

The Strategic Importance of Current Accounts



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With more than sixty-five million active personal current accounts in the UK alone, generating more than £85 billion pounds of annual revenue, should we be surprised that the churn rate for this product is generally very low? After all, this is a very lucrative market waiting to be tapped. It seems that with the further lowering of barriers to entry (to the retail banking market) this situation is approaching a tipping point. It is a good time to take a close look at the associated business opportunities. The current account plays a strategically important role in the retail banking sector and barriers to market entry are lower than they have been for years.

In addition to generating substantial revenues and, in many cases, good profits, the Current Account product:

- i) is an important catalyst in the sale of other highly profitable products,
- ii) provides a vehicle for the most frequent interaction with customers in the financial sector and thereby an opportunity to build strong brand loyalty, and
- iii) can provide a unique insight into the financial health, saving and spending profiles of customers.

With some notable exceptions, such as the Santander 123 and Nationwide Flex accounts, there has been little in the way of competitive campaigns to incentivise customers to move their current accounts. The recent Competition & Markets Authority report notes that churn rates remain very low compared to other markets despite the fact that customer satisfaction levels are less than 60%.

The Personal Current Account Market remains highly concentrated with the four largest banks accounting for more than 70% of the market. Over the last few years, the regulators have taken several initiatives to make the market more fluid as well as lowering the barriers for new entrants. This is coupled with an unprecedented rate of change in the way customers perceive their banks and the way they want to interact with them.

The developments summarised above provide an outstanding opportunity for challenger banks to move into this market and for existing mid-tier players to expand their existing footprint. Indeed, it presents an opportunity to grow several lines of business more rapidly by exploiting the features of the current account which make it a strategically important product. The changing dynamics of the market also provide an opportunity for those that dominate the sector to secure their positions and improve customer satisfaction.

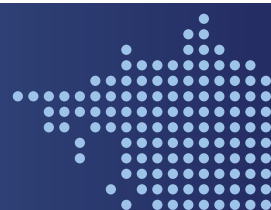
In this paper we explore various aspects of the current account product that make expansion into (or growth of) this business line such an interesting emerging proposition in the retail banking sector, as well as presenting how the regulatory and technology changes make it a very attractive one.

DIRECT PROFITS FROM CURRENT ACCOUNTS

Current accounts can be a very good source of both revenue and profit growth provided they are designed well. The key to assuring and maximising profitability is to ensure that the product can be readily crafted for specific sub-segments of the market. With a wide range of revenue sources including fixed charges, an assortment of mechanisms for overdraft charges, interest arbitrage, payment fees, etc. the product can be tailored in a way that it can address virtually all of the market segments profitably.

Versatility of a master current account product, from which all the sales products can be derived efficiently and automatically, will be a major competitive driver. Whilst this has been difficult with legacy technology, such capabilities are offered by a few of the new generation of systems such as Axxiome Banking.

Keeping operational costs, including IT and Services costs, to a minimum is an imperative. Maximising process automation



and self-service is essential. Process automation is now possible at a level that was previously intractable. This can make the difference between whether the business is highly profitable or marginal. The potential for self-service channels to drive profitability is at an early stage in most markets and should be exploited to the full. The exemplar in this respect is the level reached by the leaders in this field with up to 80% of all transactions carried out digitally. These factors highlight the importance of a well-developed omni-channel strategy.

Most established banks have well developed, multi-channel capabilities whereby the customer can interact with them in person, online, via telephone services or through mobile devices. From the customer's point of view, many of these channels appear as stand-alone capabilities. Whilst some providers have moved, or are moving, to cross-channel capabilities where the customer's experience is more aligned across the channels, relatively little attention has been given to customer-centric models that also reduce overall operational costs.

With omni-channel capabilities, such as those provided by Axxiome Banking, it is now possible to provide a very high quality experience to the customer (seamlessly connected across all channels) in a way that also reduces operational costs substantially.

Even with legacy platforms, some of the current players realise revenues of around £125 per account. This rises to more than £200-£300 per account for some sub-segments of the market. It should be noted that these numbers do not include revenues from the cross-sales of other products catalysed by the current account relationship with customers. With the latest generation of technology and optimum design of self-service channels, there is considerable scope for realising an even higher level of profits.

CURRENT ACCOUNTS – KEY DRIVER FOR SALES OF OTHER PRODUCTS

The current account is arguably the best vehicle for driving sales of other financial products and banking services. Several analyses of the market have shown that the current account is particularly effective in driving the sale of cash savings, ISA and credit card products. For example, 57% of savings accounts which opened last year were with the provider of the current account for the customer.

Although the correlation between the mortgage accounts and current account supplier is lower than for saving accounts, there is a high propensity for customers to shortlist the current account supplier when considering a mortgage. There is also a significant opportunity for cross-sales of insurance products.

Another important correlation is in that the probability of a small or medium sized enterprise (SME) electing the provider of the personal current account of the business owner as its bank is more than 50%.

It is evident that the current account business drives a lot of new highly profitable business. With careful design of the current account product, this opportunity can be exploited to grow the business much faster whilst also generating profits from the current account itself.

CURRENT ACCOUNTS – THE FOUNDATION OF PAYMENTS INNOVATION

Recent years have seen extensive innovation in the area of digital payments. New entrants from the outside of the traditional banking sector (without the bounds of legacy platforms, and with competing business lines) have introduced innovative money movement services that are proving to be very popular. The future of digital payments is unknown, but



it is clear that a combination of flexibility and efficiency is required, and that these attributes are not often the norm for the incumbent organizations.

A modern current accounts platform with an open API (Application Programming Interface) layer provides a solid foundation for payments innovation protecting and developing this important source of revenues and profits.

LOWER BARRIERS TO ENTRY

Since the financial crisis, the drive by governments and regulators to broaden the market for retail banking services has gained momentum. The barriers to entry have been reduced. The initial capital required has been reduced substantially and the process for regulatory approval shortened and streamlined.

Access to the payments systems required to service a comprehensive current account has previously been considered to be a significant barrier to entry. In particular, the costs of accessing some of the key payment platforms have been considered to be very high for new entrants. With the establishment of the independent Payments Systems Regulator we can anticipate that this hurdle will also be lowered, or removed, fairly quickly.

CHANGING CUSTOMER ATTITUDES AND BEHAVIOURS

The way customers regard their banks and their perception of risks in changing banks, particularly for current accounts, has historically been a significant barrier to entry. However, the banking crisis has changed this significantly. Many segments of the market are now prepared to consider alternative providers much more readily. The highly automated (from the customer perspective) seven-day switching service is also a key change in the operation of the UK market. With increasing awareness of this service, the barrier to entry associated with customer attitudes is at a historically low level.

Another important factor to consider is that more than a quarter of the potential market is now prepared to consider a purely online bank as their current account provider. The proportion of the market that falls into this category is likely to grow steadily. This is important as it opens the opportunity for operational models that have a much lower start-up cost, are much less complex and have a much lower set-up lead time (from approval to live operation) than conventional operations.

CONCLUSION

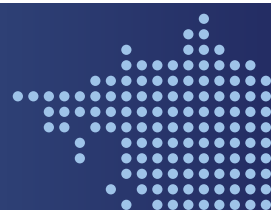
A perception that current accounts are a mundane product in a mature market now seems to be outmoded. They can play a very important strategic role in driving new business as well as generating solid profits in their own right.

The barriers to entry to the current accounts market is lower than it has been for many decades. In addition to the initiatives from the regulators, there has been a substantial change in the costs and capabilities of the technology available to support operational models that are much more efficient than established business practices. Moreover, technology such as Axxiome Banking, that can provide the capability required to craft precise products for each sub-segments of the market very efficiently from one versatile master product. This can be exploited to ensure that all the targeted segments can be addressed profitably.

With changes in customer perceptions of banks and rapid, ongoing alterations in the way customers interact with their bank accounts, this is a time when the previously intractable barrier to moving them to a new bank is low.

The conjunction of changes in all the key dimensions of the current accounts market (customer perceptions and propensity to change, lower barriers to entry and technology capabilities and costs) has created an unprecedented opportunity in the retail banking sector. Companies that target particular market segments well, will realise fast, highly profitable, growth by creating business models exploiting the new technology optimally. Such companies will provide innovative services across all channels to assure an exemplary customer experience and simultaneously set a new benchmark for operational costs. Effective cross-selling of banking and payment products will play a key role. The current account product can now play a pivotal role in such strategies.

The rate of development of this market to date may be considered, at first sight, to be surprisingly slow. However, with



the latest changes, the market seems to be at a tipping-point similar to those experienced in other markets previously considered to be mature that have subsequently changed rapidly.

The latest statistics on the market show an upswing in churn of current accounts as well as an increasing propensity for customers to use multiple banks for similar functions. There are also several new banking ventures developing plans to enter this potentially lucrative market. We can reasonably look forward to the emergence of a highly competitive market as the potential opportunity becomes recognised more widely.

ABOUT AXXIOME BANKING

Axxiome Banking is an agile, enterprise class, core banking platform preconfigured with market leading banking product templates. The Current Account template, which can be readily adapted for specific market segments and business model, incorporates a super set of the key features of the most competitive current account products in the market. The platform is ideal for launching new lines of business rapidly and reliably.

ABOUT AXXIOME

Axxiome is a global solutions provider for the financial services industry focusing on advisory in banking and insurance complexity reduction and analytics. Axxiome provides advanced SAP Banking and Insurance expertise for accelerating the implementation and integration of transformation initiatives. With these methods, products, and expertise, Axxiome helps financial institutions reach clarity from a business, technology, integration and portfolio perspective. Axxiome is committed to supporting the achievement of tangible business outcomes including: new business operating models, regulatory agility, increased efficiency, the transformation of customer channels, and reducing total cost of ownership for its clients.

To find out more about Axxiome visit:
www.axxiome.com

