FinTech: How financial institutions in Europe (should) prepare for the future

AID | AMUNDI INVESTMENT DAY
Alessio Botta, Partner McKinsey & Company
Milan, November 24, 2017
Agenda

The four horsemen of the e-pocalypse and their impact on the global financial services industry

The rise of the ecosystem economy

A roadmap for financial institutions
Fast-changing trends in global supply and demand are drastically transforming the economy across all industries.

**Supply: technology trends**
- Revolutionary mobile digital interfaces
- Decreasing cost of computing
- Wider usage of big data and deep learning
- Emergence of micro services and modular, API based structure

**Market implications**

**Short-term**
- Radical digitization of every industry
- New data-driven approaches
- Extreme customer focus

**Long-term**
- Traditional industry barriers disappear
- Rules of engagement for businesses change
- Customer journeys are rethought completely

**Demand: customer trends**

- Change in service expectation
- Transformation of product usage and behavior
- Appearance of the new tribalism
- Different attitude towards personal data

SOURCE: McKinsey analysis
In financial services, the disruption can be represented by the four horsemen of the e-pocalypse

**Disintermediation**
Banks are losing access to customers, as people switch to non-banking channels/sources.

**Unbundling**
Banking products and services are being unbundled, as consumers choose better experiences from single-service providers.

**Commoditization**
Banks are struggling to differentiate themselves, as consumers can compare banking products online with higher transparency.

**Invisibility**
Banks are losing brand awareness and becoming invisible, as consumers can access financial services without knowing the brand.

SOURCE: McKinsey analysis
Large platform players are already making meaningful performances in financial services…

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<tr>
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<th>Payment</th>
<th>P2P</th>
<th>Consumer financing</th>
<th>SME financing</th>
<th>Deposit gathering and wealth mng.</th>
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SOURCE: Press search; McKinsey analysis
… and FinTechs are expanding well beyond retail into commercial and corporate segments

McKinsey Panorama FinTech Landscape, # of startups and innovations as % of database total

Banking segment’s share of total banking revenues

- <5%
- 5%-7.5%
- 7.5%-10%
- >10%

Fintech activity

- # of startups and innovations as % of database total

1 1,700+ cases registered in the database as of August 2017, might not be fully representative
2 Includes Small- and Medium Enterprises
3 Including Large corporates, Public Entities and Non-banking financial institutions
4 Includes Investment Banking, Sales and Trading, Securities services, retail investment Non-CA deposits and asset management factory
5 Includes retail CA deposit revenue and corporate CA and non-CA deposits

SOURCE: McKinsey Panorama FinTech database, Panorama Global Banking Pools
Origination and sales – the focus of non-bank attackers – account for ~65% of global banking profits

Global banking revenues and profits by activity, 2016

$ billions

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<tr>
<th>Core banking</th>
<th>Balance-sheet provision</th>
<th>Origination/sales</th>
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<tbody>
<tr>
<td>Lending¹</td>
<td>1,153</td>
<td>281</td>
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<tr>
<td>Current/checking account</td>
<td>596</td>
<td>149</td>
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<tr>
<td>Deposits</td>
<td>216</td>
<td>54</td>
</tr>
</tbody>
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<table>
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<tr>
<th>Fee-based businesses</th>
<th>Balance-sheet provision</th>
<th>Origination/sales</th>
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<tbody>
<tr>
<td>Investment banking²</td>
<td>120</td>
<td>162</td>
</tr>
<tr>
<td>Transactions/payments³</td>
<td>216</td>
<td>620</td>
</tr>
<tr>
<td>Asset management and insurance⁴</td>
<td>216</td>
<td>605</td>
</tr>
</tbody>
</table>

| Total revenues | 2,085 (53%) | 1,871 (47%) |
| Total after-tax profits | 404 (35%) | 748 (65%) |
| ROE             | 4.4%        | 20%            |

Credit disintermediation

Customer disintermediation

1 Loans to retail and corporate clients (overdrafts, specialized finance, credit card, trade loans)
2 Corporate finance, capital markets, securities services
3 Retail and wholesale payment transactions, incl. Cross border payments and remittances sold insurance only
4 Asset management includes investment and pension products. Insurance includes bank-sold insurance only

Future profitability is limited, and an unmitigated digital disruption can further reduce it to half

**Return on Equity, Global**

Return on Equity, Global Percent

1. Unmitigated margin disruption defined bottom up by product, total impact ~11.6%  
SOURCE: SNL; McKinsey Panorama, Global Banking Pools

"New reality"-steady state  
Unmitigated digital disruption"
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A roadmap for financial institutions
As industry barriers blur, we see a new integrated network economy emerging

Traditionally, customer needs have been served by dozens of parallel value chains

... however, technology and customer trends create a shift in these chains ...

... and increasingly, value chains are collapsing into 1 chain around each key customer need

SOURCE: McKinsey analysis
We estimate it will grow to ~$60 trillion by 2025 and coalesce around 12 ecosystems

2025 total sales estimates, $ trillions

1 Estimations based on corporate sales data, GDP industry breakdowns and expert assumptions. Circle sizes show approximate revenue pool sizes, smallest circle meaning less than $100 billion in revenues. Not all industries and subcategories are shown.

SOURCE: McKinsey analysis; IHS World Industry Service
First-wave ecosystem moves are already building up with a very large momentum in China.

**Baidu Music**: Monthly users 150+ million

**Ping An**: Has reached 250+ million customers

**WeChat**: Social and mobile wallet app with 750+ million monthly active users

**WeBank**: Total loan credit line for SMEs: $300+ million

**Ant Micro Loans**: SME loans $12+ billion

**Alipay**: Number of registered accounts 800+ million

**WeBank**: Total loan credit line for SMEs: $300+ million

**Baidu Music**: Monthly users 150+ million

**Ping An**: Has reached 250+ million customers

**Alipay**: 800+ million number of registered accounts

SOURCE: McKinsey Panorama
The second wave of the ecosystem development provides leapfrogging opportunities for financial institutions.

**Ecosystems Overview**

<table>
<thead>
<tr>
<th>Scope</th>
<th>Ecosystem 1.0</th>
<th>Ecosystem 2.0</th>
<th>Ecosystem 3.0</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mainly marketplace</td>
<td>All digital products and services</td>
<td>Total economy</td>
<td></td>
</tr>
<tr>
<td>Access</td>
<td>Smartphone</td>
<td>Multi device</td>
<td>Personal Area Network</td>
</tr>
<tr>
<td>Inter-face</td>
<td>Apps/Web</td>
<td>Bots/AI L1</td>
<td>Superbots/AI L2-3</td>
</tr>
<tr>
<td>Clients</td>
<td>Human</td>
<td>M2M &amp; Human</td>
<td>Machine-Human integration</td>
</tr>
<tr>
<td>Speed</td>
<td>Fast reactive</td>
<td>Proactive</td>
<td>Precognitive</td>
</tr>
<tr>
<td>Customer experience</td>
<td>Great, simple</td>
<td>Exceptional, community</td>
<td>Immersive, invisible</td>
</tr>
</tbody>
</table>

**Leapfrog Opportunity**

- **Scope**: From mainly marketplace to all digital products and services, then to the total economy.
- **Access**: From smartphone to multi-device, then to personal area network.
- **Inter-face**: From apps/web to bots/ai l1, then to superbots/ai l2-3.
- **Clients**: From human to m2m & human, then to machine-human integration.
- **Speed**: From fast reactive to proactive, then to precognitive.
- **Customer Experience**: From great, simple to exceptional, community, then to immersive, invisible.
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For banks, going “beyond banking” to play in ecosystems means integrating and broadening offerings around customer journeys.

**From ...**

- Focus on customer’s **secondary financial needs** (e.g., a mortgage loan)
- Different set of products and services requiring **separate processes and channels** to access
- Focus mainly on **banking and financial products**
- **Siloed and often repeated data** in various formats, even across departments and branches
- Tendency to own/build everything in-house; **closed system with limited or no access to outsiders**

**... To**

- Deep understanding of **end-to-end customer intrinsic needs** within any particular journey (e.g., buying a home, from searching to moving in)
- **Integrated products and services** centered around customer journeys in different industries (e.g., one-stop platform for multiple services via social-media)
- Broader offering extending into **adjacent, non-banking areas** (e.g., B2C marketplace in order to create demand and data pool for SME loans)
- **Comprehensive centralized data lake**, comprising both internal and 3rd party data
- Partnerships across the value chain to optimize customer experience, with **open and transparent architecture** that facilitates information sharing

**Financial institutions can leverage three distinctive and unique assets**

1. Trust
2. Data
3. Compliance to regulation

**SOURCE:** Press search; McKinsey analysis
Banks can choose their role within the ecosystem economy to partner, connect or build.

**Partner**
Strategically partner with 3rd party at-scale ecosystem players to drive core business revenue.

**Connect**
Build platform to connect 3rd party services across sectors to create new revenue stream from platform business.

**Build**
Create/acquire new service providers across sectors to establish platform beyond core banking business.

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**Low complexity**
- orange
- GrabTaxi
- mBank
- SCB
- Orange (telco) + mBank (bank) = Orange Finance
- Taxi companies + Siam Commercial = SCB Prompt Pay

**High complexity**
- Di Di Mobility
- Wechat
- Foodpanda Dining
- Airbnb
- China Southern Airlines
- Travel

**Ping An**
- Ping An Housing
- Ping An Bank
- Ping An Insurance

SOURCE: McKinsey analysis
Example: Ping An created one single account as entry point for all services within its ecosystem…

**PING An 3.0 – open platform, open marketplace**

- **60 million users**
- **150,000 doctors**

**Cornerstones of the Ping An approach**

- Strong control of the brand
- Large operational and business independence for individual businesses (including, IT, HR)
- Continuous experimentation, willingness to rapidly change direction
- Leverage of the offline channel (~1 million agents) to build online scale
- Data collection from inside and outside of ecosystem (e.g., WiFi, social security)
- No bets on one single platform
... and leverages a 3-layer approach to acquire, convert, and retain users

3-layer approach for digital business

Game changing platforms for acquisition of digital users

Build consistent traffic & large user base via multiple platforms that tap in to everyday life

Conversion of users to transact

Low barrier, open platforms of bridging products (e.g., digital wallet, SNS payment)

Retention & cross-sell

Create pull for Ping An offerings via distinctive user experience and clear benefits

240+ million total internet users

~110 million mobile users

~110 million financial users (including 30 million App users)

Key platforms

Health

Auto

Housing

Finance

Personal TOA\(^1\)  
Bank TOA\(^1\)  
Financial TOA\(^1\)

\(^1\) The One Account - PingAn’s platform that integrates users’ financial accounts, life services and related information in one place  
SOURCE: McKinsey analysis
Banks wishing to succeed in an ecosystem world should unlock four key enablers: organization, talent, partnership, and data.

**Organization**
- Organize as a platform company with incubator at scale
  - Org: create decentralized “micro-enterprise”; create informal knowledge network
  - Governance: adopt more “venture investment” mindset

**Talent**
- Recruit and reward talent with strong IT/data capabilities and entrepreneurial mindset
  - New talent pool: recruit sufficient IT and data talents
  - Create culture that encourages transparency and entrepreneurship

**Partnership**
- Form partnerships across ecosystems to enable the share of economics
  - Establish broad partnerships with digital players to acquire specific resources
  - Manage partnership forms rigorously and regularly across ecosystems

**Data**
- Establish data mastery to increase scalability and flexibility
  - Introduce service oriented API architecture and cloud-based infrastructure
  - Build analytics capabilities

SOURCE: McKinsey analysis
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