KPMG
cutting through complexity

Next Generation Banking Survey

FINANCIAL SERVICES

As the world emerges from what has been described as the greatest crisis in the history of finance capitalism, banks must adapt their business models to radical new regulations, technologies, customer expectations and competitive environments. The rapidly changing financial services industry forces banks to not only evaluate the added value of their business models but also to regularly adapt them to remain solid, agile and future proof.

> “How will the business model of the Next Generation Bank in 2025 provide added value?”

In order to answer this question, KPMG distributed a survey to the members of FLAIRS (the interbank event of the youth associations of Van Lanschot, ABN AMRO, ING, Rabobank and SNS Bank). As more than 130 young bankers responded, we can safely say that this research question is one that has been actively thought of in the minds of the young bankers. This paper highlights the most interesting survey outcomes, placed in the broader context of challenges that banks currently face.

Changing Customer Demands and Interaction

To remain relevant in a swiftly changing and digitalising world, banks need to redefine both the ways of interacting with customers and the added value provided via their product and service offerings. This results in a differentiating customer experience, where technology plays a crucial role. Customers expect a seamless omnichannel experience with access to information and professional advice when, where and how they want it.

Technology is not only the 'enabler' of banking services but becomes more and more an integral part of the customer experience. The Next Generation Banking Survey shows that 55% of young bankers believe that the product offering of banks currently does not match the 24/7 demand of customers. An equal percentage agrees that the current product offering of banks is insufficiently personalized to match the client lifecycle. These results not only indicate room for improvement in the way that the Next Generation bank must interact with its customers, but also reveals the necessity to be more relevant, proactive and personalized in both product and service offering. 40% of the young bankers did not agree with the statement that banks currently are customers centric enough in both service offering and product development. Although the majority (60%) agreed with this statement, it still indicates significant room for improvement in order to meet customer expectations to the fullest extent.

In the modern day world, not conforming to customer expectations can lead to customer retention difficulty. In fact, 61% of the respondents feel that the Next Generation banking clients will switch banks as easily as they switch energy or telecom providers. The fact that switching barriers have lowered, and will further lower due to changing regulation (e.g. PSD2) and the emergence of new market players (e.g. Google Wallet, Apple pay etc.), only stresses that improving customer interaction, as well as the 'relevance' of products and services becomes more vital than ever. 85% of the young bankers expect that the Next Generation Bank will be better equipped to tailor their services to the personal needs of clients by using predictive banking in the near future.

> *"The key added value (or purpose) of a bank is to deliver an excellent client interaction regardless of the product or service it delivers."*
>
> **Brunon Bartkiewicz** | Chief Innovation Officer ING

Rise of FinTech and Technological Innovation

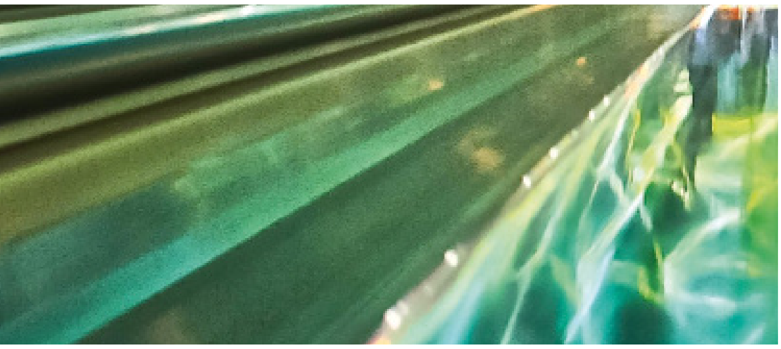
The business model of the Next Generation bank is highly enabled and impacted by the emergence of (new) technologies. The digitalisation of banking services has enabled new unorthodox competitors to enter the banking sector. Financial technology start-ups (FinTechs) are booming and have the potential to change the industry. Existing major technology companies like Google and start-up companies like Spotcap have already taken their first steps to compete with banks on traditional banking products and services, making them serious competitors.

Although new players in the banking sector might not have a financial services core, their technological expertise and IT agility could allow them to successfully compete on fronts such as payments, mortgages, and SME lending. 81% of the young bankers believe that FinTechs and technology companies (e.g. Google, Apple etc.) will take over a substantial part of the market for banking services. In addition, 61% believes that daily payments will be taken over by these technology companies in the near future, resulting in a significant impact on the banks interaction with the customer via payments. This also translates into the challenges that young bankers see, as a mere 36% are confident that banks are able to keep up with the pace of innovation of other FinTech and technology start-ups. Furthermore, more than two-thirds of the respondents expect that a number of FinTech startups will succeed in delivering 'disruptive innovations' that will put pressure on the business model of banks in the next years.

A variety of innovations seems to put pressure on the business model of banks. When questioned which technologies will have the greatest impact on the current business model, over 90% responded, mobile payments, Internet of Things and NFC. Only a mere 45% expects that crypto currencies (e.g. Bitcoin) will significantly impact the bank's business model.

Based on the survey results we see that the respondents not only recognise the challenges that FinTech start-ups and technology firms bring, but also question the ability of traditional banks to keep up with the rate of change and innovation. For example, 82% of the young bankers believe that there is a knowledge gap at board level regarding new technologies, which makes it even tougher to compete in terms of technological progressiveness. The Next Generation Bank will need to find a way to successfully compete, integrate or partner with these new technology firms in order to maintain relevant in the financial services value chain.

This challenge will most likely lead to banks becoming even more technology-driven in the near future and will potentially change their role within the value chain. In order to keep up with the fast pace of innovation, the Next Generation Bank needs to decide which technological capabilities to build in-house or attract via partnerships or joint ventures. In order to be successful the Next Generation Bank might transform into a network organisation that orchestrates and interconnects different parties in order to provide the best customer experience.



> *"It is crucial to realise a positive customer experience, not driven by products, but by the delivered service. Otherwise, it is easy to end up as a back-office for an innovative FinTech solution offered by a third party."*
>
> **Ferdinand Veenman** | Partner KPMG & Sector Lead Banking NL

Shift in People, Culture and Governance

A successful business model requires not only the right configuration of products and services, customer interaction, partnerships and technology. Equally as important are the right people, culture and supporting governance.

In the survey the young bankers were asked about their views on the current governance structure and composition of the board. 82% of young bankers believe that the average age on board level is currently too high. Furthermore, 72% of the young bankers believe that woman are currently under-represented on the board level.

These results clearly highlight the challenges for Next Generation Banks to diversify their board not only in terms of gender diversity, but also age. 69% of the respondents expect that the average age of board members of the Next Generation Bank in the near future will be significantly lower in order to enable the board to better relate to (younger) customers and new technologies. The young bankers are less optimistic regarding the challenges concerning under-representation of woman, as a mere 37% expect that more than 50% of the board members will consist of woman in 2025.

As of January 1st 2015, bankers in the Netherlands are required to swear a bankers oath (the "bankiers eed") of good conduct. With this oath, employees will be personally responsible for complying with certain rules of conduct and can be held accountable for non-compliance. 57% of the respondents did not agree with the statement that this bankers oath contributes to a more responsible banking culture". Additionally, 62% of the young bankers do not believe that the banking oath will still exist in 2025.

Regulatory Pressure with Opportunities

The changing regulatory environment has had a huge impact on banks over the last years. Significant amounts of resources, both in terms of people and budget, were allocated to programmes aimed at achieving regulatory compliance within challenging time frames dictated by the regulators. 91% of the respondents believe that the regulators have imposed too many regulations on banks.

We foresee additional regulatory challenges for the Next Generation Bank, impacting the entire organization including strategy and business models. 57% of young bankers expect that these regulations will put so much pressure on banks that they will be unable to keep up with technological innovation. In addition, 69% of the respondents believe that the regulator is acting too much as a 'board member'.

To find a balance in more stringent regulatory standards and ratios, banks need to look beyond regulatory compliance and consider the impact of such regulations on their business models. Restrictions and costs that derive from these regulatory changes potentially alter banks' client groups, products & services and distribution channels.

An interesting example of a regulation with a large impact on business models is the Payment Services Directive 2 (PSD2). PSD2 paves the way for new competitors in the financial services sector. On clients' request, banks will need to provide payment data to third-party service providers enabling all sorts of aggregator services. Consumers will also be able to use specialised third-party software to initiate payments directly. Thus PSD 2 benefits FinTech start-ups in different ways. 78% of the Next Generation Bank survey respondents believe that in 2025 FinTech start-ups have managed to operate faster and more efficiently outside of the existing regulatory frameworks than traditional banks. This will impact banks in the way they organise payments and data security, how they will interact with clients, which partnerships should be established and the impact on the business models.

The Added Value of the Business Model

> *"Show the courage to redefine your reason for existence, and relate your business model to it. Better act now - or become obsolete!"*
>
> **Lex Dekkema** | Partner Financial Services Strategic Consulting

If we look at the question that sparked this Next Banking Survey "How will the business model of the Next Generation Bank provide added value", and try to answer this question by looking at the responses of the young bankers, we distinguish multiple interesting views. Overall, one central theme echoes throughout the survey response; In order to be(come) and stay relevant in a digitalising world, the business model of the Next Generation Bank needs to increasingly focus on its technological capabilities and business agility in order to deliver innovative and relevant products and services supported by a seamless integration of channels and client interaction.

As indicated by the young bankers, this transition also requires a more differentiated composition at board level. As new players will compete with banks on the client interaction front (e.g. via payments or aggregator services), the key challenge for the Next Generation Bank will be to redefine its role within the value chain and transform into an organisation that delivers added value by orchestrating and connecting different parties in order to provide the best customer experience possible.

Key Survey Findings

Customers & Markets

78%	Expect that banks will be customer centric
73%	Expect that clients will not mind that their private and transaction data are used for product improvements and to ensure lower costs or higher interest rates
61%	Expect that clients will switch banks as easily as they currently switch energy suppliers or telecom providers

Value Chain & Added Value

81%	Expect that technology companies like Google and Apple will take over part of the market for banking services
61%	Expect that daily payments will be taken over by technology companies
55%	Expect that banks will focus primarily on the front-end of banking activities and outsource an increasing amount of the back-end

Product & Revenue Model

85%	Expect that banks will be able to tailor their services perfectly to the personal needs of clients by using predictive banking
66%	Expect that banks will offer high-end products (investments advice and private banking) primarily online
57%	Expect that peer-to-peer financing and crowdfunding will become a more important source of financing for SMEs than bank loans

Technology & Innovation

88%	Expect that some FinTech startups will have successfully challenged the traditional banking model with their disruptive innovations
87%	Expect that FinTech startups will pose a threat to traditional banks
75%	Expect that banks will mainly be technology driven companies

Management & Organisation

69%	Expect that the average age of board members will be significantly lower in order to enable them to better relate to (young) customers
47%	Expect that bonus schemes will no longer be a standard feature in contract of bank employees
45%	Expect that if an employee lacks a technology background, he will no longer qualify for a management position at a bank

Regulation & Supervision

87%	Expect that new, non-bank parties) providing traditional banking services will be subject to regulation and supervision
62%	Expect that the banker's oath will still exist
57%	Expect that regulations will put so much pressure on banks that they will be unable to keep up with technological innovation, resulting in more competition from international banks and non-banks

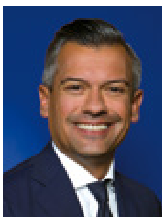
Need to Readjust the Business Model

Making adjustments to the business model will not, in itself, position a bank to succeed in the new market. The business model is only part of the challenge. No matter how sophisticated and agile the business model may be, if the business model is not constantly aligned with the corporate strategy and successfully translated in a corresponding operating model, the business model will never fully achieve what it was designed for. KPMG not only possesses in-depth knowledge regarding the latest trends and developments in banking industry but also has extensive experience with regards to business model generation within the Financial Services industry. Being on top of the market means we do not only follow, but also shape the latest trends and innovations together with our clients, providing you with the most up-to-date knowledge and best practice methodologies available.

To help achieve this, KPMG seeks to be a trusted advisor for business model challenges from the design stage through to implementation. We believe that addressing these challenges requires a tailored approach that looks at all elements of a business model both alone and jointly.

Interested?

If you would like to share your thoughts with us, please contact us:



Ferdinand Veenman
Partner KPMG Advisory
Corporate Finance

T.: +31(0)20 6568586
Mob.: +31 (0)6 22547497
E.: veenman.ferdinand@kpmg.nl

Bart van Kampen
Manager KPMG Advisory
Financial Services Strategic Consulting

T.: +31(0)20 6564014
Mob.: +31 (0)6 53249335
E.: vankampen.bart@kpmg.nl

KPMG
Laan van Langerhuize 1
1186 DS Amstelveen
P.O. Box 74105
1070 BC Amsterdam

www.kpmg.nl