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Navigating Disruption in Financial Services

How Eight Strategic Transformers Lead

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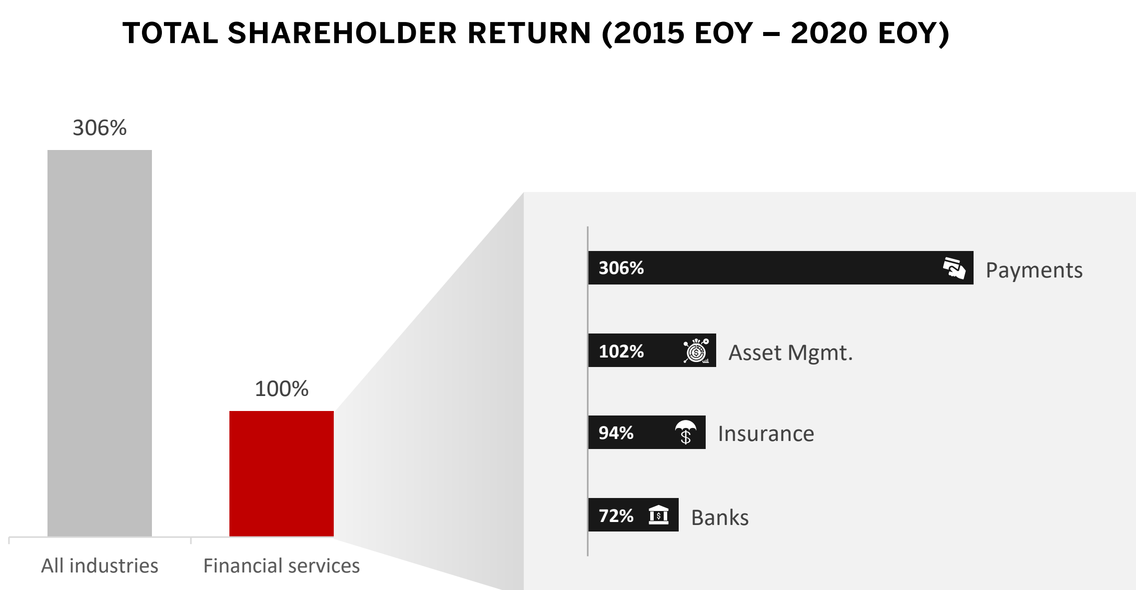
The financial services industry – a $20.5 trillion market in 2020[1] – plays a vital role in the global economy. The industry is responsible for providing capital, managing assets, facilitating payments, and much more. Yet despite the size and importance of the industry, financial services companies, specifically banks, insurance providers, and asset managers, have lagged other industries in value creation (See figure 1). Our analysis points toward a broader problem: the global financial services industry faces significant shifts that potentially threaten the survival of incumbent companies.

In this environment, pursuing "dual transformation" – reinventing the core business ("transformation A") while also creating new growth ("transformation B") – has increasingly become a leadership mandate. To better understand the dynamics of transformation, we analyzed the state of the industry and reviewed the performance of more than 700 financial services companies globally. Our team applied a unique approach proven in two global and three regional transformation studies.[2] Our analysis highlights eight "strategic transformers," companies that have demonstrated outsized performance and transformative growth over the past five years (see figure 2).

These companies have navigated disruption by committing to a long-term vision, defining a clear path to this future state, and building the capabilities to own the future. While digital transformation is a core element of their strategy, it alone does not secure long-term survival. The strategic

Figure 1: 5-Year Total Shareholder Return of U.S. Financial Services Institutions



Note: Included companies in the U.S. with >USD 1 billion in market capitalization; TSR weighted by market capitalization.
Data: S&P Capital IQ

transformers illustrate that companies must also make a strategic choice about the role they want to play in the future financial services ecosystem. Our research suggests there are two broad choices that can guide strategy: to "own the consumer relationship" by investing in consumer-centric technologies and offerings or to "own the infrastructure" by investing heavily in technologies that enable others to serve consumers. Of course, there are nuances, but these two archetypal choices provide a useful framing for the future of financial services.

Figure 2: Eight Strategic Transformers in Financial Services

Company	Sector	Geography	Transformation Summary
BlackRock	**Assest Mgmt.**	**USA**	Transforming to an infrastructure and technology provider through Aladdin, a risk analytics and portfolio management technology solution, while growing the core business with iShares ETFs. BlackRock expects Aladdin and other technology solutions to grow from 7% of revenues to 30% of revenues over the next 5 years.
JPMorgan Chase	**Banks**	**USA**	Expanding to a new business model by creating an industry-wide blockchain powered technology solutions, Liink (a payments infrastructure) and JPM coin (digital coin) through a dedicated unit — Onyx. J.P. Morgan is also digitalizing its core business and launching a digital-only bank in the UK (later in 2021).
Sber	**Banks**	**Russia**	Transforming to a "super app" by expanding its non-financial services offerings. Sber aims to drive the share of non-financial services (including e-commerce, media & entertainment, education, cybersecurity, cloud, among others) to 60% of revenues by 2030.
AIA	**Insurance**	**Hong Kong**	Expanding to a health and wellness ecosystem beyond insurance with the AIA Vitality platform that provides wellness, prevention knowledge, tools, and incentives to AIA members. AIA also offers consumers access to digital healthcare platforms and on-demand telemedicine through regional partnerships, an area it plans to grow steadily.
Ping An	**Insurance**	**China**	Creating digital ecosystems around auto, finance, real estate, healthcare, and smart cities. Ping An has also digitalized its core business with over 80% of systems hosted on a proprietary cloud and a consolidated app for all digital offerings.
Mastercard	**Payments**	**USA**	Expanding the range of value-added services, specifically cybersecurity solutions, while also opening new payment flows (e.g., real-time cross border, B2B), primarily through acquisitions. Additionally, Mastercard is allowing companies to leverage its APIs through an open portal.
PayPal	**Payments**	**USA**	Expanding to an ecosystem from a single-product company. PayPal has achieved this growth primarily through acquisitions across the customer journey including product discovery (Honey), P2P payments (Venmo), POS and funding (iZettle), among others.
Visa	**Payments**	**USA**	Transforming the business to be a "network of networks" by opening new payment flows and embedding itself in fintech and bigtech ecosystems through APIs and technology (e.g., Visa Token). Visa estimates that new flows and value-added services will account for >30% of net revenues by 2024.

Data: Company reports, expert interviews, Innosight analysis

To illustrate a successful dual transformation, consider the China-based insurance company Ping An. Over the last decade, the company evolved from a pure property & casualty insurance company into an integrated ecosystem that has invested in a strategy to "own the consumer relationship." The company began its transformation as early as 2012, as its co-founder Peter Ma foresaw the impact of the internet and as the industry was facing massive disruptive threats that were decreasing overall premiums and claims.

Ping An's "transformation A" focused on digitizing its core business and making it more consumer-centric, investing heavily in AI, blockchain, and cloud. By the end of 2019, the company had already invested $7 billion on technology and R&D and has plans to spend $15 billion more over the next 10 years.[3] The company's "transformation B" is creating new growth engines by developing digital ecosystems that span across five verticals - financial services, health care, automobiles, real estate, and smart city infrastructure.

Over the last 8 years, Ping An has launched Lufax (financial marketplace), Ping An E-wallet, Ping An HaoFang (real estate platform), Ping An Health (healthcare ecosystem), OneConnect (fintech SaaS provider), AutoHome (automobile e-commerce services provider), among other digital ventures.

Ping An demonstrates "owning the consumer relationship" through its e-wallet which provides some 300 million retail users with a suite of financial and consumption services in one place, including wealth management, shopping, lifestyle services, payment, and loyalty points management. The e-wallet also enables the operations of some 2 million merchants by providing a holistic set of solutions around acquisition, treasury management, and value-added financial services.[4]

Today, with a market capitalization of ~$208 billion, Ping An is one of the most valuable insurers globally. With several spinoffs that have achieved unicorn status, the company has been referred to as a "unicorn breeder." It ranks 7th in the Forbes Global 2000 list.

Disruptive Trends Driving the Need for Transformation

To understand the impact of disruptive threats in financial services, we analyzed the early signs of industry transformation across banks, asset management, insurance, and payments. Our disruptive threat analysis identifies five major changes that will require bold moves by incumbents to remain competitive (See figure 3).

Figure 3: Early Warning Signs of Disruption in Financial Services

	Early Warning Signs of Disruption	Banks	Asset Management	Insurance	Payments
Consumer	Decrease in consumer loyalty	HIGH	MEDIUM	MEDIUM	MEDIUM
Consumer	Shift in consumer preferences	MEDIUM	MEDIUM	HIGH	MEDIUM
Competition	Growth in competitors with disruptive business models	MEDIUM	LOW	HIGH	HIGH
Competition	Emergence of entrants at low-end or market fringes	HIGH	MEDIUM	HIGH	HIGH
Competition	Rise in venture capital investment	HIGH	HIGH	HIGH	HIGH
	OVERALL THREAT OF DISRUPTION	HIGH	MEDIUM	HIGH	HIGH

Data: Innosight disruption assessment

Decrease in consumer loyalty: Changes in consumer behavior are apparent from a decrease in loyalty towards traditional financial services companies, and consumer's growing trust in big technology companies as well as fintechs. According to a global survey, 54% of consumers trust at least one tech company more with their money than banks.[5] In asset management, commoditization is decreasing loyalty towards a single company. Finally, digitization leading to a reduction in switching costs is impacting loyalty in insurance and payments. In this environment, losing consumers to fintech and big tech companies poses a critical threat to incumbents.

Shift in consumer preferences: Financial services incumbents are largely unable to adapt to changing consumer preferences, including a desire for personalized and low-cost options, seamless transactions, and hyper-convenience. As the recent rise in retail investor activity shows, there is a desire for faster and cheaper ways to invest and access to investment-grade assets by non-consumers. Similarly, consumers increasingly prefer insurance providers with value-add non-insurance products (incl. financial planning, preventative services). Finally, consumers want convenience and speed through real-time payments globally. Across sub-sectors, financial services incumbents that do not respond to evolving consumer behavior risk being outperformed by disruptors.

Figure 4: On-the-brink Disruptors in Financial Services

Company	Primary Sector	Geography	Type	Valuation
Lemonade	Insurance	USA	Public	$4.0B
Root Insurance	Insurance	USA	Public	$2.3B
Metromile	Insurance	USA	Public	$0.9B
Robinhood	Investing	USA	Private*	$40.0B
Acorns	Investing	USA	Private	$0.9B
Nubank	Mobile banking	Brazil	Private	$25.0B
Revolut	Mobile banking	UK	Private	$5.5B
N26	Mobile banking	Germany	Private	$3.5B
Monzo	Mobile banking	UK	Private	$1.3B
Wise	Money transfer	UK	Private	$5.0B
Remitly	Money transfer	USA	Private	$1.5B
Adyen	Payments	Netherlands	Public	$52.4B
Paytm	Payments	India	Private	$16.0B
Grab Financial (Subsidiary)	Payments	Singapore	Private*	$3.0B
Klarna	Personal finance	Sweden	Private	$31.0B
Affirm	Personal finance	USA	Public	$12.5B
SoFi	Personal finance	USA	Private*	$8.7B
Kabbage	SME Lending	USA	Acquired	$1.2B

Data:Innosight Analysis, CB Insights, Yahoo Finance, Forbes, Reuters, Bloomberg

Notes: Companies sorted by primary sector; valuation for public companies is market capitalization, *initiated IPO process

Innosight identified 18 on-the-brink disruptors in financial services. The term on-the-brink disruptors first appeared in the 2009 book *The Silver Lining* by Scott Anthony. These companies:

1. Follow the basic pattern of disruptive innovation, transforming existing markets or creating new ones by making the complex simple or the expensive affordable
2. Have enjoyed enough early success that they are likely to withstand a crisis
3. Have not yet reported $1 billion in revenue

Growth in competitors with disruptive business models: Competitors are emerging to satisfy unmet consumer demand through novel business models (e.g., buy now-pay later platforms, pay-per-use insurance). Our analysis suggests that disruptors across payments, mobile banking, lending, personal finance, investing, and insurance are providing customer-centric, tech-enabled alternatives to services traditionally provided by incumbents. Technology giants are encroaching upon well-established areas, eating up market share. These new business models are fundamentally redefining how financial services institutions have operated in the past.

Emergence of entrants at low-end or market fringes: We analyzed 18 disruptors from across the world that are transforming existing markets or creating new ones within the financial services industry (see figure 4). These companies represent nearly $215B in aggregate valuation. For example, digital challenger banks, such as Nubank in Brazil, that entered at the periphery are now competing with mainstream players with full banking licenses. In asset management, challengers are emerging with low-cost solutions such as free-trading (Robinhood) or micro-investing (Acorns). Insurtech providers such as Lemonade and Metromile entered at the lower end of the market but now have full insurance licenses to compete with incumbents – a classic disruptive pattern. Similarly, in payments, companies such as Grab Financial and Paytm entered as niche players, but now have multi-line offerings to compete with incumbents. With lower barriers to entry, we expect the threat of new entrants to only accelerate in the future.

Rise in venture capital investment: Competition is being fueled by favorable policy changes such as open banking and PSD2 initiatives[6], as well as VC investments. Even in the height of COVID-19, payments fintechs alone raised over $12 billion in 2020 including 37 mega-rounds.[7] Wealthtech funding increased 86% during the year owing to 10 mega-rounds. Funding into digital banking companies increased 12% year-over-year. In 2020, there were several public market exits in insurtech including Lemonade and Root Insurance.[8] In sum, we expect that this rise in venture capital investment will fuel the next wave of competition for established financial services companies.

In the next five to ten years, competition will increasingly be digitally enabled while channels and distribution will be owned by the player that provides the best consumer experience.

These dynamics will radically reshape the industry in the next five to ten years: the competition will increasingly be digitally enabled. Data flows and APIs will reduce information asymmetry. The industry will not be locally or geographically constrained. Channels and distribution will be owned by the player that provides the best consumer experience. These changes will lead to a market with near-perfect information for the consumer that will kill fragmentation, force consolidation, and drive scale.

The question leaders must then ask themselves is "What would give our company a competitive advantage to win in this future?" While the answer to this question will be different across institutions, most incumbents will need to embark on an dual transformation (which is explored in detail in the Innosight book, *Dual Transformation*).

Lessons from Strategic Transformers

Building on our transformation methodology[9], we studied the collective efforts of the strategic transformers over several months and identified three key lessons for leaders commencing their own transformation journey.

1. Align on Your Destination

Leaders of financial service incumbents must align on their place within the future environment. This entails developing a view of what the future holds and the role of their company in that environment. A long-term vision is crucial to remain competitive amid the disruptive change in the industry.

As the CEO of BlackRock, Laurence D. Fink said, "I have always believed in a long-term view. At BlackRock, we take a long-term view of markets, and we take a long-term view in the way we run our company."[10]

One way to set a vision is to root it in a deep understanding of consumers. As Steve Jobs encouraged, "Get closer than ever to your customers. So close that you tell them what they need well before they realize it themselves." In today's age of skyrocketing expectations, consumer-centricity is imperative. The companies that are succeeding in this transformation demonstrate best-in-class consumer understanding and have developed capabilities to produce winning digital interfaces.

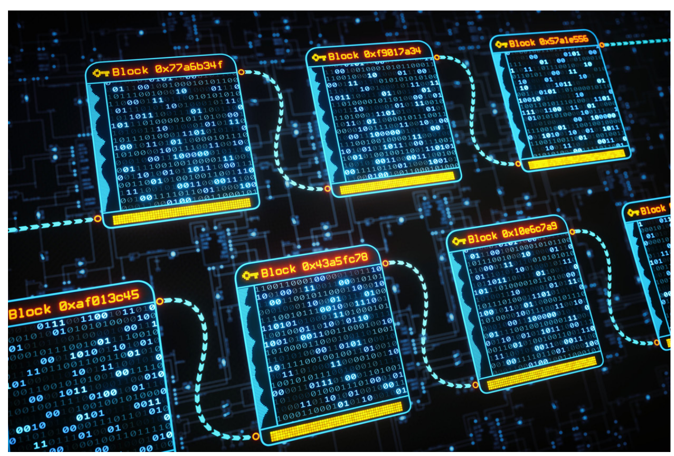
In the case of Ping An, it aimed to be a "one-stop-shop" for its customers and to become a wealth manager, health advisor, and life assistant, all in one.[11] We see the vision become a reality with several businesses that Ping An has diversified into – online financial marketplace Lufax, healthcare platform Ping An Health, fintech SaaS provider OneConnect, to name a few. Ping An Health, one of the most comprehensive healthcare ecosystems, has 346 million users, of which 210 million are also financial services customers. Through its broadened offering, Ping An avoids customers switching to other services, enabling the company to "own the customer relationship."

AIA similarly exemplifies consumer obsession. The company engages with consumers not just as a "payer" during the treatment phase but extends its relevance as an active "partner" in the prevention and diagnosis process. AIA Vitality helps consumers preempt illnesses through a range of tools including an AI-symptoms checker, personalized wellness content, nutrition coaching, and teleconsultation, among others.[12]

PayPal is another case in point. The company has made several acquisitions to expand beyond the "end-of-the-funnel" checkout button and own various parts of the consumer journey. Three key deals – Honey, Jetlore, and Modest – each target a unique aspect of the consumer e-commerce journey – consumer engagement, consumer buying behavior, and contextual commerce.[13]

Many of the strategic transformers on our list have embedded their advanced infrastructure and technology into the financial services ecosystem. They decided to bring clarity and connectivity to a complex network by allowing companies to plug into their systems. Infrastructure owners optimize the delivery of financial services and lower the cost to serve. They demonstrate digital dexterity and knowledge about key pain points in the end-to-end delivery of services, at least for their sub-industry.

At Visa, leadership has communicated that its long-term ambition is to expand from a global payments company to a "network of networks, to move money for everyone, everywhere." Visa believes that the "network of networks" strategy opens new payment flows between individuals, businesses, and governments, representing a $185 trillion opportunity.[14] Matt Dill, head of innovation and strategic partnerships at Visa said, "We see about 1,000 companies that we think have the ability to become new, flourishing digital payment ecosystems. Visa is opening the door to allow these companies to connect with our network on a global scale."[15] For example, Google, Amazon, PayPal, Square, Adyen, Stripe, among others, are partners of Visa Token Service APIs and allow the company to step towards "owning the infrastructure."



Similarly, J.P Morgan's Liink, is a platform (a mutually accessible ledger) on which 400+ leading institutions are putting information about cross-border payment transactions to cut down on delays. By leveraging Onyx's blockchain platform, Liink allows financial institutions to make fast peer-to-peer data transfers. Companies can connect to Liink via simple API integration.[16]

Of course, the above-painted picture of the future of financial services is imperfect. A major challenge of incumbent companies is to make meaningful decisions with imperfect information. However, by definition, such early decision-making is required to escape the threat of disruption. Once the disruption is obvious, it is often all too late to escape from it. The CEO of Mastercard, Ajaypal Banga said, "Rarely are you going to have perfect information. The willingness to decide at that time will depend on your ability to take a thoughtful risk, which ultimately depends on your courage."[17] Companies that focus too much on information and patterns from the past to determine the next course of action are doomed to be left behind in this ever-changing environment.

2. Define a Path to Reach Your Future State

Following the alignment on a long-term vision, incumbents must break down their transformation journey and establish measurable and time-bound goals. The clarity of goals can help them stay on track in the longer term even when perceived challenges deter their course in the short term. As the CEO of PayPal, Daniel Schulman, says "The chessboard moves very quickly. Externally, there's a lot of noise too."[18] Ultimately, setting quantifiable targets can prevent companies from being distracted by the noise.

Sber, for instance, has the ambition to drive the share of non-financial services to 60% of revenue by 2030.[19] Its non-financial services ecosystem is expected to comprise e-commerce, ride-hailing, food delivery, cloud-computing, streaming services, e-health, and virtual assistants, among other services.[20] Time will tell how the bank will turn its assets, including its >100 million client base and vast distribution network of 14,000 branches, into long-lasting competitive advantages.

Similarly, Fink targets Aladdin and the wider BlackRock solutions business to account for 30% of revenues in five years, compared with 7% currently.[21] With over 900 Aladdin and eFront clients in 68 countries and over 430K transactions processed per day on Aladdin, BlackRock is well-positioned to achieve its ambitious goals.[22]

On their path to the future, incumbents must not dwell in the past. J.P. Morgan has proven that it is willing to reconsider past failures as it is set to launch a digital bank in the UK after the failure of Finn (a similar effort in the U.S.), which closed down in 2019 due to slow pick-up.[23] "We don't look at those kinds of things like failures at all," Jamie Dimon said. "That is how you learn."[24] The company endeavors to start afresh with the digital bank in the UK in 2021 under the Chase brand and compete with digital upstarts such as Monzo, Starling, and Revolut and also Goldman Sachs' Marcus.

Finally, moving towards the future vision can also require companies to exit historically successful businesses. PayPal sold its consumer credit portfolio for $7 billion to Synchrony Financial in 2018 and thereafter deployed the cash to make some of the acquisitions mentioned above, which form the cornerstone of its future ecosystem strategy.

3. Build Capabilities to Own the Future

A financial services company that envisions to "own the consumer relationship" or to "own the infrastructure" will need to adopt new capabilities and resources. Our study of the strategic transformers indicates that most build up these capabilities with partnerships or acquisitions. Repeatedly (and successfully) executing partnerships and acquisitions is no easy feat. However, strategic transformers are compelling examples to prove that this route can help companies emerge resilient in an increasingly competitive environment. They provide access to a new consumer base, fill capability gaps, bring products or services to the market faster, and help diversify into fresh avenues. Alfred F Kelly Jr, CEO of Visa, said – "Partnerships are not simply additive to our business model, they are fundamental to our business model, whether it'd be our traditional financial institutions or fintech."[25]

Some notable acquisitions of Visa have been Earthport (cross-border payments), Verifi (dispute solution), and PayWorks (payment gateway software). Each of these acquisitions has a strategic purpose as they boost Visa's digital product, risk management solutions, and merchant product categories, respectively.[26] Earthport enables Visa to access 99% of the bank accounts in the top 50 markets worldwide.

As part of the objective to diversify beyond the core business, Mastercard has made several strategic acquisitions in the cybersecurity and fraud prevention space, including NuData Security, Brighterion, Ethoca, and RiskRecon.[27] To further augment its offerings across core streams, Mastercard acquired Vyze (POS financing) and Transfast (cross-border network capabilities). With Transfast, Mastercard can reach over 90% of the world's bank accounts.[28]

An aggressive M&A strategy has worked for PayPal as well. The company has spent over $7 billion on M&A since the start of 2018, the largest of the deals being the acquisition of Honey (e-commerce and loyalty) for $4 billion to tap into the $200 billion global loyalty industry. Other areas of expansion include payments, security, and funding. PayPal has acquired iZettle (POS and funding), Hyperwallet (global payout platform), Simility (fraud prevention and risk management), Braintree (internet payments gateway, including Venmo), among others.[29]

An alternative approach is to drive growth through partnerships. Consider the example of AIA - the company has leveraged partnerships to create its footprint across various regions in Asia Pacific. Examples include digital healthcare platforms MyDoc in Singapore and Practo in India, online-offline healthcare solutions platform WeDoctor in China, and AI-driven personalized health coaching platform Holmusk in Malaysia.

As this study shows, the strategic transformers have risen to the challenge and embraced the possibility of turning disruptive threats into opportunities. The choice for senior leaders is stark. Either they choose to own the future, or get disrupted by it.

ABOUT THE RESEARCH

Innosight has been conducting proprietary research on the topic of disruption and transformation for over a decade. For this research effort, our team began the process by screening all publicly traded financial services companies with >$1 billion in revenues. We split companies into small and large capitalization (>$10 billion market capitalization) and selected companies that outperformed their region or sector benchmark by at least 2x in TSR over 5 years from 2014-2019 (EOY).

The team then conducted qualitative research on 171 top performers to analyze the main drivers behind value creation. Together with industry and transformation experts, the team decided which value creation criterion would be considered transformative for incumbent companies. Based on this, they rated the degree and sincerity of transformation by studying various factors (e.g., the share of revenue, number of new clients, number of investments in growth initiatives, history of transformation). These analyses were complemented and validated with industry expert interviews. This resulted in a shortlist of 8 companies that were meaningfully transforming their core business while creating new growth engines in parallel.

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ABOUT INNOSIGHT

Innosight is a strategy and innovation consulting firm that empowers forward-thinking organizations to navigate disruptive change and own the future. Now a member of the Huron Consulting Group, we work with leaders to create new growth strategies, accelerate critical innovation initiatives, and build innovation capabilities. Discover how we can help your organization navigate disruption at www.innosight.com.

Contact Us

ENDNOTES

1. The Business Research Company
2. See, for example, our global study published in Harvard Business Review
3. Business Times
4. Ping An
5. Business Insider
6. The objectives of the EU PSD2 (Payment Services Directive 2) are to make payments safer, increase consumer protection, foster innovation, and competition while ensuring a level playing field for all players
7. Mega-round is shorthand for a start-up's fundraising round of $100 million or more
8. CB Insights, State of Fintech Report, Q4 2020
9. See the "About the Research" section
10. BlackRock
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12. HSBC Global Research Report, 12 October 2020
13. CB Insights: How PayPal Is Using M&A To Expand Beyond Payments Into E-Commerce And Loyalty, 2020
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