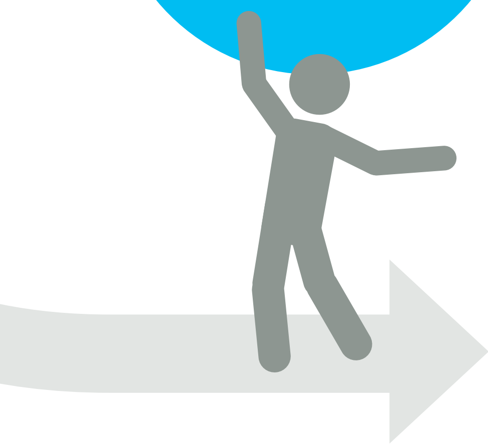
Rising to the challenge

How challenger banks are breaking through in 2016

07 Op Opinium

What people think, feel and do.

Executive summary



This report is for anyone working in the world of retail banking and covers the issues and opportunities facing the challenger banks and their tactics.

Banks and building societies have been under intense scrutiny in recent years particularly in the Personal Current Account (PCA) market with the regulators determined to achieve a better functioning, more efficient and competitive landscape. The regulators’ success, combined with a host of other factors we explore in this report, has meant that it’s an incredible time to be a challenger brand. New entrants such as Metro Bank, Britain’s first new High Street bank in over 100 years and other brands such as Aldermore, Charter Savings Bank, Atom Bank, Virgin Money and Clydesdale have been making waves, and have you heard of Tandem Bank and Mondo yet?

For the purposes of our report, all apart from the ‘big four’ banks enjoying huge market share (Barclays, HSBC, Lloyds Banking Group and RBS), are described as ‘challenger banks’.

Our insight reveals that consumers are cheering for the challengers, and while the progress of the challengers is being impeded by barriers to entry of high entry costs, low switching levels and lack of transparency, there is growing appetite from consumers to see the status quo challenged.

For a challenger offering really competitive products there is a significant advantage: the proliferation of ‘best buy’ tables in newspapers and price comparison websites makes consumer exposure easy to harness. Our brand equity data for twelve banks and building societies supports this sentiment, painting an interesting picture. You might expect the Big 4 to take the top spots, but we reveal the ‘new Big 4’ in terms of the strength of their brand equity.

And finally, while it can be a slow process building up brand equity and meaningful market share, and this is especially the case in the current account market with its historically low switching levels and barriers to entry, we explore tactics some are successfully using to make an impact and attract a significant number of customers.

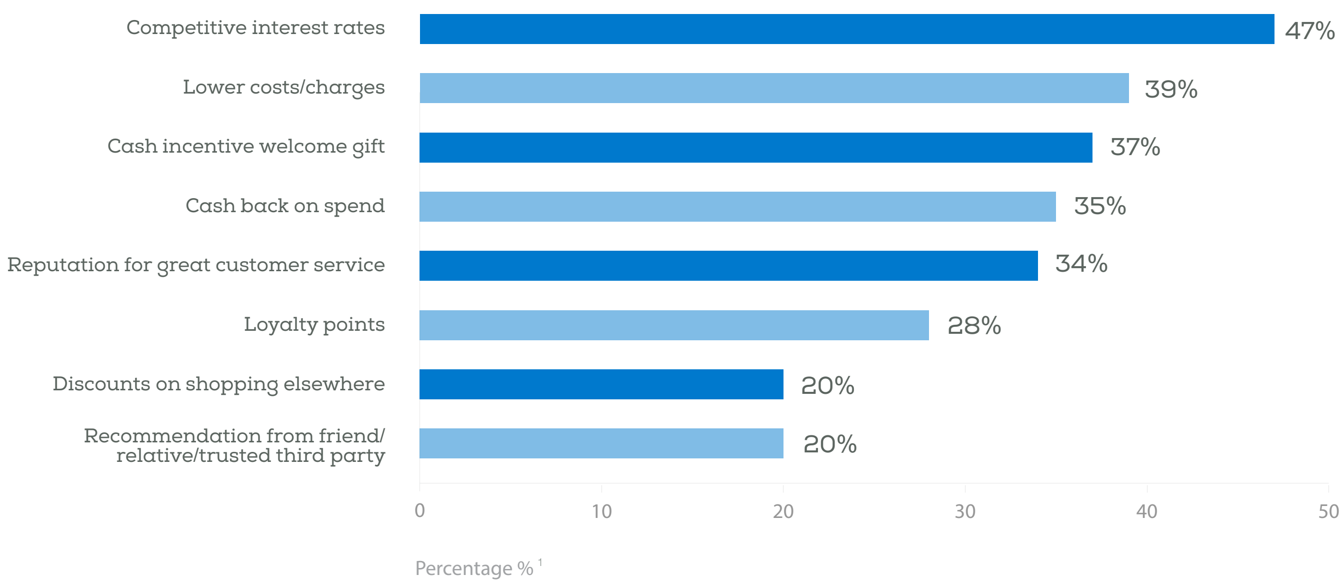
What do consumers think?

We love a challenge: and the great news is consumers want the challengers to transform the market

Awareness of the smaller challenges is understandably low (with many significantly below 10%) and one of the biggest barriers to consumers using a challenger bank is the lack of prominence in the market.

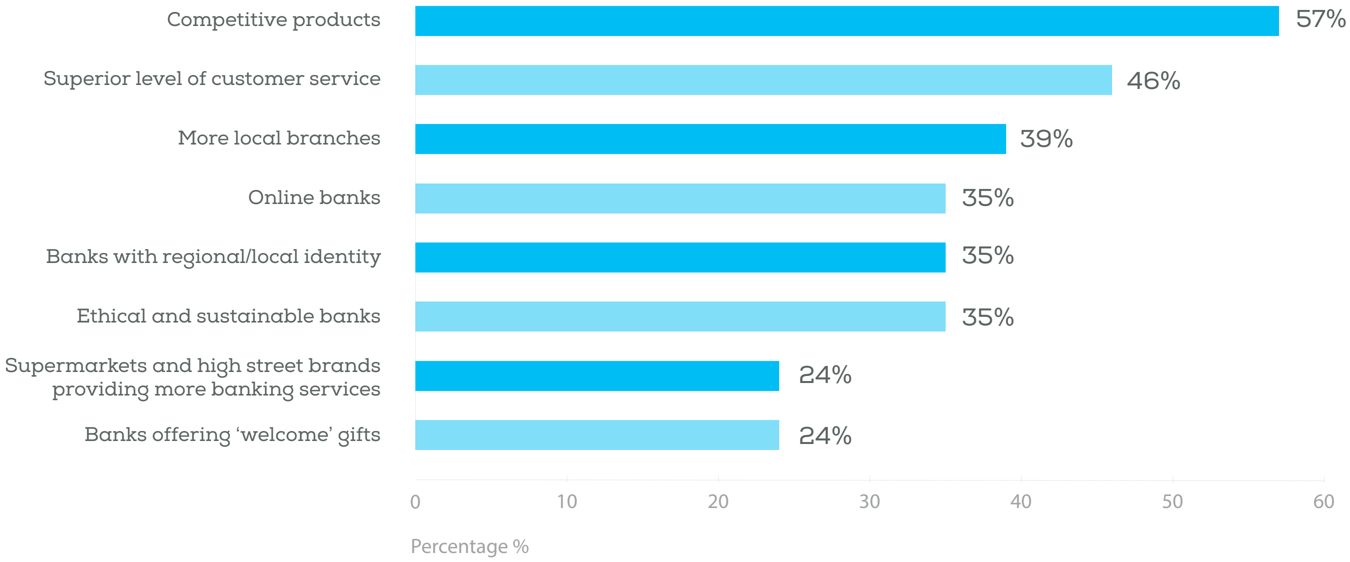
However despite this, whilst consumers do cite some concerns about using challengers, the majority do see the attraction. Ninety percent would consider having a financial product with a challenger and 82% of consumers think that greater competition from challengers should be encouraged.

Competitive interest rates, lower charges and cash incentives are the biggest attractions for considering a challenger bank.

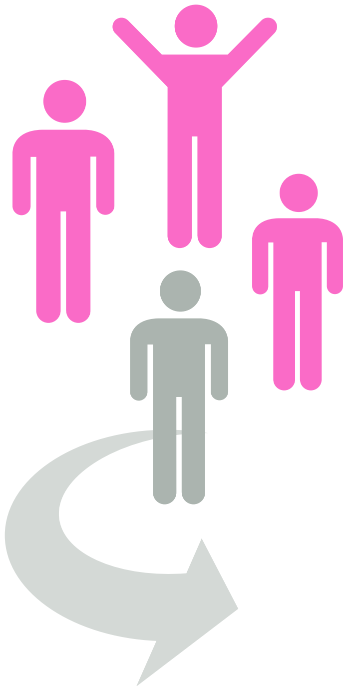


[1] Opinium conducted an online survey of 2,002 consumers (1,985 of whom had a current account) aged 18+ on 6th to 9th October 2015.

There are also encouraging signs for challengers to differentiate themselves from the mainstream banks. When asked what consumers would like to see from challengers, competitive products, better customer service and a more personable feel were all cited.



Encouraging the switch



Inertia with current accounts is undoubtedly high, but that's not to say that challengers can't win over customers.

Three out of four (78%) consumers have had their main current account for longer than 5 years and very nearly half (49%) of those aged 55+ have had their main account for longer than 25 years.

Analysing the data of those who have held their main current account for ten years or longer, such 'longevity loyalty' is highest among customers of Royal Bank of Scotland (81%), HSBC (70%), Lloyds Bank (69%) and NatWest (69%). This compares to an average of 63% for banks as a whole and it illustrates why gaining current account market share for challengers is such an arduous and difficult process.

However, some banks and building societies are getting it right by listening closely to what customers really want.

Santander is a prime example. It has gained significant customer numbers with its 123 Current Account and 37% of customers according to our survey have opened their account within the last five years.

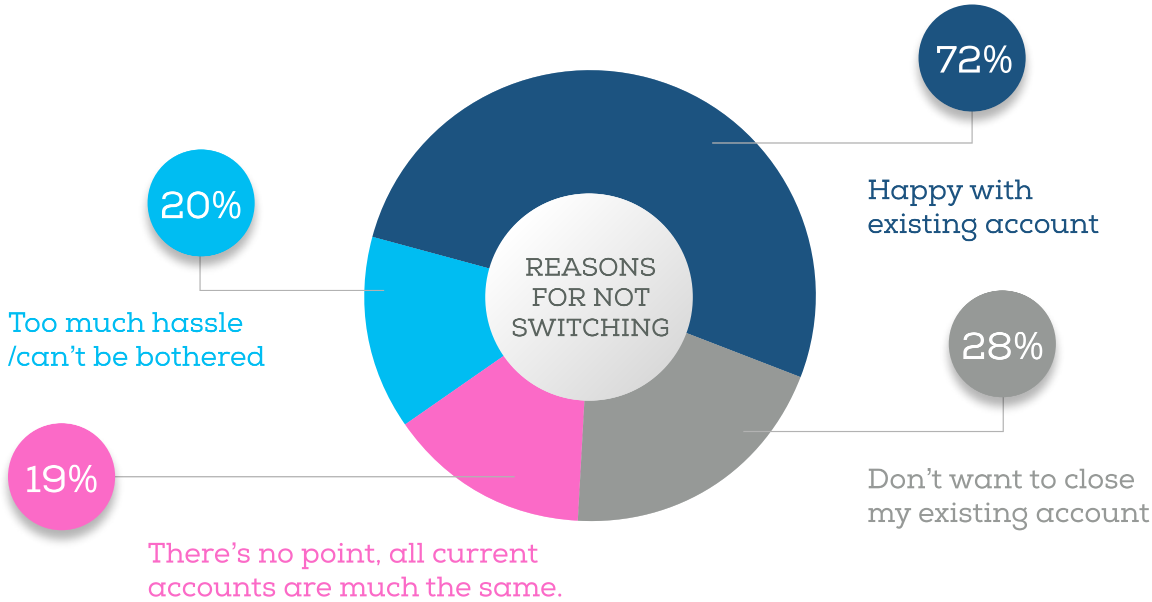
Looking at the market overall, although only 12% have actually switched their current account in the last two years, a further one-in-five (21%) have thought about doing so without actually switching.

And over the next twelve months, there is certainly a potential to win current account customers, with 49% saying they might consider switching.

Getting them over the line.

Half of us would not consider switching and clearly inertia and loyalty are the major sticking points as our data below indicates.

For the one-in-two (50%) that stated they won't consider switching the main reason(s) given were:



The one really interesting reason for not switching, and one where some providers are creating opportunities for themselves, comes from the 28% of people who won't switch because they don't want to close their existing account.

As part of the process of using the Current Account Switching Service (CASS) the consumer's existing current account will unfortunately need to be closed, and it's quite understandable, given that providers don't want to be lumbered with servicing someone's secondary little used current account. However this does mean that those consumers who do wish to retain their existing account, will need to go through the inconvenient do-it-your-self process, therefore reducing the likelihood of them switching in the first place.

However, some providers, such as First Direct, are successfully finding a way around this and attracting customers by offering generous account opening incentives to those who do use the CASS process.

Given that cash incentives are the third most popular reason for considering a challenger in the first place, this is certainly something the rest of the market needs to pay attention to.

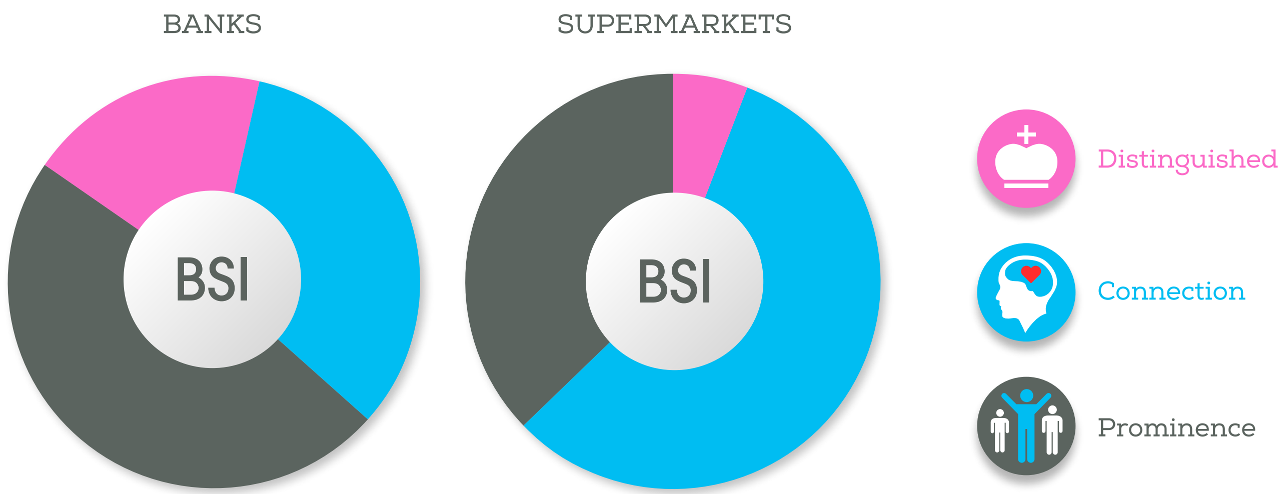
Evidence of a breakthrough

Growing brand equity: a mountain to climb for challengers, but encouraging signs, at least

Our brand equity data shows that despite the challenges, a few banks and building societies are making an impact in the minds of consumers.

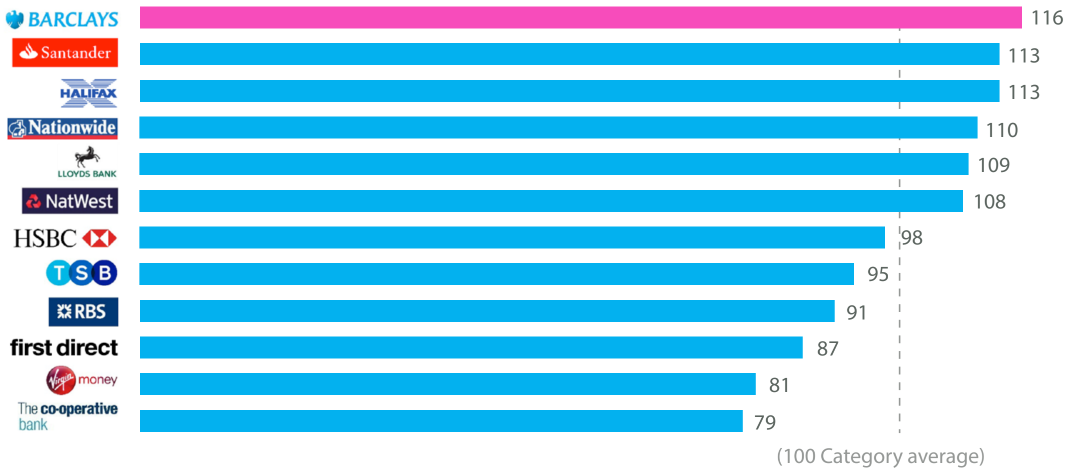
What does ‘brand equity’ mean? A brand can encourage you to pay more for something or buy it more often than another similar service or product… It can also persuade you to remain fiercely loyal or switch. The concept of brand equity is often viewed as being intangible, however the Opinium Brand Strength Index (BSI) makes the intangible become tangible. Brands with a higher overall BSI are more likely to be successful and our model unpicks the three key elements linked with this success as being ‘prominent’ in consumers’ minds, standing out from the crowd by being ‘distinguished’ and the ability to make an ‘emotional connection’. Using our BSI we are able to paint an accurate reflection as to how consumers view the market place, why certain brands have a higher brand equity and most importantly, if monitored over time, how brands can improve their brand equity to scoop up market share.

Understanding specific category drivers is also crucial. This is why our analysis is tailored to each category; you can see from the graphic below that *prominence & connection* are the most important two metrics for Banks. However, *distinguished* plays a much more important role in banking than in the supermarket category.



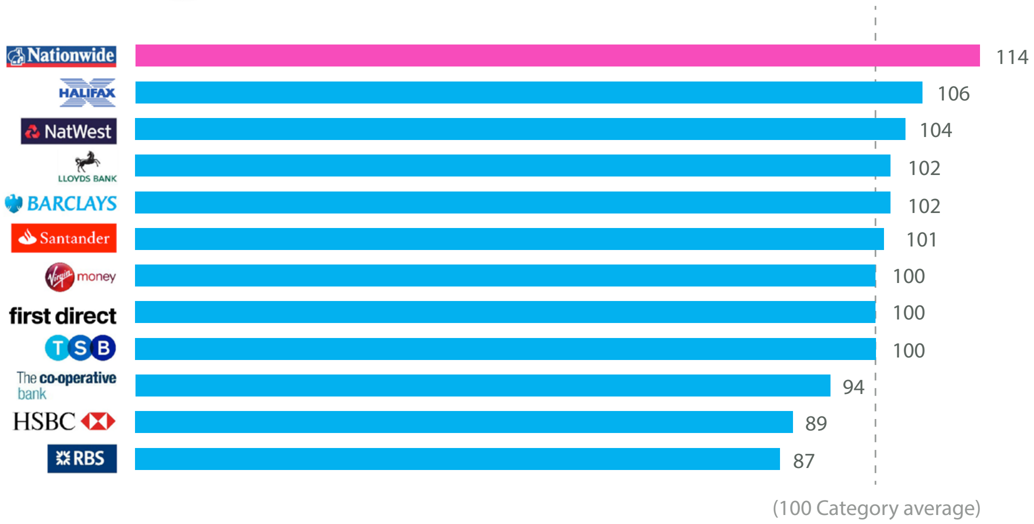
Our latest overall BSI data (below) for twelve banks and building societies with current accounts paints an interesting picture. You might expect the Big 4 to take the top four spots, but the 'new Big 4' in terms of the strength of their brand equity are Barclays, Santander, Halifax and Nationwide. This represents a significant achievement for the likes of Santander and Nationwide. There are encouraging signs for building societies and evidence that that the Big 4's market share could potentially be targeted if the brand equity barrier can be breached.

Overall Brand Strength Index

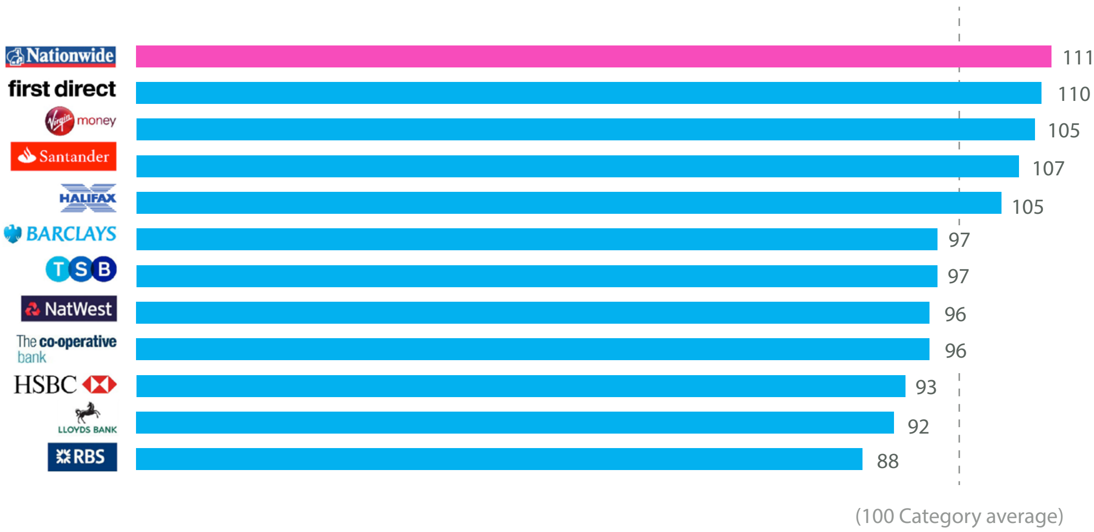


When we strip out the three individual elements that make up our brand strength index, we start to understand the components that contribute to strong levels of brand equity. While 'prominence' shakes things up slightly, it's when we isolate 'connection' and 'distinguished' that we really see where the big players start to slide and where the smaller and often more personable entity's strengths lie.

Connection index

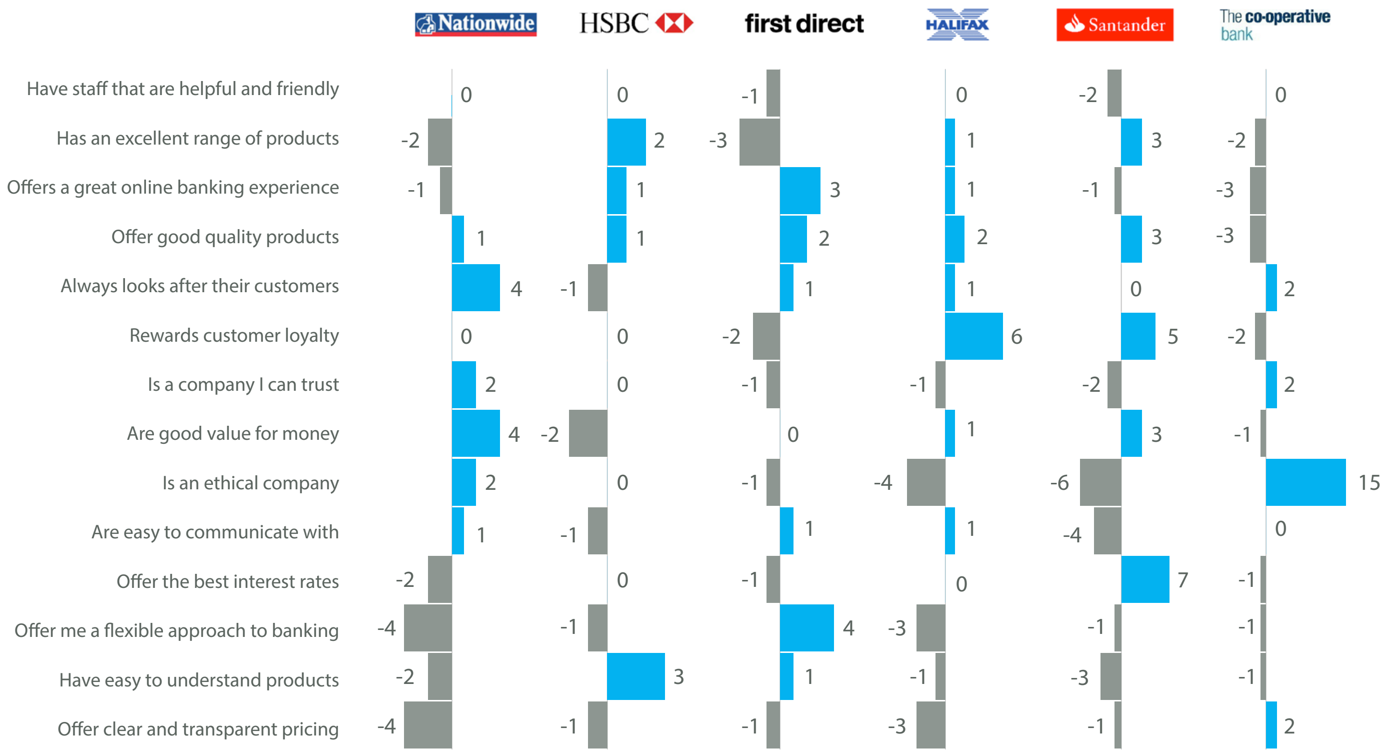


Distinguished index



Clues and evidence as to what resonates with consumers and drives brand equity for current account providers can be seen below.

Brand perceptions (-/+)



We can see why Halifax does well on *Connection* as it is known for rewarding customer loyalty as is Santander which is known for great rates. This data also shines some light on HSBC's poor performance as we can see consumers are struggling to say what the brand stands for, which in turn will feed into a stance of "why should I bank with them". First Direct is a good example of a challenger bank doing things a bit differently and managing to establish this point of difference with consumers in terms of "offering a flexible approach" & "great online experience".

So although taking on the Big 4 may seem like a daunting task for the challenger banks from a brand equity perspective, the data shows that it is more than possible to land with consumers and for them to understand your proposition.

It can be a slow process building up brand equity and meaningful market share and this is especially the case in the current account market with its historically low switching levels and barriers to entry. But what tactics are used to make an impact and attract significant numbers of customers?

1. Price.

Offering more competitively priced products than competitors garners significant publicity in the numerous best buy tables, editorial mentions and internet forums. Santander's 123 Current Account pays 3% gross interest of balances up to £20,000 (if minimum £3,000 credit balance) and pays cashback on certain household spend paid by direct debit. It has been one of the main beneficiaries of account switching although it has recently increased its monthly fee from £2 to £5 in January. Virgin Money sometimes top the best buy tables with the longest available 0% introductory rate on balance transfers.

2. Service.

Pushing the boundaries and surpassing the established service offerings. Metro Bank's branches are open 7 days a week and for long hours (8am until 8pm on Mondays to Fridays; 8am until 6pm on Saturdays and 11am until 5pm on Sundays and Bank holidays); it will also supply debit/credit cards in store within minutes and will give biscuits to dogs.

3. Niche.

Concentrate on specific product areas or on specific customer segments. Triodos Bank provides finance to organisations involved in organic food and farming, renewable energy, recycling and nature conservation. Unity Trust Bank's target market is organisations and businesses that aim to create community, social or environmental benefit in a financially sustainable way. Wesleyan Bank provides financial advice and products to specific professional groups such as GPs, hospital doctors, dentists, teachers and lawyers.

4. Flexibility in decision making.

Typically larger banks make underwriting decisions by adhering to rigid guidelines and this may mean that, for example, a seemingly creditworthy and viable mortgage applicant is turned down. Human underwriting or local decision making can provide more flexibility. Aldermore uses human underwriting to take considered mortgage lending decisions on prime customers who may fall outside the automated decision making processes used by many lenders. Handelsbanken operates a decentralised approach which empowers their branches to make decisions based on local knowledge.

5. Technology.

The financial services industry is making constant leaps in technology usage and service. Sometimes starting with a clean sheet is an advantage as it removes any legacy issues. Atom Bank, which was granted a banking licence earlier this year, will operate through an app on smartphones. It won't have any branches.

6. Regional.

Concentrating on specific areas can achieve the benefit of a local identity to attract and retain customers. While there are numerous examples of local identity among the Building Societies, the National Australia Bank's duo of Clydesdale Bank and Yorkshire Bank are clear examples of banks having a local identity. This is backed up by the findings of the Opinium consumer survey: 91% of Scottish residents are aware of Clydesdale Bank compared to its 58% awareness amongst the UK population as a whole. Yorkshire Bank has 90% awareness from Yorkshire and Humberside residents compared to 68% of the general population.

7. Take over existing customers.

Customers can be obtained by buying or taking over existing banks or specific parts or books. Lloyds Banking Group divested TSB in September 2013. While the split was enforced by the European Commission as part of its state-aid redress rules, it made TSB the eighth largest bank in terms of branch network. It instantly had 631 branches, over 4.6 million customers and a 4.3% market share of current accounts. Similarly, Williams & Glyn will be launched with the branches and customers of the RBS branches in England and Wales as well as the Scottish branches of NatWest. This divestment is also required by the European Commission and at launch Williams & Glyn is likely to have 314 branches, about 1.4 million retail customers and about 200,000 business customers. It is due to be launched in 2016.

8. Distribution.

The 'Big 4' and many of the challengers have the expense of established branch networks. New entrants have the choice of distribution methods and can choose whether or not to have branches, whether or not to distribute solely through intermediaries, whether or not to have a call centre, whether or not to be internet only or app only or combinations thereof. They can also choose whether to offer products directly to the public. Atom Bank doesn't have any branches. Shawbrook Bank will accept savings directly from individuals but only offers commercial mortgages through intermediaries.

9. 'Clean' reputation.

Newly launched banks appear with a clean sheet and aren't tarnished by the established banks' reputational issues of recent years.

10. Retailer banks.

Supermarket banks potentially hold a huge advantage as they can easily get in front of the mass market through the regular contact that their parent has with grocery shoppers be it in branch, online or through loyalty schemes. M&S Bank, Sainsbury's Bank and Tesco Bank all offer banking products with M&S and Tesco also offering current accounts. Asda Money offers a credit card which is issued by Creation Financial Services Limited.

11. Monoline providers.

Concentrating on a single product line such as credit cards, mortgages or savings gives the chance to offer table topping products or ultra-specialism. Additionally, it also opens the door to white labelled affiliate products. Capital One Bank and MBNA offer credit cards. Charter Savings Bank and RCI Bank offer savings accounts.

Final thoughts

With over 80% of consumers crying out for more competition in the sector, there are some encouraging signs with a host of established challengers making impressive strides against the traditional Big 4 and a solid stream of bright new entrants challenging the status quo and using a number of tactics to grow their market share.

Of course none of this means anything if switching levels remain as low as they have been. Consumers are seeking change, however treading carefully. Improving brand equity and moving up to the very top of a consumers choice set is a slow and tricky process to get right but it can be done as Santander have proved. Although clearly aided by massive media budgets, communicating a compelling offer and genuinely rewarding customer loyalty has proved a hit. And encouragingly for the challengers, signs that the Big 4 have perhaps rested on their laurels with HSBC struggling to differentiate or connect with consumers, perhaps opening the door to someone to share.

For challenger banks looking to gain traction in the market, there are some exciting opportunities ahead. The Government has made impressive strides recently to help open up competition in the sector and it needs to continue to help reduce the barriers to entry whilst ensuring the same high standards that have made British banking one of the most vibrant in the world.

About the authors

David Black //

David has over 28 years' experience in research, analysis and consultancy in the financial services industry and is a frequent media commentator. He has authored reports on a wide range of different market and product areas and takes pride in viewing the industry and its offerings from a consumer perspective.

Alexa Nightingale //

Alexa heads up the financial services division at Opinium and has extensive experience working in market and consumer research delivering insight across consumer and business audiences for challengers through to iconic global brands. Alexa's experience comes from across the financial services categories dealing with many facets of marketing information such as: communication evaluation, concept testing, brand planning & strategy development, and customer satisfaction.

Steve Looney //

Steve has over 15 years' of experience working in market and consumer research, specialising in brand equity evaluation, delivering insights for clients from small start-ups through to global iconic brands. Most recently Steve has turned his attentions to the financial sector providing strategic direction for business insurance, retirement planning, and investment brands.

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About Opinium

Opinium is an award winning strategic insight agency built on the belief that in a world of uncertainty and complexity, success depends on the ability to stay on the pulse of what people think, feel and do. Creative and inquisitive, we are passionate about empowering our clients to make the decisions that matter. We work with organisations to define and resolve commercial issues, helping them to get to grips with the world in which their brands operate, by ensuring we develop the right approach and methodology to deliver robust insight, targeted recommendations, and address specific business challenges.

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