Revolution or evolution?

The Starling Report: Predictions and challenges for UK fintech in 2017

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Foreword **Anne Boden, CEO of Starling Bank**

Since 2008 it has been clear that the finance industry needs to improve.

Competition between the big banks was little more than rhetoric. Systems were slow, inefficient, antiquated. As profits were further squeezed, protecting margins became the order of the day – selling new products rather than supplying solutions to real customer needs.

With the coming-of-age for financial technology (fintech), many have posited that the status quo is under fresh pressure.

As the research in this inaugural Starling report shows, from 2014 onwards, fintech has exploded into the mainstream. Yet despite millions of pounds invested in the latest fintech start-ups, and even though the number of billion-dollar valuations has established a stable of unicorns, the question of what is revolution and what is evolution remains.

When we commissioned this report with Explain the Market, we were looking for insights into the future of fintech – what trends, challenges and opportunities might there be for the next twelve months? How has emergent fintech challenged incumbent financial services, if at all? Who are the real disruptors and how are they disrupting?

As a technology start-up with a banking licence, these questions were of prime interest to us given the hype cycles surrounding investment, we wanted to look deeper, dig beneath Series B rounds, expose the key players regardless of how much limelight their names had received.

Working with Guy from Explain the Market enabled us to provide precise answers to these questions. The research gives insight into emergent fintech and conveys how complex the story is.

Fintech is no doubt creating a new understanding of what it means to deliver financial services, but it is also less competitive than intended due to the fact many start-ups are collaborating with incumbents, becoming subsumed into old systems.

Real disruption is more than a clever idea, it is about a change in mentality, a change in approach. In business, it is about breaking up business models, about making sure brand values are more than skin deep.

Fintech had a clear purpose at its inception – putting the customer, not the product, first. But this report shows the revolution is still more bark than bite. If it is revolution rather than evolution that we want, if it's the car rather than faster horses that we want to race, then 2017 is going to be a pivotal year for fintech.

Today we launch the first in a series of reports designed to establish how to bring fintech back to the customer in 2017 and beyond. ◆

Foreword **Guy Shone, CEO of Explain the Market**

I'm delighted to introduce the first in a series of reports looking behind the scenes of funding, influence, and customer demand to present a more realistic picture of the future of UK fintech.

At Explain the Market we are grateful to Starling Bank for allowing us to probe the problems and potential for fintech in 2017. Our work will use balanced research and real debate to create a useful hub of insight that moves away from blind evangelism and looks to bring the market closer to the customer.

2017 represents a pivotal point for UK fintech. Technology can improve customers' lives. However, despite continued financial support the market does have some real problems that need honest evaluation and fresh thinking.

To fully realise the potential rewards of the fintech revolution the UK needs to delve behind the scenes and encourage more self-scrutiny. Our work investigates the realities of funding structures, examines who is really in control, and explores how to listen more carefully to customers.

For a number of reasons fintech has become divorced from the desires and opinions of UK citizens. It has morphed into a conversation dominated by already interested parties and marked by a lack of diversity. This is compounded by support for start-ups that boost the IT power of our biggest banks at the expense of new competitive brands. Our report explores how some celebrated collaboration actually hinders competition.

Something is wrong when 20 million potential customers carry on as they were, while we meet in conference venues and high-end coffee shops to agree how revolutionary we are.

As a fintech community we need to listen to the public without finishing their sentences. We need to understand the views and preferences of those unimpressed by our rhetoric, who do not want to join our exclusive club. We need to test whether a diverse range of customers actually agree that our work is as important as we say it is. In 2017 it is time fintech moves out of its comfort zone.

Surviving on support from Shoreditch when customers in Stevenage and Salford are ignored is not sustainable. Our research highlights how the mistaken approach of designing for the masses based on the elite few can be rectified to positive effect in 2017.

Fintech emerged from a desire to serve customers better and it needs to find a way back to that core purpose. This is the reasoning behind the Starling report. To tell the truth about what customers want fintech to be, admit the big problems to be solved, and support innovation that can make a realistic difference to people's lives. ◆

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INTRODUCTION
FINTECH & THE ECONOMY TODAY

Fintech has become synonymous with a movement for change, a mindset geared towards disruption

A direct result of the anxiety left in the wake of the 2008 financial crisis, emergent fintech became a counterpoint to the establishment. Challenging traditional financial models, delivering smarter technology to do money differently and putting power in the hands of consumers – to be a fintech company became about creating a customer-focused product, building a faster and more accessible way to respond to society's financial needs.

Many have argued that fintech moved into the mainstream during 2014. This was the year fintech entered widespread conversation, when former Chancellor George Osborne announced the government trade body Innovate Finance, and when new challenger brands really started to make the most of the regulatory rules relaxed in 2013.

We saw the rhetoric change in 2014 too. Fintech became the common ideology linking technologists in finance against the old system and people started listening to new brands who could provide cheaper, quicker, online solutions to their problems.

As entrepreneurial ambition and consumer demand was set free by regulatory change, even the holy grail of financial services – a banking licence – became not just tangible but a reality.

Consumer-facing fintech firms, armed with an implicit understanding that they represent the very best of ideological intentions, boomed.

Fintech is nascent no more.

Yet some posit that fintech is much less competitive and much more conventional than imagined. Rather than revolution it is simply an evolution of the status quo.

Doubt has crept in despite the rise and rise of global fintech, a stable of UK fintech unicorns, and the first new banking licences to be granted by the Bank of England in over a century.

As the sector came of age its narrative looked increasingly like bravado. Successes, once extolled in the media, were now eyed cautiously. Research surfaced questioning what was hype-cycle and what was real.

Emergent fintech firms, the so-called disruptors, no longer seemed so different to the traditional financial technology companies that supported the maintenance and provision of existing infrastructure.

On paper, the UK fintech sector remains as determined and disruptive as ever before.

But as we move into 2017, it's vital to take a look behind the scenes where the structures of the industry are shifting and setting many on a new trajectory – one that may serve the UK's biggest and oldest banks rather than competing against them.

Research surfaced questioning what was hype-cycle and what was real.

The current economic landscape

The overall challenge for 2017 is the customer. As the gap between emergent and traditional financial technology products narrows due to collaboration between newcomers and incumbents, it appears fintech has lost sight of its original purpose – to release the stranglehold of non-competitive banks over consumers.

The question, therefore, is how to put real people back at the heart of fintech? Moreover, how does the current economic landscape help or hinder in that mission?

Global markets remain volatile but post-Brexit predictions provide as much scope for opportunity as they do for doom and gloom.

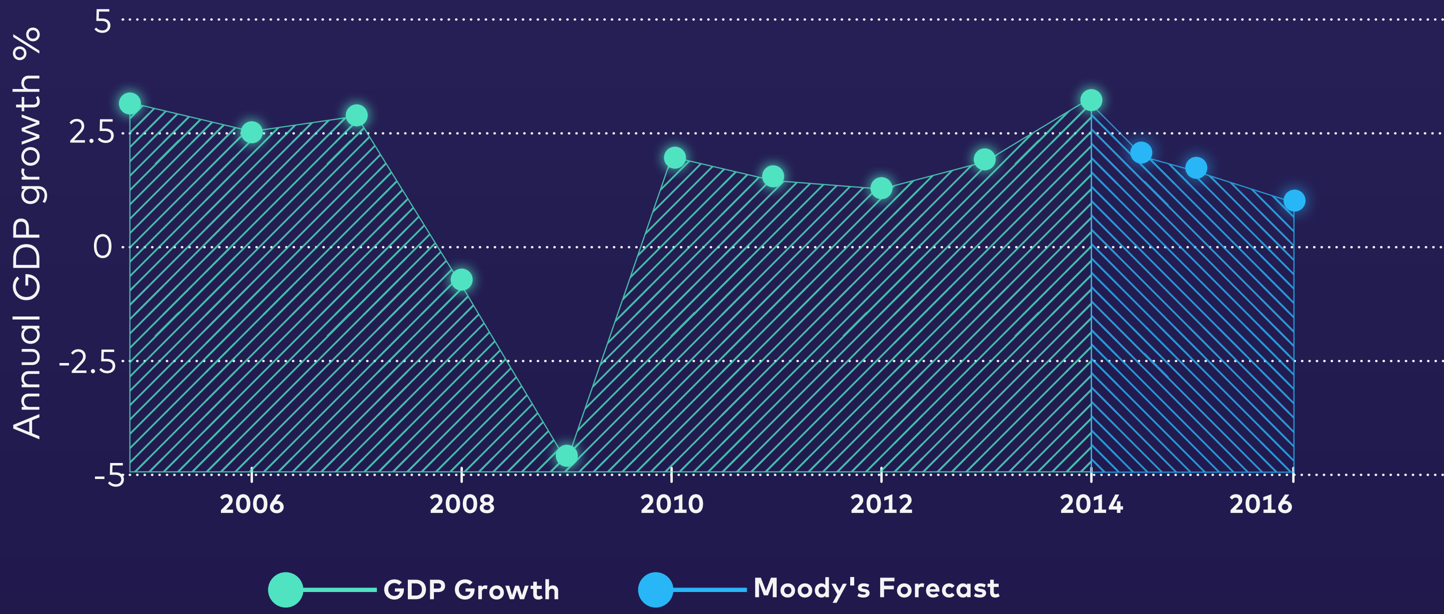
London remains a vital financial centre and the confidence of the majority of fintech investment has not waned in the months after the European referendum.

There are plenty of indicators pointing towards a flourishing 2017 for British and particularly London-based fintech companies. Not only has the pace of smartphone adoption continued a sharp climb towards a possible saturation point in 2019 but venture capital funds with an interest in finance and technology remain well funded. Moreover, UK government support has been unwavering in promoting London as the global hub for fintech in Europe and fending off the ambitions of cities like Frankfurt.

The challenges though lie not in the numbers but in the structures behind the scenes of the

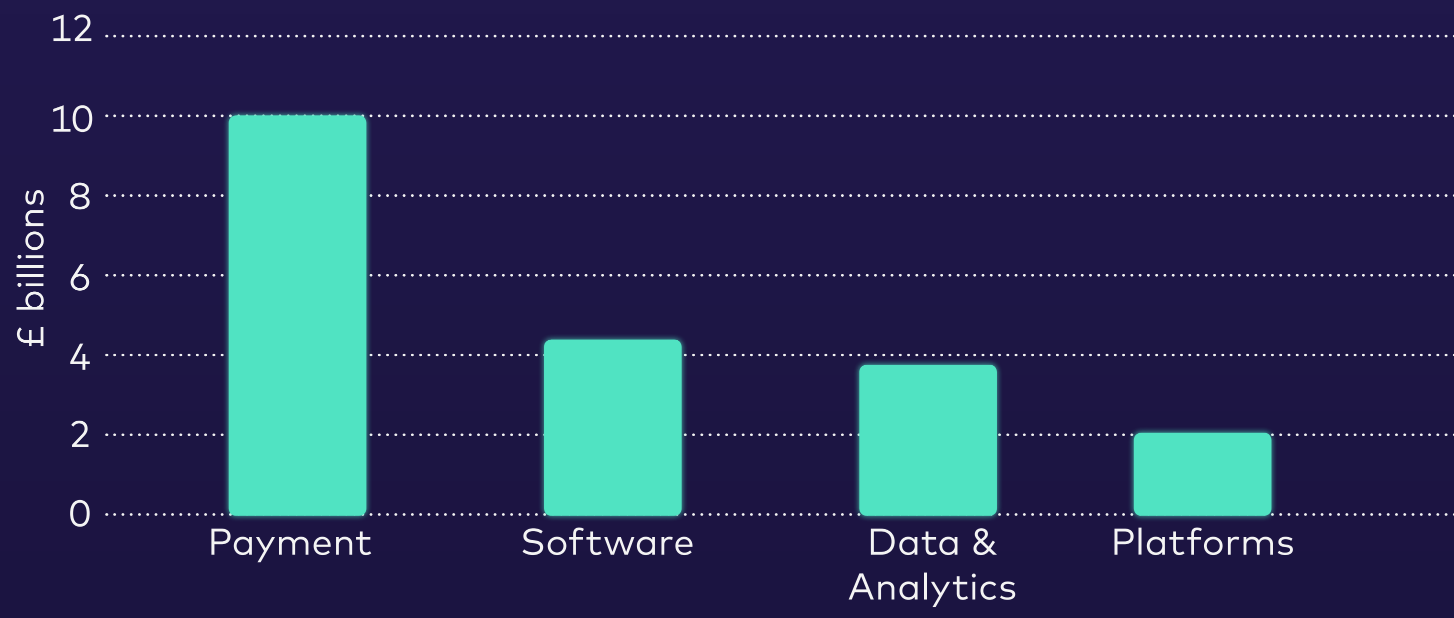
There is a modest slowdown expected in the UK economy

Source: Moody's



Fintech remains dominated by "behind the scenes" technology

Source: UKTI & EY research 2016



Areas defined as 'core'

world's most talked about industry.

Most analysts predict the UK economy will slow down as we move into 2017, but that it should not slip into a sustained recession.

Moody's has highlighted that growth in the UK, like many other parts of the world, is 'stabilising', predicting a 1.2% growth rate in 2017, slightly down on 1.5% for 2016.

Billions have been invested in UK fintech during 2016 and the threat of Brexit appears not to have dampened finance accessibility for start-ups. Several new firms have closed funding rounds since the vote to leave the EU was announced in June, including Revolut who secured a £6.75 million investment from venture capitalists in London.

The challenges though lie not in the numbers but in the structures behind the scenes of the world's most talked about industry.

But despite, or perhaps because, of all the chatter, investment and enthusiasm, the ability to champion the interests of the financial services customer appears to have been compromised along the way.

The opportunity to genuinely increase competition in the UK financial services market is proving harder to realise as our largest and oldest banks exert control across the new value chain of fintech. Moreover, giant corporations dominate one in every four fintech deals.

UK government policy is to support those areas of the 'fintech' market where a global presence and leadership position has already been established. This includes the traditional financial technology companies that prop up incumbent banks and institutions. Understandable, given these businesses constitute around 80 per cent of the wider fintech sector, but not so good for emergent start-ups or consumers.

The other key tenet of UK government policy is to encourage 'collaboration' between big and small, old and new, at every opportunity.

This creates an undertow that is hard to swim against.

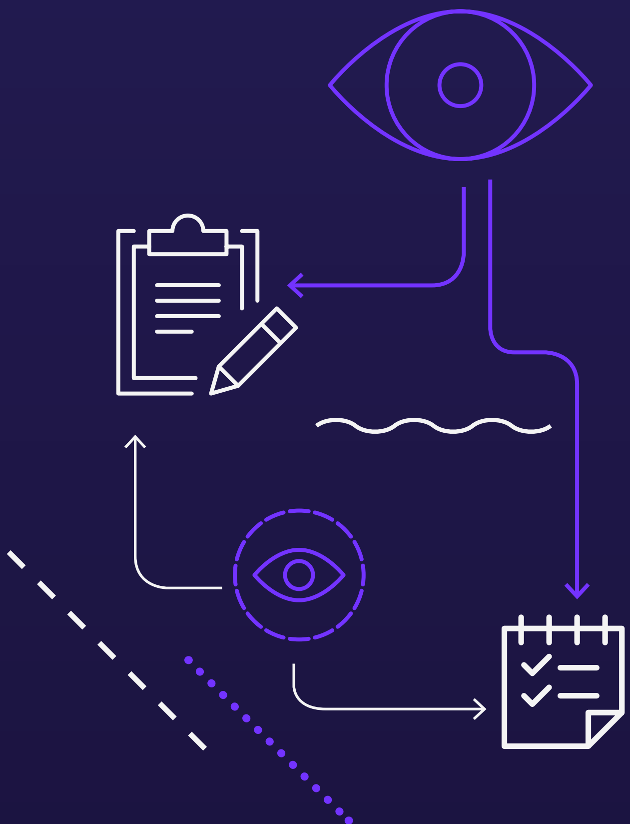
Collaboration is surely a good thing. To argue against collaboration seems churlish.

But collaboration plays perfectly into the hands of the UK's biggest and oldest banks. And we have to ask: is this something we really want to do?

Are we seeking revolution or evolution?

Our largest and oldest banks exert control across the new value chain of fintech. Moreover, giant corporations dominate one in every four fintech deals.

THEMES AND OVERVIEW



There are three macro trends to keep in mind whilst looking at 2017 predictions for the fintech market

Smartphone adoption will demand more truly mobile-first services

Most analysts expect the UK smartphone market to grow by between 4% and 6% to reach between 25 and 30 million units by 2018. With penetration at 80% of the population, 2017 will see a shift towards delivering a greater range of mobile-first services to all customers. The SIM-free market will continue to be one of the fastest growing in the UK next year underlining a growing desire from customers to control how and when they use their technology.

Video and social media will dominate how corporate content is created

Almost four times as many consumers claim to prefer video content over text when it comes to social media messaging. Marketers are picking up on the trend as well, with 69% saying their budget on video content is 'increasing' or 'significantly increasing.'

Despite this, over 70% of companies are still not collecting data from social media channels. This gap between 'social' and 'anti-social' brands is expected to close in 2017 given that 47% of marketers say that social channels offer the greatest opportunities in the immediate future. According to the Direct Marketing Association Statistical Fact Book, social media will grow to 24% of marketing budgets within five years, up from 10% today.

Trust will remain a dominant theme

Our trust in financial services, particularly the biggest brands, has been seriously eroded. If 2015 and 2016 were all about winning back the perception of trustworthiness and halting the decline in corporate reputations, 2017 will be about the much harder job of trying to build real trust and close the gap between rhetoric and reality.

Looking at the research available, this report offers a meta-study of the challenges facing emergent fintech as 2016 draws to a close, and makes predictions for 2017. ◆

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Our research points to four key predictions for UK fintech in 2017

Structural funding problems will maintain big bank stronghold

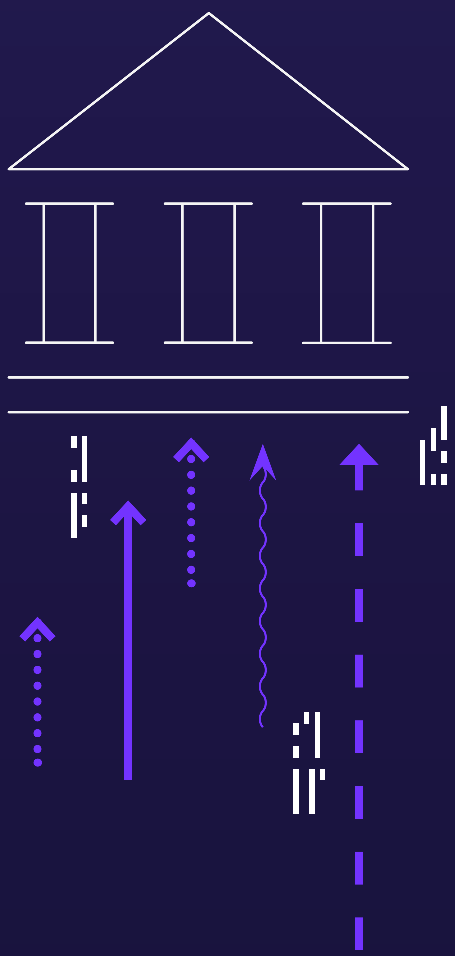
Customer scrutiny will be fundamentally different

Fintech will deliver a step-change to the financial capability of individuals in the UK

Traditional product boundaries will blur

CHAPTER ONE

FUNDING, THE BIG BANKS & THE PROBLEM WITH INNOVATION



Our biggest banks will consolidate control & true barriers to entry will remain high

The public expect more competition in the banking sector from new fintech entrants in 2017 but there is a problem.

A flurry of what looks like competitive activity helped create the impression that we are on the verge of a market with many more serious players. Meanwhile the truth behind the scenes reveals questions as to whether the right sort of competition is being created or whether it is 'competition' at all.

An emerging opportunity to make a material difference is in the convergence where fintech meets banking with an increasing number of players opting to hold true to fintech principles but still applying for the legitimacy of a banking licence.

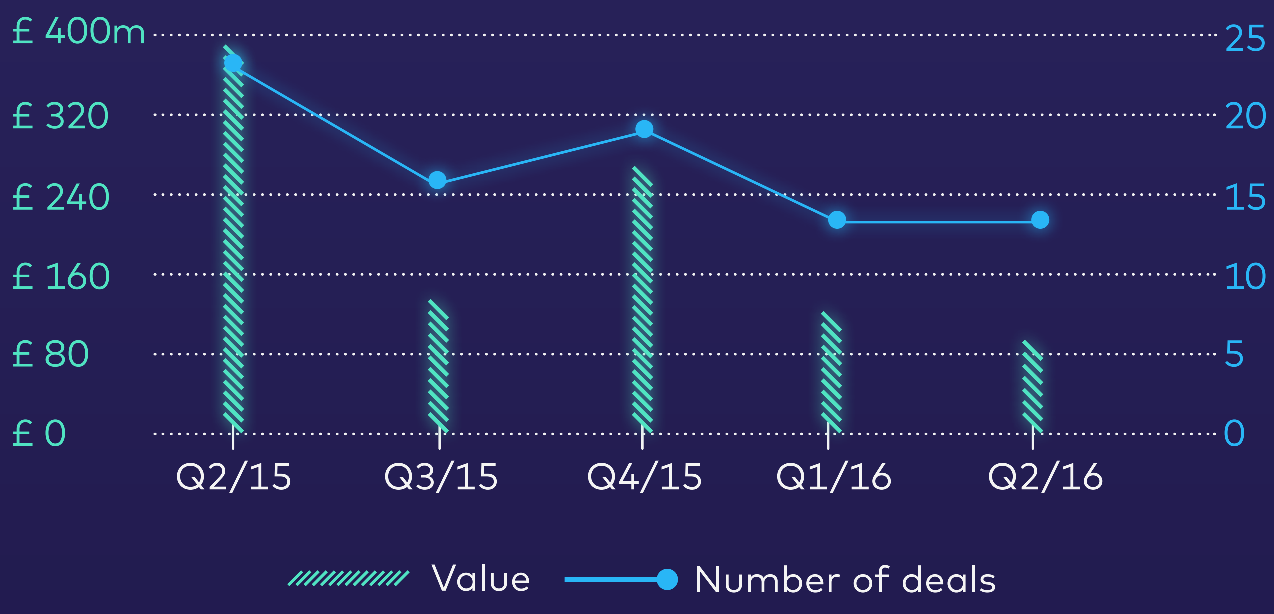
However, there is a structural problem with the way new ideas are funded in fintech. This is for three key reasons:

First, the VC industry doesn't really work for seeding a new bank. They encourage innovation but seeding a new bank is expensive and risky. Investors look for only the most experienced entrepreneurs.

Second, creating a customer-facing business in financial services is a very difficult thing to do. This is often why so many propositions with

VC funding in UK fintech start-ups in the second quarter 2016

Source: KPMG & Pulse VC report 2016



noble aims end up morphing into technology providers to the big banks.

And finally, there are so many regulatory and investment obstacles to jump through. Only once a bank has its licence does the risk profile improve.

This prevents the right sort of competition.

Visionary entrepreneurs will therefore find the structures behind the scenes working against them when it comes to launching a B2C fintech business, which in turn pushes them to become part of the infrastructure of established banks.

In 2017 it is likely to remain difficult for truly independent entrepreneurs to get funded. The value of venture capital funding fell 12% in the second quarter of 2016 and despite a handful of new entrants the big banks know that the cards are stacked to their advantage in 2017.

But consider this: one in every three funding deals for fintech start-ups now (up from last year) are by interested corporates or legal partnerships. Moreover, the trend for more and more of this market to be owned and controlled by the big corporates (including the banks) means we get the appearance of disruption while the same corporate entities embed their control on the marketplace.

As long as new products and ideas appear to keep coming, the conferences are full, and the press releases continue, the fact that the biggest banks are behind so much of this perceived competition goes unnoticed.

The control of the old guard of traditional banks is intensifying and broadening across the fintech value chain as the market matures. In many cases now, when new entrepreneurs are not supplying the big banks, advising the big banks or repairing IT estate for the big banks – they are working to funding heuristics set by the big banks.

For instance, Santander owns one of the largest fintech-focused venture capital firms in the UK – InnoVentures. InnoVentures is now worth US$200 million with money pledged for 2017 on the basis of meeting criteria.

The biggest UK banks are likewise launching more direct ways to flex their financial muscles and extend control over the start-up community.

Barclays launched a £100 million investment fund in 2015 aimed at supporting fast growing fintech firms. Rather than selling equity though, start-ups are able to borrow up to £5 million at a time. The business loan is on offer to firms that have already secured venture capital investment – thus extending the influence of the bank into parts of the market currently not under Barclays influence.

HSBC launched an £8 billion fund and extended it to a massive £10 billion in 2016. The fund also cleverly ties smaller business owners into a 'broader package' including free and reduced charges on banking services.

Meanwhile Lloyds Banking Group (LBG) has set up a series of tie-in relationships to consolidate their influence. LBG has joined with government-led Innovate Finance to launch a fintech mentoring programme where start-ups seeking funding are paired off with over 100 LBG employees to provide guidance and oversight of development.

Marc Lien, Innovation and Digital Development Director at LBG, explained that such 'collaborations' 'will help shape and inform Lloyds' digitisation journey.'

Real collaboration means sharing risk

The desire of giant banking brands to achieve efficiency and cost-saving targets has fuelled the idea of a new era of partnership.

But without shared risk most of these so-called partnerships are not really partnerships at all.

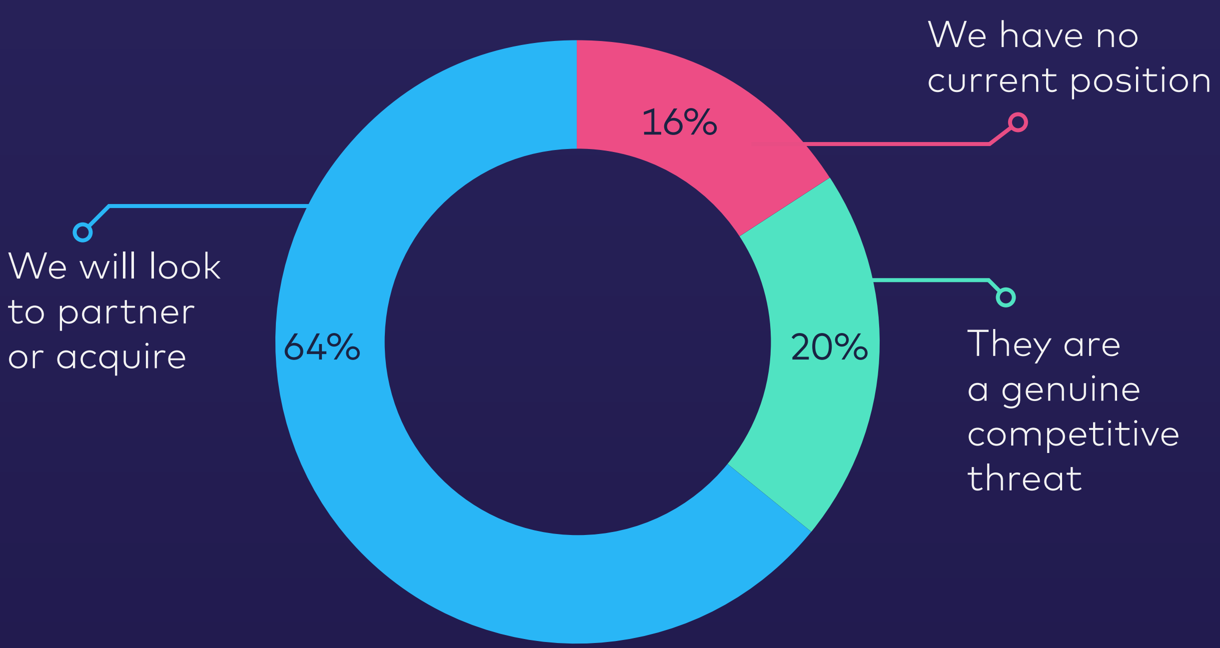
The UK's biggest banks are desperately constrained by antiquated IT systems that require billions of pounds of renewal. One of the most effective ways of navigating this problem is via third-party collaboration to utilise the smaller more innovative companies. The greater the integration of these services the bigger the efficiency savings for the bank, and the better the ability to fend off any competitive threat. The effect is an anti-competitive one that consolidates power. To state the obvious, because it isn't stated often enough, the biggest banks don't really want more competition. It is the last thing they really want.

The real war only starts now

It was supposed to take six months to get a banking licence. But in the case of most new banks that have achieved this status over the last five-year period it actually takes roughly two and a half years.

How big banks plan to deal with fintech firms

Source: IDC Insights & SAP financial services report 2016



Bigger challenger banks have taken the last two years to grapple with issues like complex IT migration projects, decoupling legal entities and relaunching long retired brands. This is why 2017 will likely see the competition start in earnest.

Before Metro Bank launched in 2010, there had not been a single banking licence granted in 100 years.

Before 2017, this was really a phony war with most of the players not able to be fully in the game. So whilst the UK's biggest banks have been enthusiastically finding ways to control competition with investment in 2016 – a trend set to accelerate in 2017 – the real war starts now.

Banks look to tighten grip on competition in 2017

The control of the old guard of traditional banks is intensifying and broadening across the fintech value chain as the market matures.

Challenger banks controlled by giant corporates will find innovation even harder

Innovation is hard.

Innovation in financial services is harder.

Attempting innovation where your plan is riddled with restrictions and predicated on re-using ill-fitting assets has been shown up to be near impossible.

Divestment disasters have defined much of 2016. Telling customers that something new is coming is tough when everyone can see that the brand and the products are being awkwardly re-purposed rather than built on fresh insight.

The latest high profile example is the £1.5 billion spent by RBS on carving out Williams & Glyn.

Analysts described the move and subsequent back track as a 'mind-boggling fiasco.' However, bankers briefed with the original plans said the aim of creating a standalone system was to provide Williams & Glyn complete autonomy and flexibility to create new products.

In similar, less than successful moves, Tesco and TSB have also come under scrutiny, not to mention Virgin Money.

Over the last 18 months Tesco Bank suffered technical issues preventing customers accessing their account. This was further compounded by issues of trust when mortgage customers reported feeling betrayed by the company reversing offers for what was perceived to be tiny differences in valuation figures. The general discontent was not helped by the fact the technical issues came during widespread criticism of the multi-million-pound severance pay deal for executives of the parent brand. As ever, integration of reputations just like IT systems can prove tough circumstances in which to solve problems.

TSB similarly continued to pursue their challenger bank status, lobbying hard on behalf of 'smaller banks'. Meanwhile, the brand has been closely consolidated into the Banco Sabadell group (one of Spain's biggest lenders). The acquisition has delivered a huge boost to the net profit of the parent group. The banking giant now creates over US$285 million in profit and last year hit close to US$1 billion in revenue. This glaring mismatch between rhetoric and reality has been picked up by many across social media who are asking difficult questions about how the TSB brand is different to the other big banks. This question becomes even more significant in light of the fact that they remain reliant on LBG for their IT infrastructure and will be until 2023, limiting their ability to really innovate.

On the other hand, Virgin Money's attempts to stretch the brand across a variety of machinations over the last two years has all been under the banner of 'a quest to make banking better.' The 'quest' component has arguably become the dominant interest at the expense of actually making anything tangibly better. Credit cards for football teams, 'money lounges'

£1.5 billion spent by RBS on carving out Williams & Glyn.

where customers are invited to relax and enjoy refreshments and free use of iPads has all created the perception of innovation but increasingly can also be interpreted as a commitment to fashion rather than customers. It's banking as a brand but with no real, tangible advancement.

In the worse case, Virgin Money has created a sense of indecision with customers – exacerbated by the shelving of recent plans to launch a new small business proposition after the Brexit vote was announced. Customers become understandably nervous when scenarios clearly possible to the public are seen to surprise and panic those we are asked to trust with our hard-earned money.

One of the characteristics of the social media age is that the public can see behind the scenes. And can comment on what they find.

Large banks owned by massive corporations are already starting to experience the impact of social media's unmoderated transparency. Customers and commentators are demanding corporate level transparency and not just openness at the product level. Social media relationships between customers and brands ensure that searching questions can't easily be ignored. Larger self-declared challengers with massive corporate owners are going to be more exposed to this area of scrutiny in 2017.

The public is already starting to ask, and ask publicly, what 'challenger' really means.

CHAPTER TWO

CUSTOMER SCRUTINY IS CHANGING

What is the customer's relationship to a bank?

The contemporary customer expects to be the decision-maker in their life, with brands there to present useful options and even alternatives to their usual behaviours. When it comes to favourite brands, many anticipate a particular kind of relationship but are mostly content as long as the product works.

However, customer scrutiny is different now to five years ago. Social media and 24-hour news cycles have seen to that.

Furthermore, in finance, banker-bashing has morphed into less of a black and white way of thinking. It is no longer about good versus evil.

Many recent start-ups have been built without profit as a priority. The impact or lack of it on people's real lives is evident. Examples abound of fintech firms struggling to become real self-sustaining businesses once the investment life-support is withdrawn. The stories of OnDeck, Lending Club, Venmo and Square demonstrate the problems of building businesses without a clear plan for sustainably and profitably winning customers.

Investment has been crucial to fintech. It will continue to be the lifeblood of essential new products and services in 2017. Nonetheless, as the sector moves further into mainstream consciousness, a greater level of public scrutiny will ensure the public are aware of the difference between an investment fund cashing in its investment and a person with a vision joining a team to help customers.

The mere act of an investment changing hands or even a team borrowing some money will be celebrated with more realism in 2017 than the unbridled 'high-fiving' of 2015-16. Delivering a return will become the main thing. And this only comes from impacting the lives of customers in a positive way.

Research suggests more and more that the ability to really influence people's lives is not a byproduct of combining top technology with market conditions. Rather it is a skill, and like all skills, something people and firms are either good at or bad at. The presumption used to be: find the right insights from the best data and victory is as good as yours. But all sensible evidence suggests that this simply isn't true. Customers are demanding effort, skill and a demonstrable desire to win trust. None of this is possible by simply adding great data to the same old approach.

In the rush to win investors, the need to develop skills and expertise that impact the customer has lost priority between 2013 and 2016.

Recent examples of firms getting it wrong with customers point to a shift in momentum.

Recently TransferWise has been caught out for misleading customers about how cheap it is compared to banks whilst LendingClub sent shockwaves through the fintech sector when it revealed on its earnings call that the CEO had been removed for unethical behaviour.

In the rush to win investors, the need to develop skill and expertise that impacts the customer has lost priority between 2013 and 2016.

Furthermore, Prosper has had to lay off a third of its staff, Nutmeg has replaced its CEO and Wonga simply refuses to see the importance of being authentic – a series of cynical ploys exposed over the last 3 years saw losses double in 2015 and provoked a reluctant regulator into taking action.

Those firms demanding investment or partnership support in 2017 will need to demonstrate customer capability.

Trust and transparency

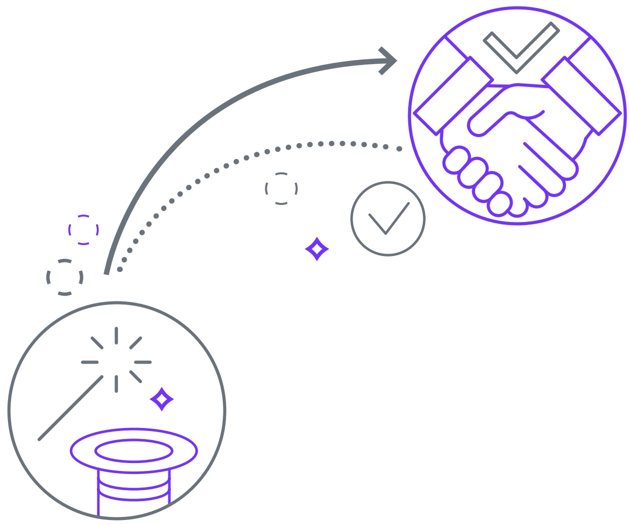
Trust in financial services has been a problem for over a decade.

Despite initial enthusiasm, the evidence from our meta-analysis of qualitative research into UK financial services over the last five years reveals cracks in fintech brand credibility due to an apparent lacklustre desire to engage and listen to end customers.

The challenge in 2017 is thusly to listen better than ever before.

Furthermore, the evidence shows a strong correlation between levels of customer trust and the efforts of brands to demonstrably try to win trust. Staying quiet, not declaring intentions, keeping away from social media debates and taking defensive PR positions – all erode trust.

Three distinct elements that inspire customers' trust therefore emerge: awareness, endurance, and empathy.



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Corporate behaviour most likely to inspire trust

Source: Explain the Market UK Trust Mix method study 2015

Awareness
"Show me the truth (warts and all) of how you make money and your priorities"

Endurance
"Demonstrate your character not your wordsmithing abilities. Show you make the right calls when it's personally difficult"

Empathy
"Listen to me properly and then show me you've understood"

Honesty

Corporate behaviour most likely to inspire trust

Customers define honesty as a mixture of communications and behaviour but the emphasis in the customer definition is much more on the personal conduct of leaders than when the same definition is offered by the brands themselves.

In general, traditional financial brands prefer to concentrate on product level candour and final financial returns whereas customers have a strong interest in profit motive, corporate ownership and the personal gain of executives.

The leadership team is therefore just as integral to maintaining brand reputation and trust. Research with both customers and corporate leaders conveys that customers see personal behaviours as an important indicator of trust.

Evidence shows that when it comes to honesty and trust, a disconnect between what customers mean and what brands say they mean is increasing. Brands that can demonstrate more personal honesty in their customer relationships will win in 2017.

Brands that can demonstrate more personal honesty in their customer relationships will win in 2017.

CHAPTER THREE

FINTECH WILL FINALLY IMPACT FINANCIAL HEALTH IN 2017

Fintech can help improve the financial health of customers but to do so the industry must solve the right problems

Firms need to fix what needs fixing and resist pointlessly tinkering with what is familiar.

'Financial Inclusion, Capability, Health' etc has become a booming cottage industry but so far much of it has limited capacity despite good intentions.

The overwhelming weight of evidence points to a public with a high degree of inherent skill who have been let down by a self-interested and self-serving industry.

Customers do not need 'educating' but banks need to keep saying so because it serves as a seemingly benevolent distraction from continued failure to deliver better products and trustworthy behaviour. Plus, if customers do need educating in the traditional sense, then the very last choice of teacher would be the traditional banks.

Dragging the public down to the same level as the banks is the wrong type of harmony to hope for and only complicates the problem.

Financial health has many variables but the mistake that banks make (often quite deliberately) is to focus on how to change customers over how to change themselves.

It is in the supply side where the biggest changes are needed to reverse years of anti-competition, cynical marketing and an addiction to old fashioned products that serve shareholders first, regulators second and customers last.

The Money Advice Service's 2013 report, the financial capability of the UK, and the proceeding government-backed UK financial capability strategy reveals evidence that confirms the UK public is far from financially incapable. In fact, the data suggests that tough economic conditions may have even had a positive effect on people when it comes to doing things that benefit financial health.

The number of people regularly and thoroughly checking bank statements almost doubled in the years following the financial crisis.

Over 80% of the UK now consciously keep track of income and expenditure. Despite stress (48% worried about finances) and a dysfunctional banking sector – British customers have been managing money with a high degree of skill.

Of those customers who regularly make a budget almost four out of five stick to it and over 90% make a point of shopping around when buying more expensive items.

Despite tight household budgets, 88% of the nation now claims to 'hardly' or 'never' run out of money before payday.

The scope for traditional banks to distract the press and the regulator with the notion of 'educating' people is running out.

The financial capability data does show some gaps in knowledge but mostly in areas with a weak association. Ironically, these are the examples that the industry most likes to reference. Understanding APRs or recalling the Bank of England base rate have a very marginal impact on people's ability to manage their budgets responsibly and the establishment to its shame knows this very well. When it comes to the type of knowledge that truly impacts financial health all the signs are that UK customers do not need educating at all. For example, 89% are perfectly able to identify the better deal from two complex and similar options.

Most traditional bank products were designed before the financial services industry had started to take note of behaviour change theory and the weight of insight available from thousands of studies around the world.

Despite tight household budgets, 88% of the nation now claims to 'hardly' or 'never' run out of money before payday.

How can fintech make financial capability better?

Design

Stripping away the 'middle-man' of financial products and designing services aligned to the UK Government framework (MINDSPACE) framework from scratch

Communications

Clear and open social media policy

Transparent about how brand makes money and who owns the business as well as at a product or service level

Support

Mobile first support

Aim to fit in with people's lifestyle not tell them to change

Present next right thing and implement customer decision

CHAPTER FOUR TRADITIONAL PRODUCT BOUNDARIES WILL BLUR

Technology needs to be for all types of people – not just a highly logical and organised stereotype. And key to this are the products themselves.

Helping with the next step is what customers increasingly expect from banking brands – without lecturing and without 'educating'. This type of relationship is ubiquitous in the mobile-first world where customers of all ages now live their lives online. What disruptors like Amazon have delivered for years, customers now expect from financial brands.

Yet the majority of financial services are still delivered through the lens of specific and traditional financial products, not least because the IT systems on which they have been built and managed are so inflexible.

Big banks are burdened with inter-divisional turf wars because of the sheer number of conflicting products and personalities at play. Cutting through the noise and inefficiency to deliver what customers want is always going to present major challenges.

Technologies predicted to boom in 2017 such as artificial intelligence (AI) can help solve this problem by providing highly personalised services all delivered within the context of what different customers want next, their location, and the type of service they appreciate.

40% of customers cite complicated products as top frustration.

Banks unburdened with multiple products have the edge

Multi-product organisations are typically too complex to deliver services efficiently in a changing market where customers care little for abstract product boundaries.

Newer systems built with mobile services in mind may be better able to cope with advances in AI and biometric data as well as providing richer, faster and more reliable experiences than the giant banks still struggling with decaying but patched up IT architectures.

But there is another potential advantage for the small, next-generation firm as we move into 2017: an advantage of organisational design and scale. History shows that the bigger the organisation gets, the harder it is to organise around your customer rather than your products.

The fact is, product centricity is a troublesome symptom of larger and older organisations. It is an inevitable consequence of decades and centuries of organic growth. But the true test is whether the company really has the unrestricted ability to solve problems in the best way for customers or is well intentioned innovation destined to be stifled and contorted to fit a vast array of vested interests.

More than half of customers complain about 'technology and processes taking too long'.

Technology as part of your financial life hasn't really happened yet

The evidence demonstrates that customers today remain as frustrated at financial products as they did four years ago.

There has been a huge amount of activity over the last 18 months, including a 50% increase in banking providers offering current accounts. We also have more current account products than ever before, a rise standing at 143 in 2016 compared to only 120 in 2011.

However, customers are not recognising any tangible benefits and have seen no improvement.

This is indicated by the number of Financial Ombudsman Service complaints, which increased in the first half of 2016.

Switching rates have also remained low. Despite a tiny rise in customers switching, this number is far too low to have any meaningful effect on the competition. In fact, figures show this is less than one per cent of the 65 million active current account users in the UK.

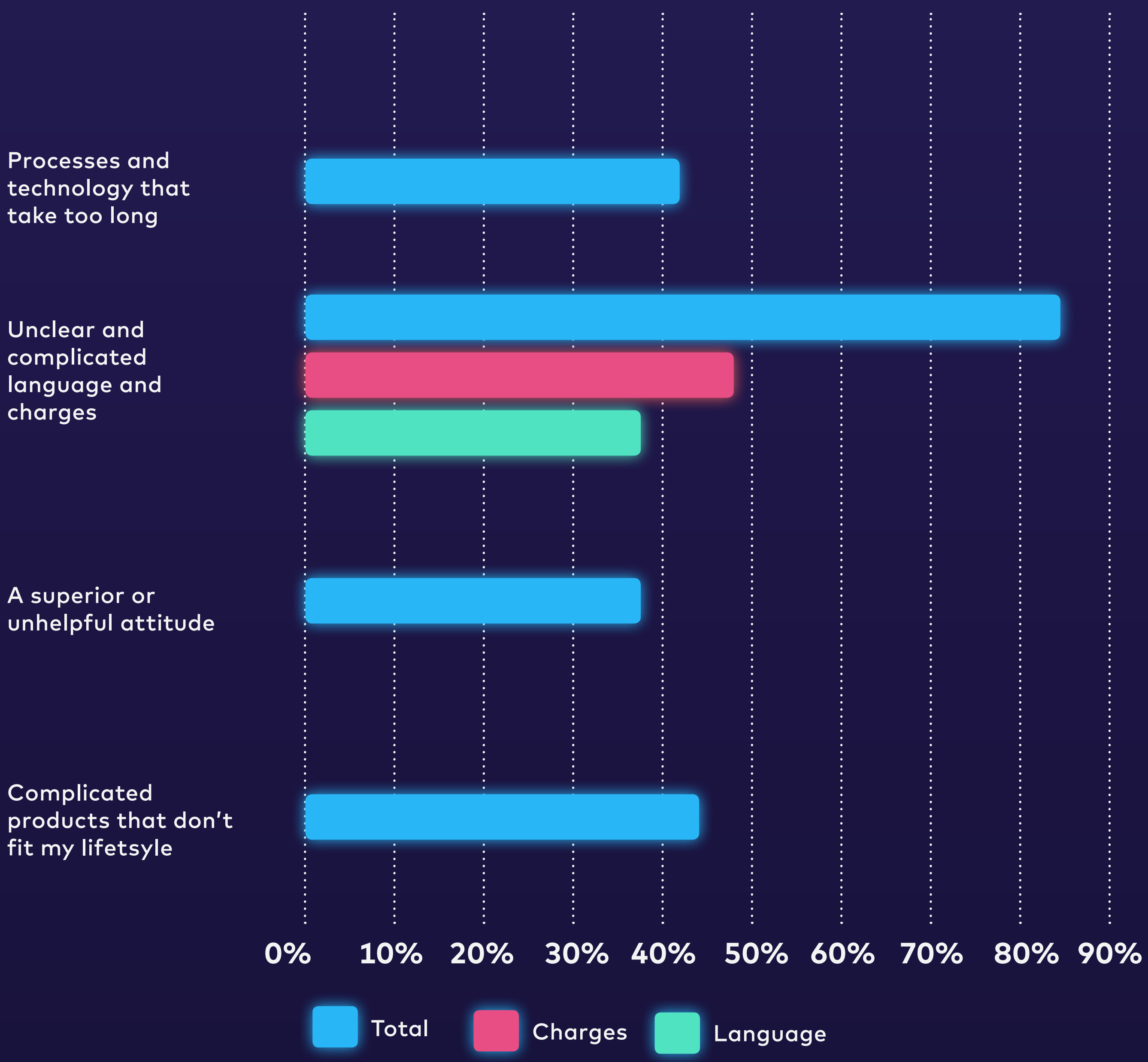
The number of products has increased but it becomes apparent providers have not changed their approach. Technology has entered the lives of customers but the products available are not necessarily the ones they want. A lack of customer insight means that financial services products are still built to fit within old restrictions and old IT systems. From bank opening times through to cumbersome security processes, they are out of sync with the modern customers' real lives.

Traditional financial products typically interrupt rather than adapt to people's lifestyles.

As part of this investigation into the future of fintech in 2017, independent interviews with a nationally representative sample of UK adults 18-65 were conducted during August 2016. The interviews took place online.

Customers share top frustrations with current UK banks

Source: Interviews with 100 fintech familiar customers conducted by Explain the Market and Starling Bank August 2016



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CONCLUSION IS REVOLUTION THE FUTURE OF FINTECH?

What becomes apparent from this research is that whilst there is plenty of opportunity ahead, there remain huge challenges for fintechs moving into 2017.

Whilst fintech is no longer a nascent industry and has moved more and more into the mainstream, the narrative has become stuck in its own echo-chamber and lost sight of its original focus: putting customers at the heart of the financial system.

Moreover, hundreds of fintech start-ups aiming to revolutionise banking and finance have now fallen under the control of UK's biggest banks through acquisitions and investments. This is particularly evident considering one in four fintech deals is dominated by giant corporations. Furthermore, UK banks such as HSBC, Lloyds, and Barclays, now control new fintech firms with hundreds of millions of pounds in behind-the-scenes investment; and foreign banking groups, like BBVA and Banco Sabadell, similarly have huge influence.

Because of this it seems that rather than increasing competition, the fintech industry so far has been helping the banks fend off competition.

The UK government and the regulatory landscape it has cultivated has done much to enable new players to enter the financial market and create products that can empower people in their everyday lives. They have also been vocal in their support of fintech, accentuating how new technology plays a crucial role in increasing competition in financial services.

However, the evidence reveals that because the biggest banks are controlling things behind the scenes, competition is becoming little more than superficial – a layer that thinly veils old systems rather than transforms the core of financial services.

Mindset and business models are the difference between revolution and evolution. Shiny products and pretty cards do little if there is not a shift in mentality and delivery.

We are therefore calling for change in three areas:

Firstly, we would like to call for action at category level – asking the fintech industry to join us in examining who controls investment and who stands to benefit the most from the billions being poured into our sector. Moreover, we would like to ask that this include an overview of government sponsorship and discussions with political bodies such as the Treasury to ensure the maximum can be done to encourage true competition and customer-first products.

Secondly, at a product level, we believe more needs to be done to ensure customer insight is the focus of new fintech propositions. The evidence demonstrates that customers today remain as frustrated at financial products as they did four years ago. More needs to be done to ensure that products adapt to the lives of customers not interrupt them.

Last but far from least, because our users come first, at a customer level we should put people in the driving seat. We need to bring them into the boardroom. We need to listen better and instead of trying to 'educate' those who don't need educating, ensure we provide the best service possible.

Our results reveal the priorities of customers with both the experience of mainstream UK banking and also newer options made available by fintech brands. Considered in combination with how the market is responding – the evidence points to six distinct expectations from fintech in 2017.

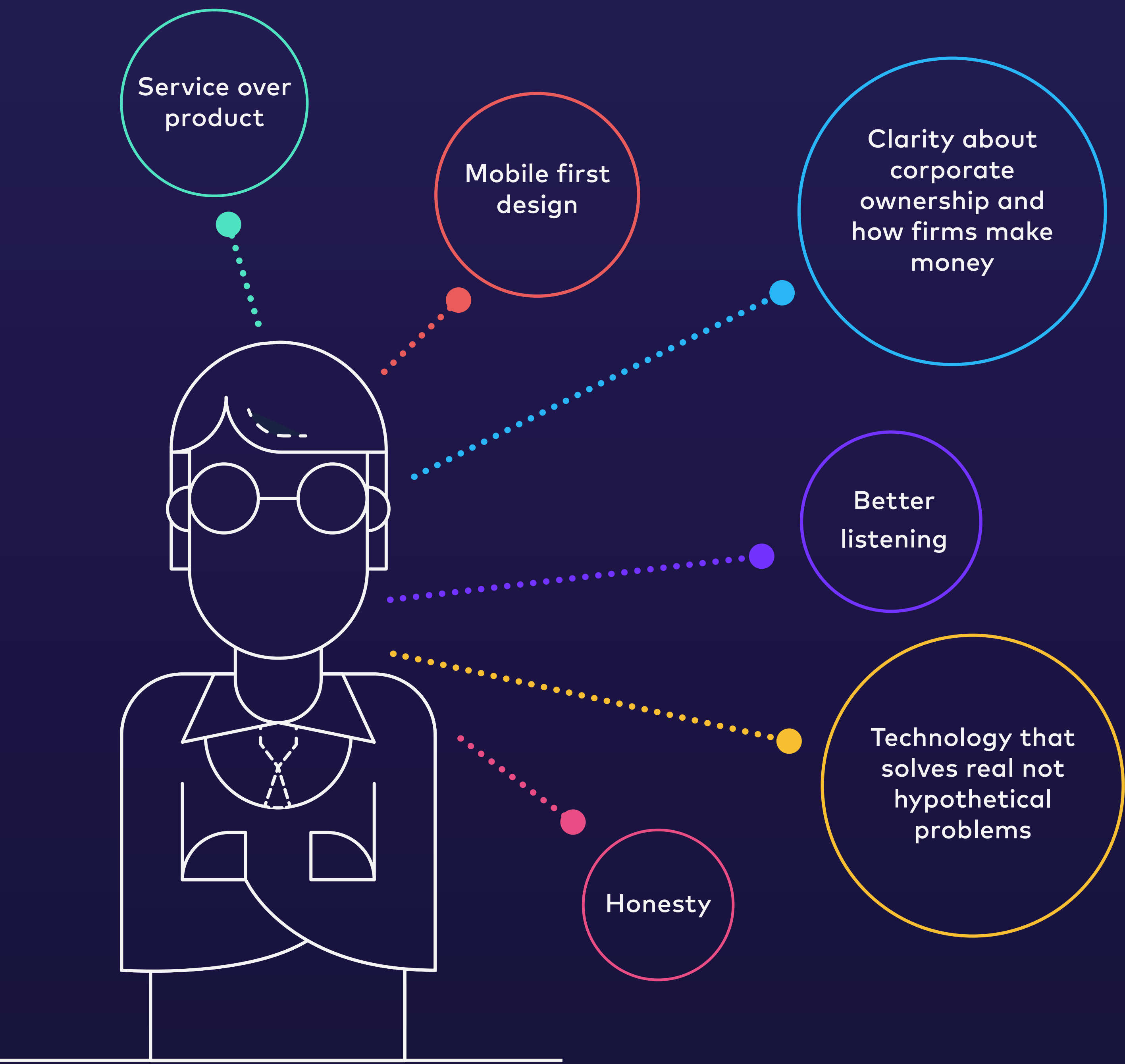
To conclude, if we can provide the above whilst simultaneously reminding ourselves of the mindset underpinning the fintech movement, then making the future of money about empowerment of customers is entirely possible.

The public are ready for change and 2017 gives us the opportunity to deliver that change.

Our research reveals six disctinct, customer expectations for fintech in 2017 .

Shiny products and pretty cards do little if there is not a shift in mentality and delivery.

Customer research reveals six distinct customer expectations for fintech in 2017



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- A series of interviews with influencers from the finance and technology investment community

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About Starling Bank

The idea behind Starling Bank was conceived by **Anne Boden** back in 2011. After a year spent travelling the world and seeing the latest developments in technology, Anne realised that the real-time customer experiences we are accustomed to in life, were missing when it came to banking. However, working within the systems of traditional banking, it was all but impossible to bring the same transformation to how people manage their money.

The answer was to build a brand new bank from the ground up – an answer that became Starling in 2014. Two years later, with a team of engineers, artists and economists, the build of the bank is nearing completion .and a mobile app launch is on the horizon.

The bank was awarded its UK banking licence in July 2016, and is focusing on a single current account product for UK individuals.

Visit www.starlingbank.com

About Explain the Market

With 17 years experience leading research into UK and global financial services, **Guy Shone** is CEO of Explain The Market. He is an expert in ethnographic research and was honoured as a Market Research Society finalist in 2013 for excellence in the field of financial services research.

Previously, Guy was Head of Global Research for Old Mutual Group plc leading all research programmes across Europe, Asia and Africa; and before that he was Head of Research for UK government backed Money Advice Service. During this time, he directed the largest study into the financial lives of UK families ever undertaken – a study that formed a central part of the evidence base for the UK financial capability strategy.

Guy holds an MBA from Cardiff University and has also previously worked as a journalist and broadcaster.

Visit www.explainthemarket.com

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