in which this different environment is positive for both potential new entrants and for consumers.

Recent years have seen a marked trend of new and disruptive technologies in personal and consumer finance. This has been driven by the rise of internet penetration as well as the increasing power and prevalence of smartphone technology.

With these new platforms, consumers can now check balances and transfer money from the palm of their hands, and the facility to pay in cheques remotely is even being introduced. These new technologies allow customers to interact with their bank's services more quickly and easily than in branch, with the potential to increase customer satisfaction.

In addition, mobile banking users are increasingly able to pay for items in shops using different payment technologies. These range from contactless payment using radio-frequency identification systems, through using third party balance transfer software, and even paying through simply knowing the recipient's phone number. With these convenient new methods of payment on the rise, consumers are more likely to use a non-bank provider in the future for many of their financial needs.

These different consumer banking aspects are looked at in turn, and the structure of this report is as follows:

- **Section 2 examines recent trends in and the outlook for banking channels**
- **Section 3 analyses recent trends in and the outlook for payment channels**
- **Section 4 provides conclusions**

2 Recent trends in banking channels

The last ten years has seen a rapid rise of alternative and additional banking channels, notably over the internet and through mobile applications. However, these new channels are largely automated. This means that the higher the volume of customers that use these channels, the lower the average cost to the bank, allowing for efficiency savings. These channels are examined in turn in the following sections, with the key findings in bullet points below:

- The number of internet banking users is projected to rise from 27.7 million in 2014 to 35.1 million by 2020, taking the amount transferred through internet banking from £6.4 billion a week in 2014 to £9.4 billion a week in 2020.
- The number of mobile banking users is projected to rise to 32.6 million users by 2020, from 17.8 million in 2014 and just 4 million in 2009.
- Both of these trends offer significant opportunities for new banks or electronic-only banks, with online transaction costs to the bank at up to forty times lower than traditional channels. Internet banking also makes it cheaper and easier to reach customers around the country.
- However, the electronic banking experience must be seamlessly user-friendly, as more than an estimated million users have switched provider following technical faults and lack of access[1].

2.1 The growing importance of internet banking

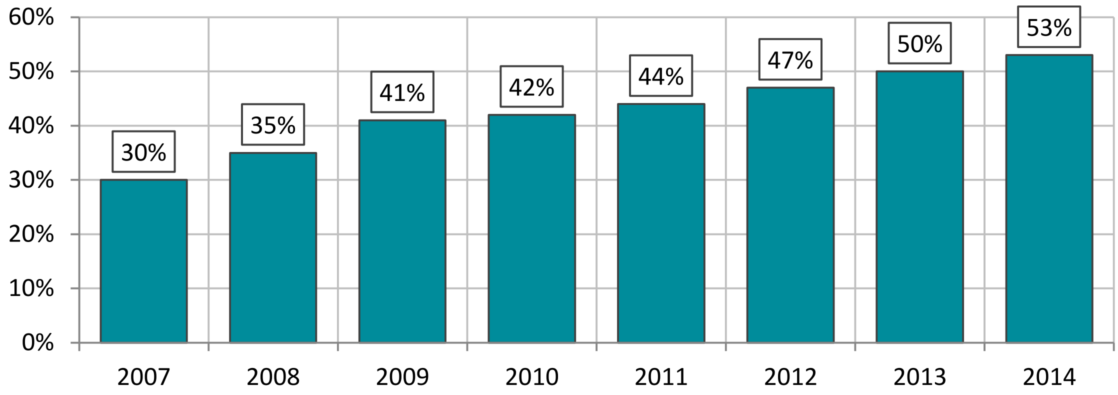
As illustrated in the chart below, the percentage of UK adults (aged 16+) using internet banking has climbed notably over much of the past decade. More than half of Brits now use internet banking, compared to under a third (30%) in 2007, the earliest period for which comparable data are available.

This has been partly at the expense of more traditional channels, such as telephone banking. According to Research and Markets, the number of telephone banking customers declined between 2008 and 2012 by 28%[2].

[1] Calculations carried out based on Fiserv/Opinium survey results

[2] Research and Markets 'Internet and Telephone Banking Market Report' 2013

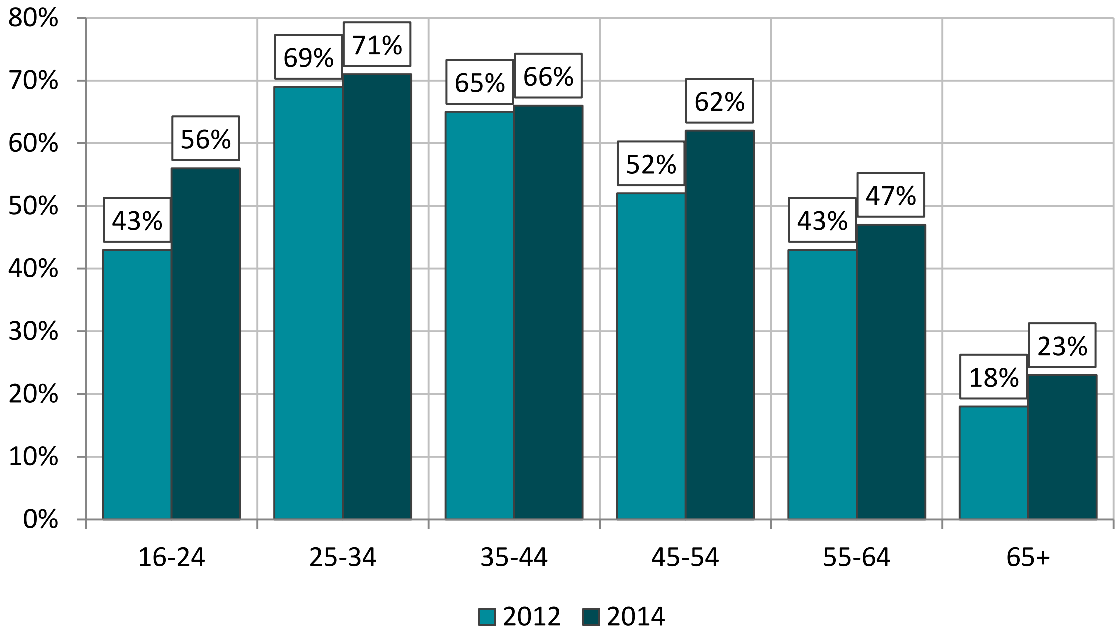
Figure 1: Proportion of UK adults (aged 16+) using the internet for banking



Source: Office for National Statistics *Internet Access – Households and Individuals 2014*

Younger age groups are more likely to bank over the internet, particularly those in the 25-34 group, with over 70% doing so. All age groups have seen a rise in the prevalence of internet banking over the past two years, particularly the oldest (65+), the youngest (16-25) and those aged 45-54. Only a small increase was seen in the 25-34 age group, suggesting this group may be approaching a saturation point. These findings are illustrated in Figure 2 below.

Figure 2: Proportion of UK adults (aged 16+) using the internet for banking, by age group



Source: Office for National Statistics '*Internet Access – Households and Individuals*'

Looking ahead, this upward trend in the number of people accessing bank accounts online is likely to continue. The proportion of those aged 25-34 banking online is likely to increase over the next five years, but **relatively slowly given that currently almost three quarters of people in this age group already use the service.** However, there is much more scope for those in other age categories to catch up.

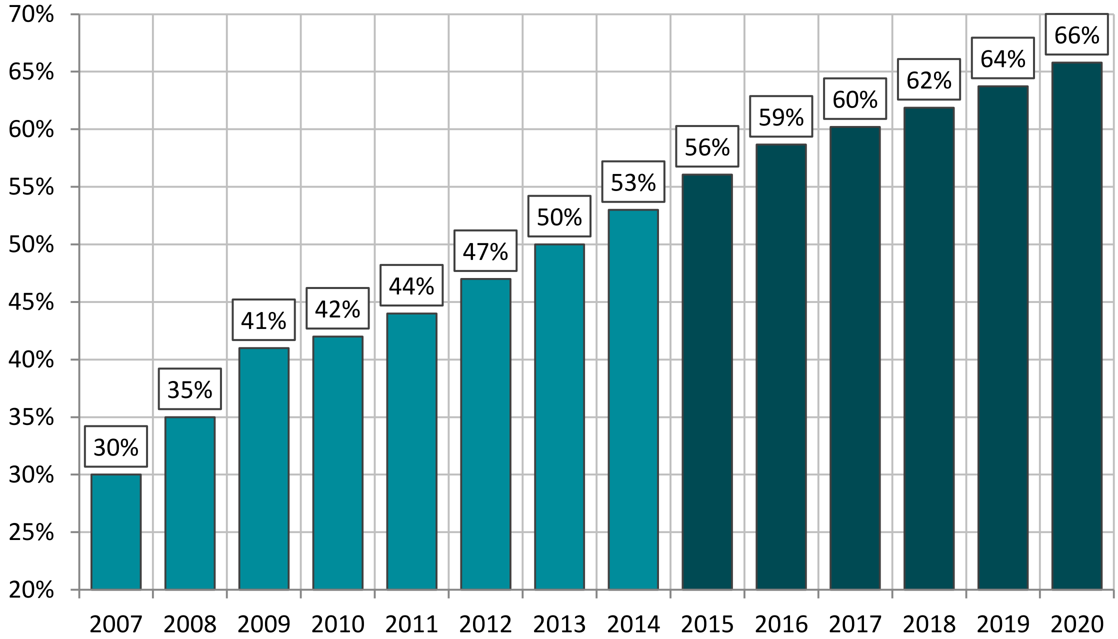
For instance, although only around half of those aged 65 and above are internet users in 2014, this proportion is likely to increase over the next five years. This is because a number of slightly younger adults who already use the internet will enter this age bracket by 2020, and also due to increasing penetration of the internet. With the number of web users among the oldest age bracket on the rise, a subsequent increase in the proportion of those subscribing to online banking is also expected.

Although the oldest age bracket has the most room to show increases, other age groups are also likely to show notable increases in take-up over the next five years, moving toward the level seen in the 25-34 years group. The overall effect of this increasing penetration of internet banking is given in Figure 3 below. The overall proportion of UK adults using the internet for banking is projected to reach over **65% by 2020, up from 53% in 2014**. This is a projected increase of nearly 7.5 million new internet banking users, **representing a significant boost to the size of the online banking marketplace that new entrants may be well placed to capture**.

The British Bankers Association estimates that in 2014, £6.4 billion was transferred using internet banking per week, up from £5.8 billion in 2013. The expected upward trend in online banking usage, combined with inflation and a stronger economy, suggests that **by 2020, as much as £9.4 billion could be transferred through online banking per week.**

The implications and potential benefits of this shift in banking behaviour are discussed in greater detail in section 2.3, later in the report.

Figure 3: Forecast of the proportion of UK adults (aged 16+) using the internet for banking



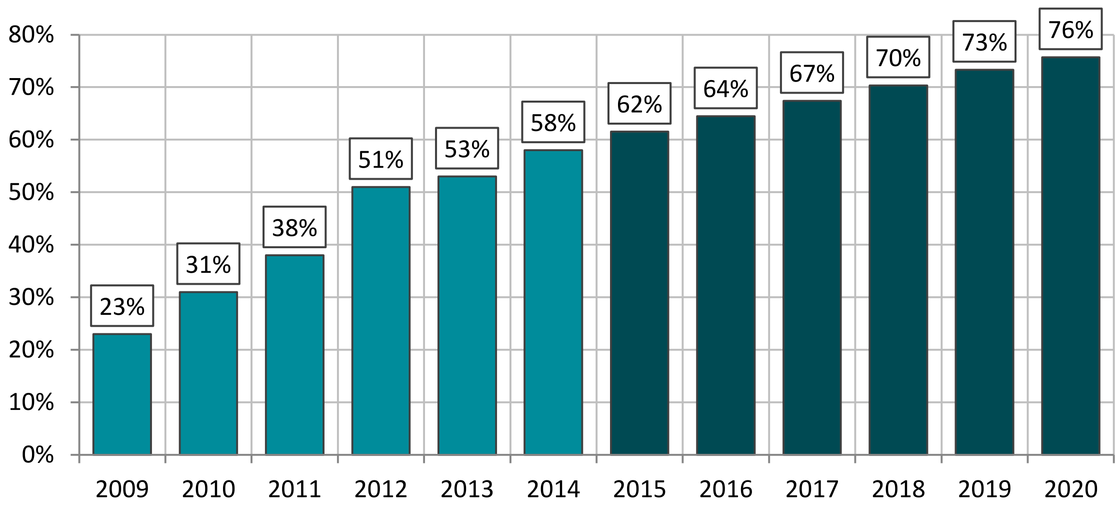
Source: Cebr analysis

2.2 The rise of mobile banking

Mobile banking is only a relatively recent trend in the banking sector, with the British Bankers Association suggesting that the first mobile applications (apps) were launched in 2010. These apps only allowed users to check their balances, compared to the wider suite of options available today. While it was possible to "bank on the go" through mobile browsers before the introduction of dedicated applications, mobile banking was used by significantly fewer people in 2009 and earlier due to the relatively low penetration of smart phones before 2010.

The increasingly widespread ownership of smartphones with mobile internet connections is one factor helping to boost the popularity of mobile banking. As can be seen in the figure below, the share of UK adults accessing the internet through their mobile phone has climbed sharply in recent years, and is projected to continue increasing over the coming half decade.

Figure 4: Proportion of UK adults that have accessed the Internet through their mobile in the last three months



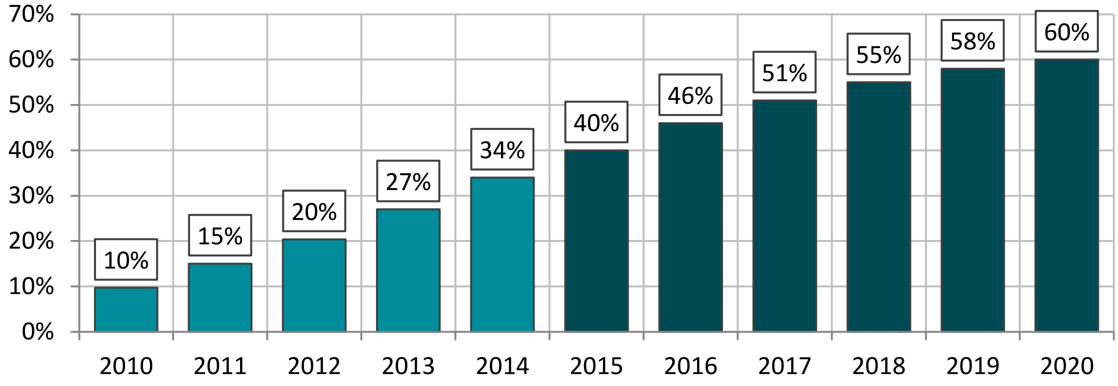
Source: ONS 'Internet Access – Households and Individuals 2014', Cebr analysis

With greater penetration of smart phone usage and wider publicity around mobile banking apps, the share of UK adults "banking on the go" is climbing quickly. Just one in ten UK adults was estimated to be banking on their mobile in 2010, with this share rising to 20% in 2012 and 34% in 2014.

Although the European Financial Management Association suggests that 60% of all banking transactions could take place on mobile devices by 2017, it is likely to take longer than this for the share of adults using mobile banking to reach that level. This is due to much lower mobile banking penetration rates and slower growth in take-up among older age groups, holding down the UK average. However, by 2020, a higher proportion of older adults are expected to be using mobile banking – both as smartphone penetration increases amongst this group and also as current users grow older into these groups. Overall, this translates to a forecast of **six in ten UK adults using the service**, as illustrated in Figure 5 below. This is a projected increase of 14.8 million mobile banking users between 2014 and 2020, marking a **huge opportunity for potential new banking providers to capture these newcomers to the mobile banking market**. As with internet banking, the accessible-anywhere nature of mobile banking means that new providers would not need as extensive a branch network to gain customers and market share as they would have done a decade ago.

These estimates mean almost all mobile internet users are expected to be using mobile banking, and almost as many are expected to be banking through mobile apps as through bank websites more generally.

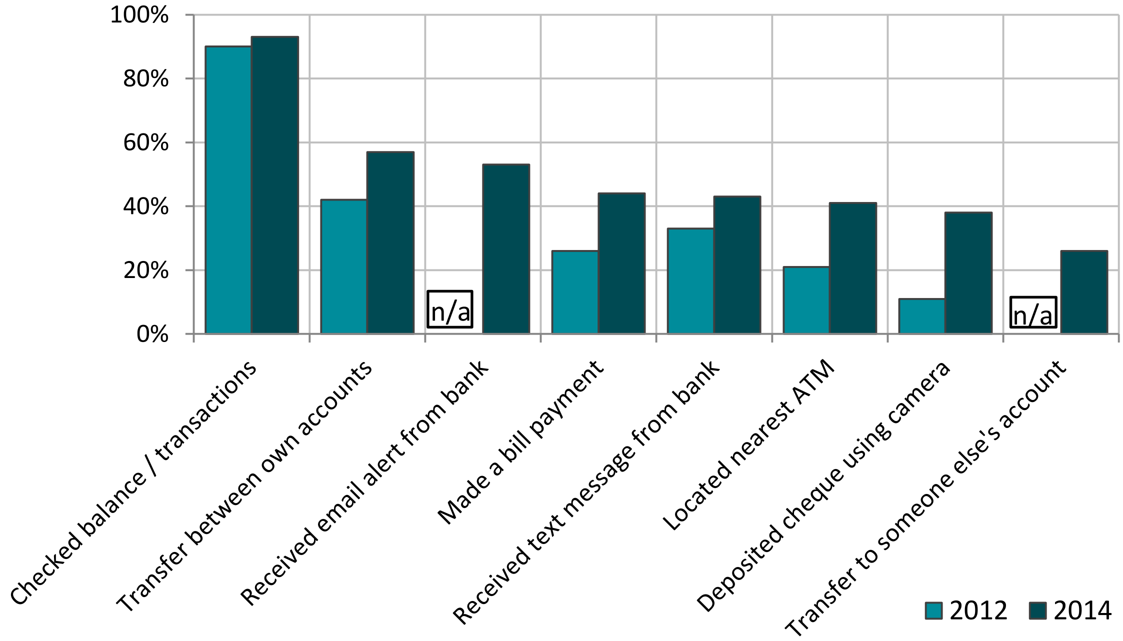
Figure 5: Share of UK adults who use mobile banking



Source: FICO Mobile Banking Revolution 2013, Future Foundation Money on the Move 2012, Cebr analysis

Looking at the way that users interact with mobile banking across the world, the more basic functions of mobile banking are the most popular, with almost all (93%) of US mobile banking users checking their account balances or recent transactions through this technology. Functions such as transferring money to one's own or someone else's accounts are less popular, with 57% and 26% respectively of mobile banking users doing this in the last 12 months. However, all activities have become more popular over the past two years and are likely to continue to do so, particularly more high-tech features such as depositing a cheque using the phone's camera. This is a function that is not widely available in the UK yet, but is starting to be piloted by a number of banks who expect regulation to change to allow remote cheque capture in 2015.

Figure 6: What mobile banking users have used in past 12 months, US, 2014



Source: US Federal Reserve 'Consumers and Mobile Financial Services 2014'

According to the British Bankers Association, some £1.7 billion is transferred a week through mobile apps in 2014, up from £1.2 billion in 2013. With more people using these apps, alongside a stronger economy and inflation over the period, **£3.4 billion is projected to be transferred a week through mobile banking apps by 2020.**

2.3 Digital banking: creating opportunities for new entrants to the sector

There are clear benefits to consumers directly from the rise of mobile and internet banking. The top reasons given by more than half of surveyed US consumers for using mobile apps were convenience and being able to track their balance on the go, as well as speed and not having to go into a branch[3].

These positive aspects are reflected in the satisfaction that bank customers feel – 83% of those using the bank's mobile app more than once a week are likely to be satisfied with their bank, compared to 71% that don't use the app[4].

However, there are also notable benefits to the bank or financial institution from offering internet and mobile banking. A report by the Financial Conduct Authority (FCA) notes that mobile app users interact with their bank 20 times more frequently than those that bank in branch, and internet banking users do so almost seven times more often than branch-only customers. This more regular contact gives banks the opportunity to provide greater exposure to other services and products that the customer may wish to subscribe to – effectively acting as an additional avenue for advertising to existing customers. This is a substantial benefit, as it is considerably more cost efficient to retain an existing client than it is to acquire a new one. The Chartered Institute of Marketing[5] notes that while there is no definitive estimate for how much more efficient it is, many estimates put the multiple as between 4 and 10 times cheaper.

As well as the opportunity of upselling their existing customers, banks also gain significant other cost advantages through mobile and internet banking. The estimated worldwide average cost per transaction in person at a physical bank branch is $4.25. This compares to just $0.19 online, and $0.10 through mobile banking.

Overall, the technological developments allowing for the recent surge in mobile and online banking gives significant advantages to potential new entrants to the banking market. There has been a trend in attitudes away from branch-based banking – the FCA notes that the number of branches declined by 18% between 2003 and 2013. **This acts to reduce barriers to entry for new challenger banks, as an extensive branch network is no longer as important to customers. In addition, the increasing number of people using internet and mobile banking mean that it's cheaper than ever to reach new customers around the country.**

However, there are risks to a bank's reputation from the increasingly electronic interaction with customers. According to the same survey, a quarter of people with current accounts said that they'd had an IT problem with their account, with half of these being unable to use or access their internet or mobile banking. Many of those with difficulties (22%) encountered a fine or financial loss due to losing access, and an estimated 12.5% customers subsequently switched banking provider as a result. **This is estimated at an approximate 1.5 million users that have switched accounts following technical hitches and suggests that although online and mobile channels are a significant opportunity for new and existing market participants, the user experience must be problem-free, given the lack of an immediate physical presence to protect the relationship.**

Overall and as illustrated above, some barriers to entry for new banks are on the way down – including lower costs per transactions in digital banks, and the available-anywhere nature of online banks

[3] Future Foundation Emerging Trends in Mobile Banking

[4] FICO Millenial Report

[5] http://www.camfoundation.com/PDF/Cost-of-customer-acquisition-vs-customer-retention.pdf

removing the need for an extensive branch network. Such a business model is more likely to appeal to younger customers than older ones. To reach a broader market, a mixed approach may be needed: Findings from a survey commissioned by Fiserv suggest that 17% of current account holders still visit their branch at least once a week. Although this is significantly less than the 75% saying that they log into their online banking portal on at least one occasion every seven days, it still represents around nine million people. As such, the presence of a bricks-and-mortar store is likely to be a prerequisite for some banking customers.

3 Recent trends in payment channels

Alongside the technological innovations making it easier to bank more conveniently, recent trends in payment methods have also seen disruption from new technologies. These are explored in the following sections, with the key findings in bullet points below:

- Cash is projected to continue to fall as a share of all retail transactions. Taking its place is predicted to be non-cash non-card payments, including payment methods provided by platforms such as Paypal, Google Wallet and Apple Pay. This new technology-based payment channel allows for more innovation and new entrants than the traditional cash-based channel – potentially leading to greater consumer benefits.
- UK SMEs are also becoming more likely to use online banking to pay their suppliers than other channels, such as cheques. Nearly 26,000 more SMEs have started using online banking to pay suppliers over the past five years, and 50% expect to use it more over the next three years. Alongside the upward trend in online banking among consumers, many more SMEs are likely to use online banking by 2020, illustrating a growing market for new banking entrants to take advantage of.

3.1 Trends and outlook

One rapidly growing example of technological change is the introduction of contactless payments via debit and credit cards. According to the UK Cards Association, some £158m was spent in June this year using contactless cards. This is an increase of 238% over the past year, highlighting the recent rise of this technology. As of June, 48 million contactless cards had been issued, out of a total of roughly 160m credit, debit and charge cards in issue. The recent rollout of contactless payment technology on Transport for London’s network has been cited as one factor driving increased usage of this type of payment.

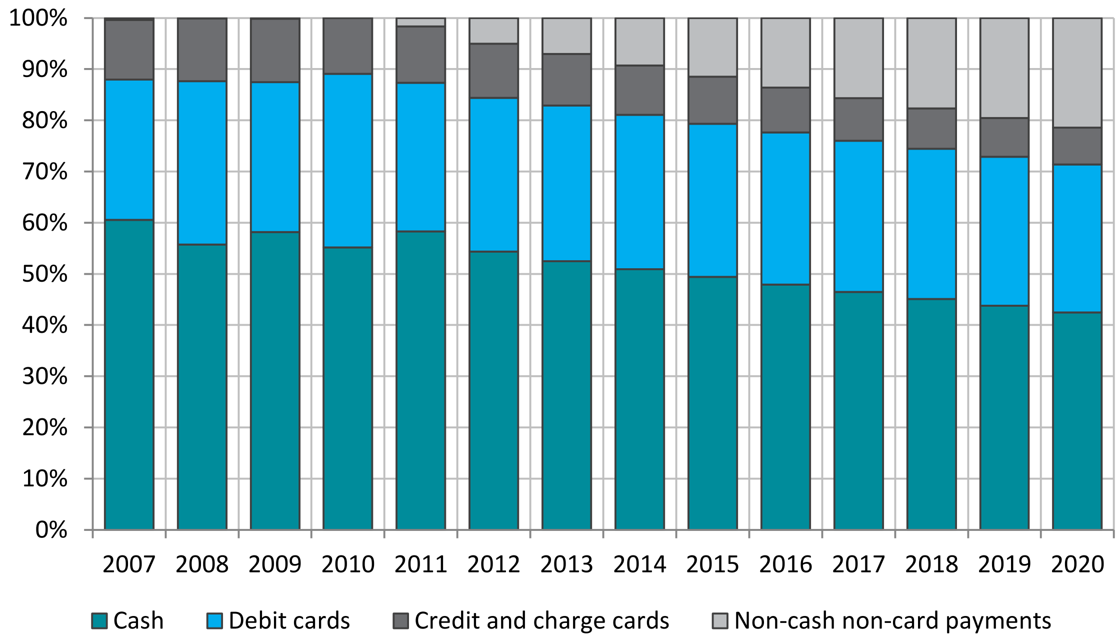
The introduction of contactless technology is helping to reduce the popularity of using cash. The UK Card Association notes that average transaction values on credit cards have been on a steady downward trend over the past few years, even as total expenditure has been on the rise. This suggests that more people are using plastic instead of cash to make small purchases – the limit is £20 per transaction for contactless payments.

However, this recent innovation is only acting as an expediter of a longer running trend. The share of cash being used to make payments in store at British Retail Consortium members (which account for 60% of all UK retail sales) fell from 61% in 2007 to 52% by 2013, and is projected to fall further to 43% by 2020. This drop in popularity came alongside rising volumes of debit card use – the total value of transactions through debit cards overtook cash purchases in 2010.

The rest of the decade is likely to see relatively new forms of payment gain in popularity. Non-cash non-card payments were traditionally the realm of cheques, but these form just 2% of the category these days. Instead, the category is comprised of a rising number of money-off coupons (e.g. Groupon and similar) and alternative methods such as online payments (such as PayPal) and mobile wallets (including Apple Pay and Google Wallet). According to OFCOM in 2014, 7% of smart phone owners paid for goods in store using their phones by accessing a website, while 6% did so through an app – such as Paypal or banking apps. Just 3% paid by touching their phone against a reader: a process that uses technologies such as Google Wallet or Apple Pay. This low share reflects the fact that only the most recent phones tend to have the features required for contactless payment. In addition, only 3% have paid for items via sending a text message, through services such as Pingit. This service from Barclays was one of the first 'paym' facilities, which enables a user to send or receive money using just a mobile number. However, many of the other major banks now offer similar services and as a result, the usage of this type of service is likely to rise.

Electronic forms of payment remain relatively rare in 2014, as only the latest flagship smartphones tend to be able to use the technologies for mobile wallets, and not many retailers have the facilities to make these transactions. However, as mobile technology improves and smartphone penetration deepens, paying using a phone is likely to become more popular. **Indeed, the share of UK smartphone users that pay for goods in this way is relatively low compared to other countries, such as the USA or China, highlighting the room for expansion. By 2020, the proportion of transactions made through these methods is expected to reach 22%, as illustrated in Figure 7 below. These technological trends look set to change the banking environment through increased access and competition, as discussed further in Section 3.2 below.**

Figure 7: Total number of retail transactions at British Retail Consortium members by payment method

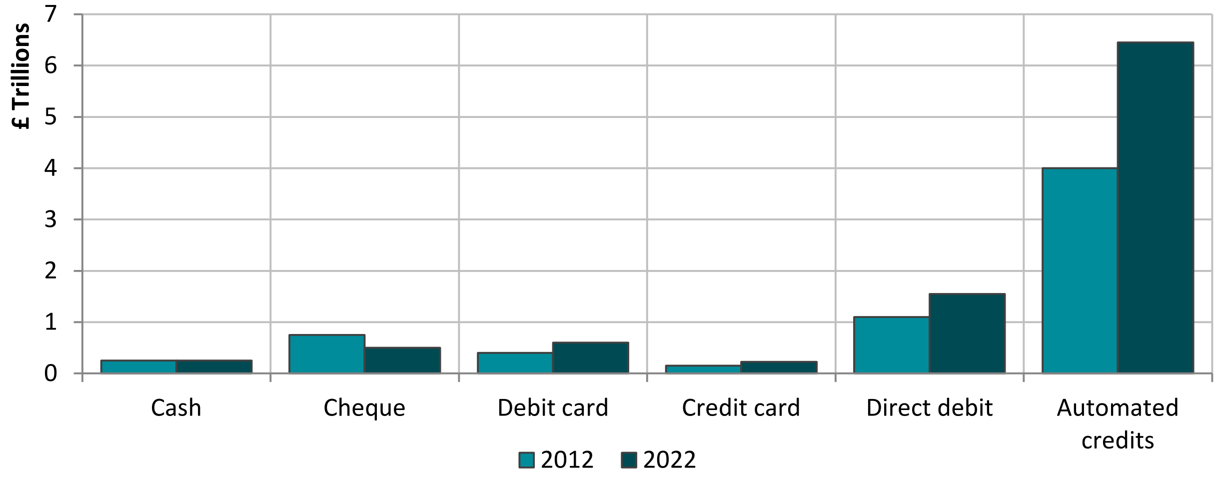


Source: British Retail Consortium data, Cebr analysis in Paypoint's *Future of Payment report*

The above analysis focusses on how consumers are able to pay for goods or services from retailers. However, similar trends are also highlighted by the UK Payments Council, in their wider look at their outlook for the payments industry.

By 2022, automated payments (which includes things such as direct debits and online transfers) are set to dominate the payments market by value by even more than currently, with an estimated £6.5trn sent through this method annually by then. This is up from £4trn in 2012, and includes the trend towards mobile payments discussed above. The Payments Council also expects more people to have their wages paid through automated transfers by 2022 than in 2012. These estimates are presented in Figure 8 below.

Figure 8: Total UK Payments by channel and year



Source: UK Payments Council August 2013

As illustrated above, consumers have been embracing new electronic payment methods. However, the same is true for the UK's small and medium-sized businesses. In 2013, a survey[6] showed that 32% of SMEs preferred to use Bacs direct credit, which Cebr estimates as equivalent to 72,400 firms with between 10 and 249 employees. In addition, 20% prefer to pay suppliers by online bank transfer (equivalent to 45,200 SMEs), compared to just 12% by cheque (27,100 SMEs).

Use of electronic payment forms has been on the rise over the past five years, with 75% more SMEs (with between 10 and 249 employees) using online banking now than they did in 2008 – an increase of 19,300 businesses. In addition, 68% of firms expect to be using online banking more in three years' time than they are now.

These findings highlight how there is a significantly growing segment of the SME market that is looking to develop closer online ties with their banks and as such, represents a sizable opportunity for new entrants to the sector, compared to the more mature high street banking market.

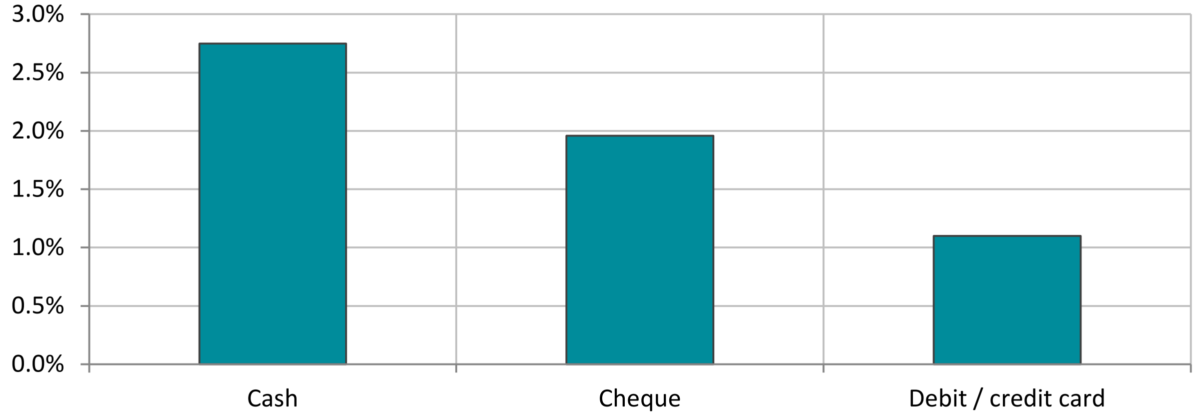
3.2 Effects on banks, businesses and consumers of new payment channels

For banks and other businesses, the rise of new payment methods offers the chance to reduce their cost base, particularly in the form of a reduced need to handle cash. Cash is cited as the most expensive payment option for retailers (see Figure 9 below). This is largely due to the cost in store of count and preparation, at 70.3% of the total cost, as well as the cost of transporting the cash, and room for human error in cash transactions.

For banks, this is also true, as well as the fees associated with providing access to automated teller machines (ATMs). A new bank setting up in a more cashless society will have less of its cost base devoted to the handling of cash than a bank establishing itself in previous decades. This is particularly the case for online or telephone only banks, which may seldom need to physically move cash at all.

[6] Bacs: Understanding SMEs' attitudes to payment methods, June 2013

Figure 9: Cost to retailers of different payment methods (as share of takings from each payment type)



Source: Centre for Retail Research – Cheque Use and Payment Systems in UK Retailing

However, there are signs that the providers of these new payment methods may start to act as competitors to those providing more traditional banking facilities. Recent research[7] showed that almost a quarter of survey respondents are likely to be banking with an alternative payment provider such as Paypal within two years. Although this means that the majority of Brits still expect to be with a traditional bank in the short term, it highlights the threats to existing banks from both challenger entrants and other less obvious banking providers.

Outside of the banking sector, the clearest direct benefit to consumers and retailers from the rise of new payment methods is speed and ease of use – American Express reports that contactless card transactions for instance are 63% faster than cash and 53% faster than traditional card payments. Although in absolute terms this is only likely to amount to a low number of seconds saved by each customer per transaction, shorter processing times are likely to have the effect of moving queues through more quickly, thereby saving a more significant amount of time for customers overall. Contactless payments using mobile phones are reportedly just as quick as contactless card payments.

Another direct benefit to consumers is that new technologies such as mobile phone payment mean that more retailers will be able to offer cashless payment – particularly in more remote locations or low-tech environments such as market stalls – due to there being no need for a dedicated infrastructure.

A less direct benefit for customers is the potentially market disrupting forces that come with new and competing technologies. Currently, credit card transactions carry a fee of 2-3%, a cost that is often shouldered by the retailer. Some mobile payment platforms carry lower fees than this, making accepting cashless payment more commercially viable for small retailers and potentially allowing for greater price competition among larger retailers – Walmart for instance cites credit card fees as making a significant dent in already slim profit margins.

[7] YouGov / Pinsent Masons survey 2014

4 Conclusions

The banking sector has seen much change over the past decade, with significant disruption coming from the financial crisis, but also from the rise of new consumer technologies, devices and communications networks. Some of the most notable trends affecting the industry have been analysed in this report, from which the following conclusions and implications for banking providers have been drawn.

Mobile and internet banking channels have dramatically changed how customers interact with their banks. Before the financial crisis only a minority accessed their accounts and made transfers in this way, but in 2014 these methods accounted for more than half of UK adults, and by 2020 is expected to be used by two thirds of British adults – particularly as the older generation become more familiar with the technology. These trends help to reduce the barriers to entry to new challenger banks, as costs per transaction are much lower online than in-branch and the available-anywhere nature of internet banking means that a less extensive branch network is required. These factors are making it cheaper to reach new customers around the country, and with improving technology are likely to continue doing so in the years to 2020.

Another trend changing the banking landscape is the emergence of new, technology-based payment channels. As well as being able to bank on one's phone, there is an increasing trend of paying for goods or services using the phone. Currently this is largely through indirect means such as through Paypal, but as average mobile phone computing power increases, more will be able to pay directly through contactless services such as Google Wallet and Apple Pay. This trend is again positive for banks, as it acts to reduce the prevalence of cash – a payment medium that is expensive to transport, store and administrate. However, the rise of these alternative payment providers may also act as a threat to incumbent and challenger banks – nearly a quarter of people say that they are likely to move their banking to a payment provider in the next two years.

As such, the improvements to technology in recent years present both opportunities and threats for existing banks. Increasing use of mobile banking makes it much easier for current customers to interact with their provider, and potentially easier to reach new customers. Mobile and internet banking also makes it cheaper for the bank to provide services. However, the rise of technology also brings with it additional competitors from outside the traditional banking sector, which incumbents would do well to keep in mind.