



# on the horizon

Emerging trends that impact retail financial services

March 10

## What's love got to do with it?

The potential for new banking entrants to use customer service to acquire business

After more than two years of savage criticism by consumers, media, political parties and regulators alike, the British banking industry appears vulnerable to new competition. Major brands from outside the sector - such as Tesco and Virgin - are queuing up with new private equity-backed firms and overseas competitors to look for opportunities in the embattled sector. According to media speculation, most appear to be basing their proposition around better customer service and in some cases a branch-based offer. Given the trend from bricks to clicks and the historically low levels of current-account switching - just how realistic are these assumptions? Has consumer opinion really shifted sufficiently to support these new business models?

## Love at first sight

Some potential providers would be completely new to the UK market. The highest profile of these is Metro Bank, modelled on Commerce Bank in the United States, which has just received its banking



licence from the FSA. Metro Bank's claimed point of differentiation is a superior branch-based service; Commerce Bank in the USA operates longer hours than other banks, with seven-day banking and 'drive-thru' facilities.

Media reports indicate the bank plans to open 12 branches in London within the next two years. Using the FRS and ONS data we estimate that the potential market for Metro Bank is nearly seven million customers - 5.8 million current account holders living in London and a further one million commuters (the ONS estimates that around a fifth of London's 4.6 million workers commute to London from the surrounding areas - ONS, 2005). The FRS finds that London-based current account holders have a lower level of satisfaction than the country as a whole. The question is does this mean they are

more likely to respond to a new offer, or are they just harder to please? Looking at the geographical distribution of current account holders on the FRS, we calculate that Santander and Barclays will feel the greatest competitive threat from the London-based Metro Bank.

Metro Bank's strategy is built around branch-based selling. Vernon Hill, the man behind Commerce Bank as well as Metro Bank, has described the bank's staff as "retailers who happen to sell bank products." This runs counter to the steady move towards remote management we have seen on the FRS in current accounts, credit cards and savings. But, the success Commerce Bank has enjoyed in New York, a city with a similar banking profile to London, suggests this approach may produce results.

## Familiar Faces

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Other providers, while not new to financial services, are looking to expand their offer. Virgin is one such British institution. To date its products have remained fairly niche, with a strategy focussed on partnerships, but it has also been involved in launching innovative and ethical products like the One Account offset mortgage and the climate change ISA. Early indications are that it will seek to expand into mortgages and savings now that it has secured a banking licence through the acquisition of Church House Trust. Virgin is aiming to focus on customer service - a common theme in Virgin's offers. Yet the challenge is to convert dissatisfaction into switching - 12% of the population switched any financial product (excluding any insurance) in the last 12 months, but only current account switchers are strongly motivated by dissatisfaction with their current provider institution, rather than the product features or rates.

Tesco is also seeking to expand into new markets, including current accounts and mortgages. This follows the recent trial of 30 branches in Tesco stores around the country. In-store branches represent a significant departure from its existing strategy of focusing on products sold through remote channels, primarily the internet. Current accounts and mortgages are the two financial products with the greatest reliance on face-to-face channels, with people preferring face-to-face arrangement over direct channels for current accounts by a factor of three to one, and four to one for mortgages (source: FRS). Reaching these customers should not be a problem for Tesco. According to the FRS two in three British adults shop in Tesco in an average month, but converting them to Tesco financial products still remains a challenge.



## Love is all you need?

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Selling on service is likely to be a considerable challenge for the new entrants. The key challenge is to convince a sceptical British public that what the new brand offers really is worth the perceived hassle of switching. Importantly, despite all the media focus on the public's anger with banks after government bail outs and high profile bonuses, and despite countless stories of mis-selling and unfair charges, consumer satisfaction with current banking providers remains unchanged. Around two in three are either extremely or very satisfied with their main current account provider, and that hasn't changed in years (source: FRS). A successful new entrant needs to offer something more – service plus innovation. This might be product-led as Halifax did so successfully in 2001 - supported by heavyweight and innovative advertising - or through a channel shake-up, as Metro is considering for the branch.

We believe that Tesco has the strongest prospects, with a strong brand, potentially strong products and broad geographic reach, but implementation will be critical to its success.

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