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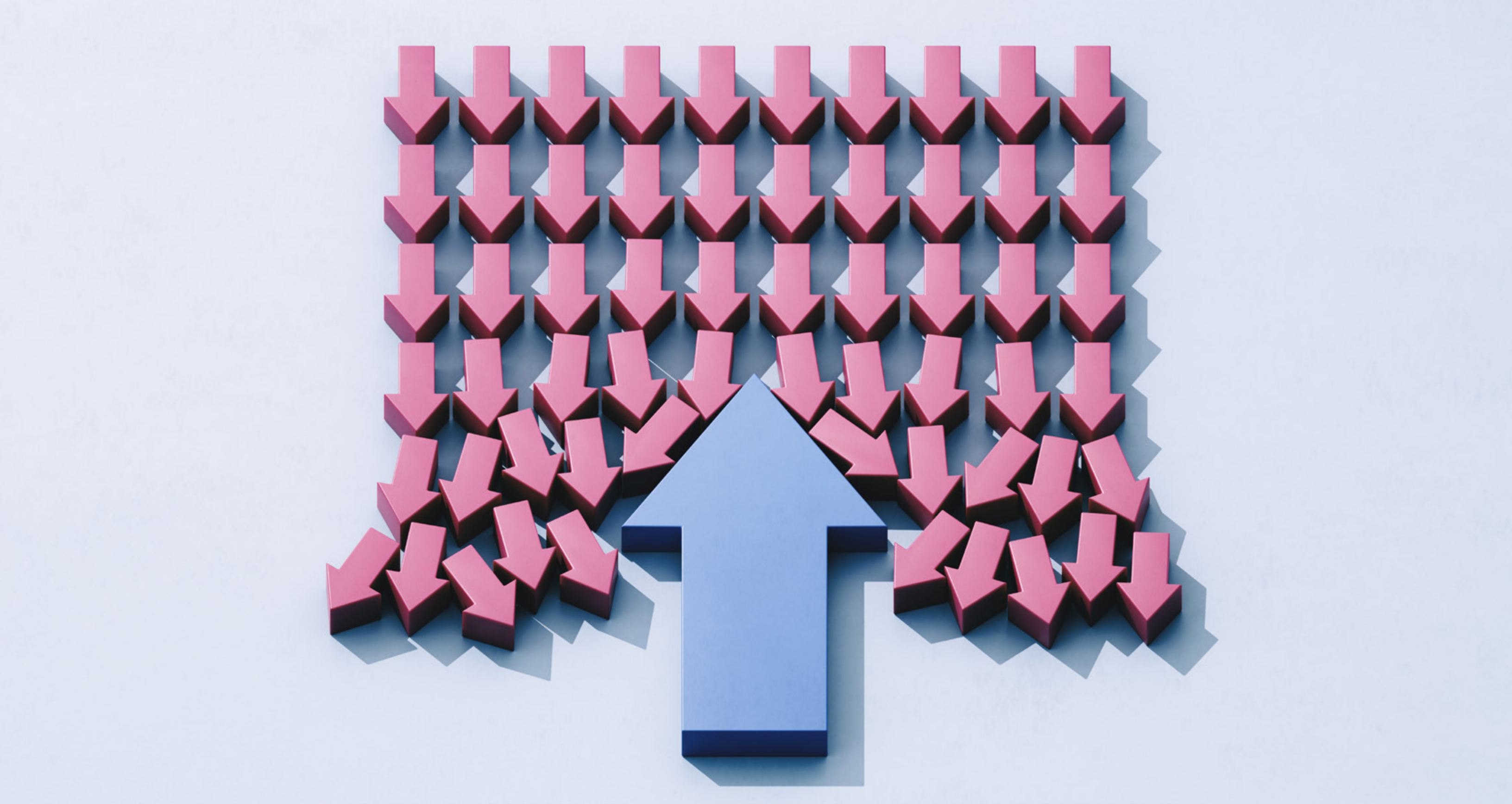
Financial Services Practice

# Disrupting the disruptors: Business building for banks

Although banks face intense pressure from new entrants in financial services, they have an edge in resources they can use to rapidly launch their own digital businesses.

*by Rohit Bhapkar, Ido Segev, Chris Smith, and Zac Townsend*





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**Today's economic** and competitive challenges are making the status quo untenable for the banking industry. The macroeconomic slump associated with the COVID-19 pandemic continues to pressure the industry's bottom line, with little expectation of a turnaround anytime soon. The competitive landscape, meanwhile, is becoming more challenging as digital technology lowers barriers to entry. With fintechs attracting millions of new customers, incumbents face a need for bold action that is becoming more urgent by the day.

A potential way forward for banks is to disrupt the disruptors. Large banks have the capital, resources, and expertise to turn the tables on new entrants and launch digital attackers of their own in consumer banking, wealth management, payments, and a range of specialist services. Some banks have already taken up the challenge and shown it can work (see sidebar "Early wins show the potential of business building").

## Business building as competitive advantage

Banks that prioritize business building tend to outperform their peers (Exhibit 1). According to a recent McKinsey survey, 65 percent of financial-services businesses that made business building a top-five priority saw revenue growth above that of their competitors.[1] Indeed, over a seven-year period, organizations that launched four or more businesses

## Early wins show the potential of business building

### Marcus by Goldman Sachs

*Objective:* Goldman Sachs decided to use its legal bank entity to create a retail bank aimed at Main Street users. By offering savings and lending services to retail consumers, Marcus helps Goldman Sachs diversify its revenue and funding sources.

*Segment focus:* Digital mass-affluent

*Strategic rationale:* With no existing retailing offering, Goldman Sachs was able to build a completely digital bank with new tech infrastructure while leveraging its regulatory experience, tech capabilities, and brand.

*Results:* Over five million customers and $1.2 billion revenue in 2020

### YONO by State Bank of India

*Objective:* State Bank of India (SBI) launched YONO—a mobile banking application—with the idea that customers would need only one application to do all their transactions: banking, shopping, lifestyle, and investment.

*Segment focus:* Full SBI customer base, with focus on convenience

*Strategic rationale:* YONO was part of SBI's digital transformation and its effort to create a platform for customer ownership.

*Results:* Over 30 million users and 100 e-commerce partners

### digibank, powered by DBS Bank India

*Objective:* With few consumers in India before the launch, DBS had the opportunity to become the first digital bank in a country where mobile penetration was high but access to banking services was limited.

*Segment focus:* Mass consumer

*Strategic rationale:* DBS built a fully digital platform that significantly reduced its cost to serve and could be deployed in multiple regions.

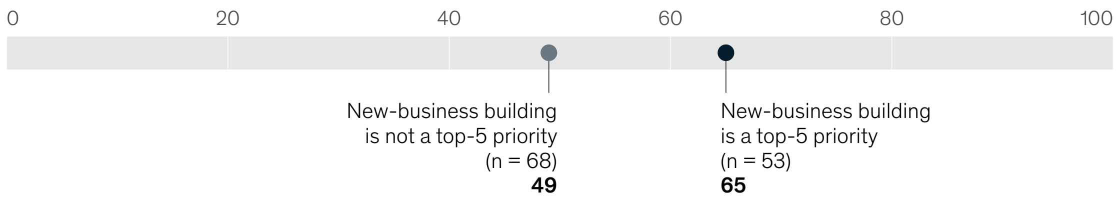
*Results:* 3.5 million digital-banking customers

[1] See also Shaun Collins, Ralf Dreischmeier, Ari Libarikian, and Upasana Unni, "Why business building is the new priority for growth," *McKinsey Quarterly*, December 10, 2020, McKinsey.com.

Exhibit 1

## A majority of financial-services companies that prioritized new-business building grew above market rates.

**Financial-services companies with revenue growth above market rate, by strategic priority, 2017–19,[1] %**




[1]Question: From 2017 to 2019, how did your organization's rate of revenue growth compare with that of its primary competitors?
Source: McKinsey Global Survey on business building, August 2020

were more than twice as likely as businesses that launched three or fewer to see an average return of more than five times.[2]

Companies that develop business-building "muscle"—and are thus more likely to outperform the market—proceed on the idea that change, whether intended or not, catalyzes value creation. Over the coming decade, that presumption may play to their favor. Amid prolific digital innovation and the pandemic's impact on consumer behaviors, change is accelerating. Disruptors may not have developed their business models with the idea of a lockdown in mind, but they are ideally positioned to serve customers whose behaviors are changing as a result of the pandemic.

## New-business building may be the best way to grow

Low interest rates, the impacts of customer derisking, tougher banking regulation in many countries, and other headwinds are forcing banks to rethink their long-term trajectories. If business expansion is a priority, the main options are large-scale M&A, digital transformation of the core business, bolt-on deals, or new-business building. All have pros and cons. Large-scale M&A offers speedy access to new markets, products, and technology but often comes with a hefty price tag and the perennial challenge of integration. Bolt-on deals are easier to handle but rarely have as much potential to change the game.

Of the four options, building a new digital business is increasingly seen as an effective way to grow, because of proof points in the market and the ability to launch digital businesses more easily than ever before. Through a stand-alone vehicle, banks can extend their product offerings, engage new customers, attract deposits, and create opportunities for talent identification and development that might get overlooked in an established organization. These benefits should enable the new business to pursue growth opportunities faster than the incumbent. Indeed, the new business should benefit from the parent's talent, funds, market insight, intellectual property, data, and other assets—all deployed in an environment designed to jump-start growth. We've already seen a variety of offerings globally, such as the following:

— "neo-banks" with integrated digital offerings for banking, private wealth management, and beyond—some focused on mass-market segments and others on private wealth offerings

[2] McKinsey Global Survey on business building, August 2020.

— vertical offerings in healthcare, housing, mobility, or e-commerce with seamless payments enablement and embedded lending

— white-label or cobranded point-of-sale or “buy now, pay later” offerings

— a digital-first merchant-acquiring business for medium-size enterprises that have too much scale for fintechs

— an ecosystem serving small and medium-size businesses with a bank account linked to services including accounting, invoicing, and bill payments provided through a one-stop shop

— digital-asset or crypto-payments networks or exchanges

— cross-bank utilities or other shared digital infrastructure (for example, a know-your-customer utility)

— a white-label banking-as-a-service API platform to enable embedded finance for large corporations

To get off to a flying start, banks need to get the pricing and offering right, develop a distinctive value proposition, monetize quickly, focus on customer acquisition, manage costs, and apply the right talent and operating models. Alongside those fundamentals, an important differentiator between new businesses that generate early momentum and those that struggle is the ability to leverage the strengths of an incumbent in a start-up environment. Balancing incumbency and innovation may not sound complicated, but more companies get it wrong—by measures such as shared culture, talent, and resources—than succeed.

## Why banks should act now

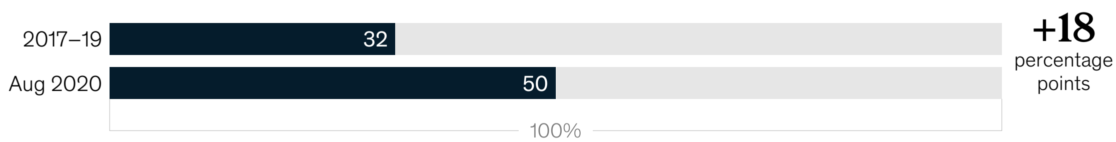
Even before the pandemic, digital business models were in the ascendance, with banks and their digital challengers creating new customer interfaces, streamlining customer journeys, and modernizing middle and back offices. Indeed, in many segments, banks are starting to look more like their tech cousins, which are making waves of their own in financial services, particularly in Asia. And according to our recent survey, half of all financial-services companies currently rank business building as a top-three priority, an 18-percentage-point increase compared with a similar survey conducted two years ago (Exhibit 2).

As customer demands and behaviors shift, five key benefits that some companies already recognize are

Exhibit 2

**Half of all financial-services companies report business building as being a current top-three priority.**

**Financial-services companies with new-business building as a top-three strategic priority or higher,**[1] %




[1]Question: From 2017 to 2019, how important was building new businesses compared with other strategic priorities at your organization? How important is it currently? Excludes responses for “Don’t know” and is scaled to 100%. Includes responses “A top three priority” and “The top priority”; n = 130.
Source: McKinsey Global Survey on business building, August 2020

adding motivation and urgency to bank business-building aspirations:

1. *Combat fintech competition.* The need to act now is intensified by the success of fintechs. Approximately 40 percent of consumers leverage a fintech platform for daily financial activities, and more than 90 percent of those who do so are satisfied with their experience, McKinsey research shows. This finding holds across general banking, payments, lending, and wealth management. In addition, fintechs now command consumer trust on a par with that of banks. Indeed, many fintechs have become stronger during the crisis, amid the shift to digital-first channels.

2. *Tap into innovation.* Many banks are stuck with clunky legacy data and IT architecture. However, stagnant ROEs call for trimming the cost base, of which IT represents a significant portion. A new business can open the door to lighter-weight, packaged solutions. A greenfield launch would also spark innovation, attract new talent, accelerate time to market, and facilitate automation of processes and use of cloud solutions.

3. *Defend the franchise and grow faster.* In light of the challenges to profitability likely in store for banking,[3] forward-thinking banks are already exploring alternative sources of growth. With an eye on competitors that have launched new businesses, these banks are taking to heart the maxim "If you can't beat them, join them."

4. *Ramp up lending and payments.* Digital technology unlocks opportunities in both lending and payments. Both spaces are seeing transformative change, reflecting shifting customer demand for new products (for example, point-of-sale financing and "buy now, pay later" terms), easy applications, and faster decisions. Increasingly, loans and payments are tied to specific digital journeys, with financial institutions finding opportunities to create value through the customer journey, informed by advanced analytics and personalization.

5. *Access a new source of funding.* For most financial institutions, the cost of capital has risen over recent years, amid higher regulatory and operational costs and lower returns on equity. Banks are thus seeking alternative sources of funding. New digital businesses can be an effective way to raise funds, through new segment offerings such as a small-business proposition or a digital product for lower-income or lower-credit customer segments that have historically been difficult to reach through branches or other legacy channels.

## Successful business builders develop strategies tailored to their strengths

The strategic target of a new build should be nothing less than radical disruption. Banks should aim not only to expand their own core offerings but also to create a unique combination of products and functionality that will disrupt the market.

Successful new launches come with a clear sense of mission and direction, as well as a road map to profitability (see sidebar "Successful business builders are realistic about the journey"). One regional digital attacker in Asia targeted merchant acquiring and developed a network with more than 700,000 merchants. In just four months, it created a product with the capacity to process payments through QR codes at the point-of-sale systems of the two main merchant acquirers in the region and to transfer money between personal accounts. In another case, an incumbent bank launched a state-of-the-art digital solution in

[3] "Global Banking Annual Review 2020: A test of resilience," December 9, 2020, McKinsey.com.

## Successful business builders are realistic about the journey

**Our experience in working** with banks shows that alongside a clear strategy, what banks need for success in launching digital businesses is a set of common experiences related to scope, timeline, and the necessary level of investment. For example, among banks we surveyed, ideation to launch has taken an average of 15 months, and the average number of day-one employees has been 30 (Exhibit).

Exhibit

### Successful business builders share common experiences with scope, timeline, and level of investment.

**Typical digital-bank building process among surveyed financial-services companies**

| 15 | 18 | >$20M | 30 | 55% |
|---|---|---|---|---|
| average number of months from idea to launch | average number of months from launch to breakeven | investment prior to breakeven[1] | average number of employees at launch | share of new business heads sourced from existing business core |

[1]According to 83% of respondents.
Source: McKinsey Global Survey on business building, September 2020

just ten months. In China, a leading global bank launched a digital-hybrid business that focuses on financial planning and uses social media to connect with customers. A midsize Asian bank, meanwhile, launched an ecosystem of services for the digital-savvy mass and mass-affluent segment, aimed at making it easier for customers to manage their financial lives. After 24 months of operations, the bank had achieved 2.5 million Android downloads and 750,000 customers.

Whatever the idea, the strategic common denominator should be a laser-like focus on creating a differentiated proposition that solves problems. This will achieve the vital goal of making life easier for customers, so it is more likely to achieve a durable advantage in the marketplace.

## Key questions for business-building planning

Before embarking on creation of a new business, executive teams must think carefully about their strategic positioning, their operational and market challenges, and the mechanics of building and then managing a new business while maintaining the core. Following are three key topics for consideration (Exhibit 3):

1. *Do we have a clear business proposition?* Is there a strategic rationale for launching the digital bank? What is our competitive advantage? Do we have strengths in areas like innovation, customer segmentation, product and pricing strategy, or customer value proposition?

Exhibit 3

**Leaders should consider issues across three broad areas before building a business.**

**Business proposition**

Strategic rationale for launching the digital bank and degree of innovation

Customer segmentation and unmet-needs assessment (eg, mass, affluent)

Product and pricing strategy (eg, savings, wealth)

Articulation of the differentiated customer value proposition (eg, cost, experience, service)

Extent of incumbent advantage (eg, access to large customer base)

**Distribution**

Partnership strategy (eg, telcos, service industries)

Customer-acquisition strategy (eg, direct web, contact center)

Servicing channel (eg, web only, omnichannel)

Branding and marketing strategy, including go-to-market launch and hooks

**Operating model and tech/digital capabilities**

Tech architecture and vendor/ partnership strategy (eg, build vs buy)

Organization structure, hiring plan, and near-term action plan to mobilize the organization

Regulatory posture (eg, separate charter and governance model between existing assets and the new company)

2. *Is our distribution strategy robust?* What are the options for distribution? Have we considered a partnership strategy in the telco or service industries? How strong are we by measures such as customer acquisition, servicing channels, and branding and marketing?

3. *Can we scale our tech/digital capabilities and adopt a flexible operating model?* What is our tech architecture and vendor or partnership strategy? What are our delivery resources and staffing plan? Have we specified our organizational structure, governance, and hiring or reskilling approach?

The banking industry has been digitizing incrementally for some time now, but only a handful of banks have yet turned digitization into a strategic advantage. Building a new digital business from scratch is a way to accelerate this process. However, to do it right, banks must excel on multiple fronts, combining the strengths of an incumbent with the agility of a start-up. They also need a unique idea, a top-notch team, and a clear path to profitability. None of this is easy. However, banks that make the grade are likely to boost group performance and, potentially, create a star of the future.

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