The future of banking

Time for a change of perspective

CONTECTS

Bringing post-digital banking models into focus I

Challenge of banks for the next decade: II

Finding value beyond vertical integration

New angles on banking business models: III

It is time to see banking in a new light

Flipping the perspective on banking: IV

Evolving from a single to multiple business models

Embracing the strategic kaleidoscope V

Rethinking banking business model

Banking is changing as value chains are fragmented, products are componentized, and new adaptive players emerge.

The banking industry is undergoing a transformative shift characterized by the fragmentation of value chains, componentization of products, and the emergence of agile and adaptive players. This paradigm shift presents both challenges and opportunities for leading banks to navigate and stay ahead in a rapidly evolving landscape.

In response to these dynamics, forward-thinking banks have recognized the need to embrace innovative strategies that coexist with traditional approaches. They understand the importance of agility and adaptability in reconfiguring their business models and product offerings to effectively meet the ever-changing needs of customers and markets.

By embracing innovative strategies, adopting agile business models, prioritizing customer-centricity, fostering collaborations, driving and embracing digital transformation, ensuring regulatory compliance, and nurturing a culture of innovation, banks can position themselves at the forefront of change.

The banks that effectively navigate this transformative journey will not only survive but thrive in the fast-paced and dynamic world of modern corporate investment banking.

Executive summary – bringing post-digital banking models into focus

Bringing post-digital banking model into focus

Our analysis shows how digital-only players that use non-linear business models and target specific roles in the banking value chain outperform those that simply emulate vertically integrated models in the digital world. These specialist providers, who can adapt easily to product componentization and leverage value chain fragmentation in their business models, have enjoyed compound annual revenue growth in the past years.

By contrast, digital-only players with vertically integrated business models achieved impressive but lower revenue growth of **44 percent** over the same timeframe. Both, however, outperformed revenue growth in the traditional banking sector, with even the best-performing mature banking markets expanding at average rates below **2 percent** after the global financial crisis.

The performance of digital-only players that challenge vertically integrated business models with non-linear approaches and innovative propositions offers inspiration for incumbent banks that want to achieve breakout growth and higher market valuations. It illustrates how banks can play different roles in the value chain at scale, depending on their size, capabilities, market positioning and regulatory environment.

In this world – where banking customer experience, distribution, product manufacturing, and balance sheet management are uncoupling, and traditional products are being broken into smaller components – business models that once seemed as immovable and fixed as a stained-glass window now more closely resemble the changing colors and patterns of a kaleidoscope.

As each bank brings a new vision into focus, it can operate a kaleidoscope of indirect – **B2B2X** and direct – **B2C** and **B2B** business models by unbundling traditional products; re-bundling its own offerings and components from other providers into innovative personalized propositions; collaborating with ecosystem partners for distribution reach; and finding new ways to leverage its balance sheet and regulatory expertise.

By breaking down the old value chain and reconfiguring its parts to offer better customer propositions, incumbent banks, too, can unlock a multitude of new growth opportunities. However, unbundling products into components and playing new roles at multiple levels of a delayered value chain will demand a clear strategy, advanced use of data, a robust technology architecture coupled with intelligent operations, and the ability to manage multiple business models in a portfolio.

- Product componentization – today's traditional banking products are componentized into new micro-products or services, which may be sold separately or with their re-bundled versions.
- Value chain fragmentation – the layers in the value chain from product manufacturing and proposition packaging to sales or distribution become uncoupled, and instead of the bank owning the entire chain, different parties own different layers.

About the research

Our future of banking research aims to identify how the ongoing fragmentation of the traditional banking value chain and the componentization of key products and services will reshape the banking market of the future. It also seeks to understand the potential strategic implications of this emerging landscape for incumbent banks.

To these ends, we mapped out the business models and activities of incumbent banks and digital-only banking and financial services companies to understand the roles they play in the value chain, and how next generation models differ from the vertically integrated approach of the past.

Our quantitative and qualitative analyses spanned nearly **100** leading incumbent banks defined by size of total assets and more than **210** leading digital-only players – new entrants in the banking and financial services market identified by their valuation, funding, and revenue data in **11** countries across North America, Europe, Asia-Pacific and Latin America.

We also used persona data from the a banking consumer study to map the degree of innovation of digital-only business models against customers propensity to use new propositions. The findings obtained from our research were rigorously validated and further enriched through a series of in-depth qualitative interviews conducted with various key stakeholders within the banking industry. These interviews encompassed a diverse range of perspectives, including incumbent banks and investors, ensuring a comprehensive and multifaceted understanding of the subject matter.

By engaging with incumbent banks, we gained valuable insights into the challenges, opportunities, and strategies employed by established players within the industry. These interviews provided firsthand accounts of their experiences navigating the evolving banking landscape and shed light on the initiatives they have undertaken to stay competitive in an increasingly digital world.

Industry analysts played a crucial role in contributing their expertise and knowledge to our research. Their insights provided a broader context and a deep understanding of the industry trends, regulatory developments, and market dynamics that shape the current banking landscape. Their perspectives helped us gain a comprehensive understanding of the forces driving transformation in the banking sector.

In addition, we engaged with digital-only banks, which represent a new breed of financial institutions that have embraced digital technologies and innovative business models from the outset. These interviews provided unique insights into the strategies and practices employed by these disruptors, offering valuable lessons for traditional banks seeking to adapt and thrive in the digital age.

Lastly, we sought the perspectives of investors who closely monitor and evaluate the banking industry. Their insights provided a valuable investor's lens, offering perspectives on market trends, investment opportunities, and the factors they consider when assessing the performance and potential of banking institutions. These interviews helped us understand the investor sentiment and expectations within the industry.

By incorporating diverse perspectives, we ensured a comprehensive analysis, enhancing the relevance and reliability of our conclusions.

Challenge for banks for the next decade

Traditional banks look healthy but cracks are beginning to show in these models

On the surface, the banking industry looks to be in good health. Major banks worldwide have posted robust revenue growth and handsome profits in recent years, in the face of rising competition from fintech players. Even the pandemic has not crimped their performance. Indeed, for many it has been an excellent opportunity to reassert their relevance in a changing world and close some of the digital gap between themselves and fintechs.

Scratch deeper, however, and it becomes apparent that incumbent banks are seeing a steady attrition of value and revenues. Relative to the size of the global economy, the traditional banking system is shrinking. Low interest rates, fee compression due to heightened competition, an inability to differentiate their offerings, and migration of revenues to non-banks are slowly eroding banks share of GDP.

This flow of banking revenues to new players started as a trickle, when the first neobanks burst onto the scene with new fintech experiences that offered a slick mobile interface and more personalization. Yet these players failed to fundamentally change the market because they largely emulated the vertically integrated business model of the incumbents and because many incumbents have become fast followers, in turn emulating the attractive product offerings of the neobanks.

Now, however, the slow drip is building into a steady flow. Digital-only players with non-linear business models are attacking the foundations of the vertically integrated banking model with new value propositions that delayer the value chain and break products into discrete components. This process, which has already played out in payments via several innovators, is now unfolding in commercial banking, personal credit, deposits, investments and more.

The new wave of competition could change everything

When the first wave of neobanks hit the market with familiar banking propositions in a shinier digital wrapper, the response by incumbent banks was obvious – to become the best digital versions of themselves.

Yet this approach has reached its limits in a world where, from the consumer s point of view, the digital banking challenge is mostly resolved.

Digital payments, mobile banking apps and online banking experiences are almost universally good, and it is becoming increasingly difficult for any incumbent or neobanks to use them as a point of differentiation. Now, the competitive arena has moved to product innovation, with new players attacking the incumbents in the areas where they are most exposed in attempts to exploit them.

In a fragmented world, presence and vertical integration are no guarantee of success

In choosing the layers of the banking value chain and the micro product niches in which they wish to play, non-linear digital competitors have gained the ability to configure innovative products and propositions fast and at low cost. They have the flexibility to rapidly create differentiated products for a digital customer who searches online for financial products and creates a custom bundle that meets their specific needs.

The result, in most markets, is a steady outflow of banking and payments revenues from incumbents to new entrants. This shift is unfolding in different markets at different speeds, depending on factors such as industry structure, regulatory policies and consumer readiness. Some, like the Nordics, the U.K or the U.S, are more advanced in revenue migration, but incumbents in few markets will be spared.

Inexorably, this process is weakening the grip banks once had as owners of customers primary transaction accounts. The power they held through traditional banking relationships, vast branch networks, workforces that focused on cross and up-selling, and the invisible packaging of products sold through physical distribution channels has been eroded.

What is more, the strengths of a vertically integrated business model are not easily replicated in the digital world. To beat back competition from innovators who excel at manufacturing better banking products and assembling product components into compelling offers for customers, banks will need to do more than invest in digitizing their existing sales and distribution capabilities.

As such, banks can no longer count on cross and up-selling to grow share of wallet and maintain their franchise power or distribution reach. As best of the breed competitors attack different product segments and links in the value chain, banks in the years to come will face the loss of market share by attrition and disintermediation. To defend and grow their share, they will need to play new roles in the value chain, reflect on their purpose and engage with sustainability.

The competitive edge that most of these adaptive players have?

They have focused on the customer intent, decoupled themselves from the traditional value chain, and embedded their services into the right place and time in the customer journey. Some achieved further differentiation with their purpose-driven approach and emphasis on sustainability. Their business models enable them to scale with lower customer acquisition costs. BNPL companies, for example, thrive because their product is inserted into the checkout process at the point of sale rather than being an overlay that customers navigate separately.

Our analysis shows that digital-only players with **B2B2X** or product bundling business models have more than **50 percent** higher market valuations measured by a valuation-to-revenue ratio than those with vertically integrated models. For banks, this illustrates the potential of finding new sources of value by complementing their existing vertically integrated business models with product bundling and indirect distribution partnerships.

Opportunities emerge from delayering the value and product componentization

As digital-only players or fintechs continue to attack different parts of the value chain, they are breaking it into fragments that can be reassembled in multiple innovative ways. Where they were once tied together, product manufacturing, distribution, risk management and the regulated balance sheet, and the customer interface and experience have become uncoupled.

Consider the business model of **Stripe Treasury**, which offers Stripe merchant platform customers powerful application programming interfaces. This allows the platforms to embed financial products into their services, enabling their customers to easily send, receive and store funds. Shopify is partnering with Stripe and its financial institution partners to build **Shopify Balance**, the business account designed to help merchants take control of their finances.

As Stripe invests in its treasury infrastructure, it plans to deepen a partnership with Goldman Sachs to add features in the US over the next year. While Stripe Treasury may have the compliance capabilities and balance sheet of a traditional bank partner like Goldman Sachs at the core of its business model, each of the layers in its **B2B2X** configuration plays a different role in enabling online merchants.

Skeptics argue that such treasury services often target smaller businesses that are unprofitable for incumbents to serve. However, **Square** shows how small businesses can grow into profitable customers when served with the lower customer acquisition costs, exponential growth and massive scale enabled by digital models.

Banks should thus assess where their differentiators lie and how to monetize them via different business models. Their balance sheet power, ability to manage risk, and familiarity with regulations are difficult for new entrants to replicate – a key strength and one that does not need to be constrained through a model of monolithic vertical integration.

Along with value chain fragmentation, the componentization of products is also accelerating. Fintechs and other new players are breaking products into sellable micro-units that can be offered and consumed via application programming interfaces. Today, there are in excess of **100** companies in the banking-as-a-service space, among them fintechs and major banks that provide product functionality to other organizations.

This enables any other player – a retailer, a bigtech or a neobank – to use these components to create banking experiences or embed financial solutions into its core customer experience. Consider, for instance, how consumer credit is becoming embedded in the shopping experience via **BNPL**, or the steady rise of **B2B** embedded finance solutions.

It is the scalability and cost efficiency of the cloud, paired with plentiful consumer data and maturing artificial intelligence, that enable these new players to quickly get to market with customized and innovative banking propositions. This is creating fertile ground for innovative banking plays to take root. For instance, embedded banking plays where non-banking companies with sizeable distribution networks embed banking products in their offerings to drive additional value for their customers and increase lifetime value of customers.

The growing threats to revenues of banks

As these new banking plays continue to mature, there is a real risk that more banking products will disappear into super apps and platforms offering a range of financial and non-financial products and services from a company and its partners and those incumbents will bleed more revenue to these new players.

As banking services such as payments and credit are embedded into other services and platforms, larger banks without a clear response face the danger of customer attrition and fee compression in the face of digital competition. Regional banks, community banks and credit unions, meanwhile, face an existential threat as they become more tightly squeezed between mega-incumbents and neobanks.

For multinational banks, this calls into question the validity of running a similarly vertically integrated banking business in each market. Progressive banks will instead be looking at how they can accelerate their growth by developing new business models that enable them to defend their vertically integrated businesses in their core markets, while seeking growth through non-linear strategies such as **B2B2X** plays and product bundling in both domestic and expansion markets.

For many, the fragmentation of the value chain may be as liberating as it is frightening. No longer does every bank need to develop and maintain every capability and product itself, at great expense. There is much to learn from neobanks like **N26**, which offers a seamless customer experience while it selects and smoothly integrates products and services from best-of-breed partners.

Growing and differentiating with a kaleidoscope of business models

Few large banks will want to jettison their vertically integrated businesses, as they are still the engine of profitability. In the fragmented U.S market there is also still an opportunity to consolidate that traditional business through M and A and grow revenue and profitability within that business model quicker than the overall market. However, there are also numerous opportunities for them to introduce new products and offerings in discrete parts of the value chain. The leaders will differentiate themselves and grow faster than the market by operating a kaleidoscope of business models.

To date, many banks have focused on how they can be the best possible digital version of themselves. Yet the leaders of the future will be those that are considering how they can formulate and operate adaptive, profitable models – such as indirect digital distribution and product bundling – while running their traditional vertically integrated business at the same time. As the CEO of one major U.S bank recently put it, his bank is going to have to learn to “walk and chew gum” and excel at both if it is to be a long-term winner.

This process starts with reimagining the role of the bank in the digital value chain of the future. For a vertically integrated incumbent, the process will begin with delayering internal capabilities and componentizing products in order to create sellable capabilities and components that can be offered to other players or reassembled into new product offerings.

This is far from a trivial undertaking, since it involves challenging the traditional business structure and operating model. Yet there are precedents for such a radical approach in banking and other industries. **Amazon** has turned the cloud platforms it initially built to serve its own retail business into the world s most powerful hyperscale cloud provider. With **AWS**, it transformed an internal strength into an external offering that has set the standard for the rest of the market.

nCino, the salesforce-based banking operating system, started life as an internal solution that Sky Curve Bank created to process small business administration loans at speed. The bank has since spun nCino out as an independent venture that today has hundreds of banks as its customers and is worth billions of dollars. Many other banks could also unlock latent value in parts of their business which they take for granted.

The most successful incumbents will use the same product manufacturing and operations infrastructure to seamlessly serve both internal and partner distribution channels, with distribution and customer management being a decoupled layer sitting on top.

For those banks that do not see themselves changing their legacy technology and operations quickly enough to make that a reality, the alternative is to build a parallel tech stack and ops capability that still allow participation in a fragmented banking market while tolerating some duplicate costs.

Yet the more comprehensive the commitment of a bank and approach to delayering its capabilities and atomizing its products and to repackaging internal and external components, the more new revenue streams it can develop.

Those that take a tactical or experimental approach will struggle to develop the metabolism they need to digest the current speed of change and innovation in the banking market. They may also struggle to scale up the impact of new business models.

33 Percent

of banking executives report the "re-bundling the unbundled" trend is essential to the success of their respective organizations or businesses, while **48 percent** see it as somewhat important.

53 Percent

believe that the "re-bundling the unbundled" trend will mature in the next few years, say **3 – 5 years** while around **47 percent** believe it will mature in the next decade.

98 Percent

of banking executives reiterated that to succeed in the future they are willing to operate more like broad federations of businesses in response to market fragmentation.

The concept of "product unbundling and re-bundling" refers to the process of breaking down traditional banking products and services into their individual components or features – **unbundling** and then reassembling or combining them in new and innovative ways – **re-bundling**. This approach aims to offer customers greater choice and flexibility by allowing them to select and customize specific features or functionalities according to their preferences and needs.

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Understanding the world like a non-linear, digital only company

Our analysis shows that there are far more examples of digital-only players successfully exploiting the fragmentation of the value chain and the componentization of products than there are incumbent banks grasping the opportunity.

Nearly half of leading digital-only players have adopted non-linear models against **52 percent** that still emulate the traditional, vertically integrated, models. In some countries, like the U.K, U.S or Australia there are more than **60 percent** of digital-only players with non-linear models, while across other countries analyzed that number is on average below **50 percent**.

While digital-only players commit wholeheartedly to non-linear business models, incumbents tend to experiment with them for fear of cannibalizing their traditional vertically integrated businesses.

Digital-only players that build their businesses on the non-linear packager and **B2B2X** models are often rewarded with rich valuations and strong growth.

Stripe, for instance, evolved from a niche payments processor to bundling components from banks and fintechs and providing them to platforms like Shopify.

Shopify, in turn, is not only using payment processing service of stripe to drive Shopify Payments, but also recently embedded **BNPL** offering powered by affirm called **Shop Pay Installments** into its platform.

Meanwhile, Square, a provider of payments, e-commerce and financial services to merchants, recently acquired the Australian **BNPL** provider **Afterpay** for **29 Billion USD – 24.65 Billion EUR**, and will embed the Afterpay offering into its consumer and merchant offerings. Afterpay has also become a major partner to an incumbent bank that is becoming more adaptive in its strategy.

In this world, to grow and be profitable, it is no longer necessary for banks to always own the value chain end-to-end or to manufacture all of their own products. What matters more is how they can design value for the end customer or for the next player in the value chain. They can play a range of roles in the chain, giving them the flexibility to create value and capture growth from new sources.

Architecting value is about creating, and defining the value of a banking product, service, product component or experience. It goes beyond selling a product off the shelf, towards putting together a proposition that addresses the need of an end-customer through direct channels of the bank or as part of an offering a **B2B** distribution partner puts together for its customers.

Options to configure a kaleidoscope of business models

- Reimagine sales and service by selling your own product, selling through others and selling the products of others.
- Reimagine value propositions – act as a value architect by bundling the products of others with yours, and rebundling internally.
- Reimagine manufacturing and products.

Becoming a value architect

The banks that will lead the future will be those that have mastered the role of the value architect.

This is not a shift from the business model of today to a completely new one. Rather, it is an evolution from managing a single, vertically integrated business model towards managing multiple non-linear business models and roles in the value chain – a strategic evolution already underway at some incumbents.

Large banks may embrace all these strategies based on their target market and customer segments and the way they choose to use their balance sheet. With higher **cost-to-asset ratios** than the largest banks – up to twice as high in Asia-Pacific and Latin America – mid-size banks will need to build on their current strengths to better leverage their balance sheets and improve efficiency.

Customer ownership is a powerful differentiator, but it comes at a cost. However, direct acquisition of customers within a vertically integrated model is not the only option for growth. As they adopt their kaleidoscope of business models, banks can play a range of roles in the value chain and scale by leveraging technology to gain speed and flexibility.

There is a choice between an approach where new models are built from scratch and run in parallel with the traditional business, and one that involves creating a single technology and operations layer that can drive multiple business models.

The former is quicker and simpler, but building a common platform from the outset is likely to create more value over time.

Embracing the strategic kaleidoscope

introspection, assessment and evaluation

As a starting point, leading banks will evaluate in which areas they are best in class, in which areas they want to develop their own capabilities and products, and in which parts of the business they could benefit from sourcing capabilities and products from partners.

In those areas where they excel, they could unlock value by driving white label models.

Right now, banks can choose between three approaches. They could choose to stay their current course, continuing to evolve into the best possible digital version of a vertically integrated institution and take share in what is a slowly shrinking market. This seems on the surface like a safe bet, but growth may stagnate as more aggressive players continue to reshape the industry and revenue and value leak out of the vertically integrated business model at an increasing rate.

Choosing to be a fast follower is a second option. Here, banks will monitor the trends affecting the markets and products they want to own, respond fast to innovations as they come to market, and strive to hold and perhaps slightly grow market share.

The third option, for the most ambitious banks, is to not only defend market share but to go on the attack. They will choose markets where they have a competitive advantage and seek to scale up growth through adaptive and non-linear – **packager** and **B2B2X** – business models.

Our research department recommends that as we position for a world of endlessly configurable business models, we must consider the underlisted strategic aspects to differentiate and to grow.

Setting strategic direction

Identify opportunities and viable capital or cost-lite models to achieve growth, keeping sustainability in the core.

Decide which markets we want to own and dominate and in which you are best positioned to drive success at scale.

- Adapt to the speed of change of each market by choosing where and how to generate value.
- Determine how to use the power of our balance sheet, our regulatory compliance and our risk management ability to drive growth and start decomposing products into components and delayering our value chain.
- Differentiate by building purpose into the core of the business and focusing on sustainability.

Select our roles in the value chain and find sizeable companies with which to partner.

- Learn from the philosophy of **Amazon** which primarily implies partnering with others in markets where it cannot be the best. Examine how product bundling and indirect distribution partnerships can help us grow in these markets.
- Evaluate options to package products from other providers as part of our solution for the customer, and configure products that can be repackaged by other providers. Decide where to plug in infrastructure, services and products from best-of-breed partners.
- Identify options for distributing products through or with others to complement our own networks.

Ability to execute and align

Align your strategic choices with your operating model and technology capabilities to manage value architecting.

- Define the impact of the kaleidoscope of business models on our culture, leadership, performance models and current talent. Identify and fill our capability gaps.
- Enhance our compatibility with the fabric of the wider network of banking and non-banking service providers. Decide where to buy and where to build technology capabilities to strike the right balance between the speed and the thoroughness of our transformation.
- Create simpler customer propositions designed to be embedded into the right place and time in the customer journey.
- Excel at intent-driven, zero-touch operations – use data and intelligent automation to personalize propositions for customers, predict their needs and respond to their intent while keeping operational costs low.
- Adjust our technology roadmap for the **B2X** and **B2B2X** markets, since we could be either be in the value chain.
- Evaluate the impact of these measures on our ongoing investments and decide whether to accelerate or stop investment and when to leverage new options from external partners.

As their diminishing contribution to the overall economy reveals, several banks are unlikely to achieve this goal by following the same business models and strategies as they do today. Yet the strong performances and high valuations of a new breed of digital-only financial services player show that there are abundant opportunities for those that are willing to shift perspectives.

Banks that master the discipline of managing multiple business models at once, and of putting together different capabilities and product components in innovative propositions, will be able to outperform the market. They will need to approach this challenge strategically and with a focus on architecting value for all stakeholders.

By playing different roles in the value chain at scale and managing a kaleidoscope of value propositions, banks can move from defending market share to once again targeting real growth.

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