How to monetize your digital bank?
The path to a viable digital banking offering in times of COVID-19

Resilient Innovator Series
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Why should you read this, and who is this for?

COVID-19 and broader financial conditions have amplified the need to focus on human experience, profitability, and balance sheet strength. Shifting customer needs and margin challenges amplified the digitization of bank products, services, and experiences.

COVID-19 is fundamentally altering the banking landscape, pressuring banks of all asset sizes, from the smallest to the largest, to reinvent themselves and accelerate their digital transformation journey. Customers across age groups and income brackets are more willing to sign up for digital banking products and services, since the pandemic.¹ Now more than ever, digital transformation is essential as a means to improve efficiency and optimize costs.

Shaping attractive digital offerings with sustainable economics and monetization strategies has been challenging for large national and regional banks. How can banks shape digital banking business models attractive to customers and profitable in the long term? Deloitte embarked on a mission to answer this question by exploring the business models of successful digital banking challengers, as well as customers’ digital banking needs.

Based on market research involving more than 1,000 consumers during the COVID-19 pandemic, deep industry expertise, and insights from designing and launching several digital banking propositions, our study outlines key winning principles in the digital banking space.

77% of CEOs are saying their company’s digital agenda has been significantly accelerated since COVID-19.²
The digital banking landscape is shifting - again

With the surge of Fintechs, challengers,3 and big technology firms expanding their propositions towards financial services, the banking landscape is changing. International players, such as N26, entering the U.S. market are intensifying the competition by challenging established players with differentiating offerings, whereas existing local players, like Varo, are expanding their propositions to provide full-scale banking services. Big technology firms, like Google and Apple, have also been getting their skin in the game, delighting customers with attractive financial products, and experiences.

The move to digital has been compounded by COVID-19, propelling it to the forefront of incumbent banks’ agenda. Since the pandemic began, there has been an inflection point as customers across segments move towards digital channels, away from branches. In May 2020, PNC reported sales jumped from 25% to 75% digital, condensing 10 years of changes into 60 days during the early months of COVID-19.4 With social distancing measures becoming the new normal, the adoption of digital banking is accelerating across segments, moving beyond digitally fluent millennials and Gen Z, to older generations.

Often, in a quest to launch products that can win over customers as quickly as possible, business model viability takes a backseat. Customers’ demand for a seamless and engaging experience often requires costly digital transformation. Additionally, investors’ expectations for quick results can lead to short-sighted firm culture, constraining long-term digital transformation efforts.5 Building an attractive and viable digital banking proposition, can set banks up for long-term success.
How are challengers winning in the digital banking space?

New players disrupting the banking landscape with attractive digital products - "Challengers" - are pressuring incumbents’ profit pools, through rapid customer acquisition and competitive offerings. Deloitte recently analyzed the value propositions and business models of more than 100 challengers and identified three stages of monetization strategy as described in the chart below.

**Digital Banking Business Models**

<table>
<thead>
<tr>
<th>Strategy</th>
<th>Consumer Only</th>
<th>+ Small Business</th>
<th>+ Midsize and Commercial</th>
</tr>
</thead>
<tbody>
<tr>
<td>Customer Type</td>
<td>Checking, savings, debit</td>
<td>+ Credit, personal loans, investment, value added services</td>
<td>+ Large loans, life/home insurance, integrated software, platform-as-a-service, etc.</td>
</tr>
<tr>
<td>Product Evolution</td>
<td>Checking, savings, debit</td>
<td>3rd Party Marketplaces or referrals</td>
<td></td>
</tr>
<tr>
<td>Revenue Streams</td>
<td>Cash withdrawal, Foreign exchange</td>
<td>Freemium subscription models</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Interest, Interchange</td>
<td>Instant cash advances</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Financial Advice</td>
<td></td>
</tr>
<tr>
<td>Non-Interest Income</td>
<td>90-100% (Varies depending on core product (e.g. savings vs. checking with a debit card))</td>
<td>70-80%</td>
<td>30-40%</td>
</tr>
<tr>
<td>Net Interest Income</td>
<td>0-10% (Varies depending on core product (e.g. savings vs. checking with a debit card))</td>
<td>20-30%</td>
<td>60-70%</td>
</tr>
<tr>
<td>Sample Players</td>
<td>CHIME, VARO, TANDEM, DAVE, STASH, ALBERT, KAKAO BANK, WEBANK, FIDOR BANK, TINKOFF BANK</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Monetize the core product for net interest and interchange revenue, likely through a deposit account with a debit card.

Monetize value-added services and new products, including subscription-based services, small loans and investments.

Monetize from diversified set of products and platforms, focusing on loans, platform, or banking-as-a-service, and business banking.
Challengers apply several tactics to monetize digital banking business models, along their stages of evolution. Below are some key tactics we observed in the marketplace:

**Stage 1 Tactics**

**Attract customers and build the brand**

- Focus on rapid customer growth through a “no fee” proposition, higher deposit rates and a frictionless experience
- Leverage cost-efficient digital marketing channels to lower acquisition costs
- Monetize checking or savings accounts for net interest and interchange revenue
- Gradually expand the portfolio to become the primary bank of newly acquired customers

**Challengers tend to have abnormal customer and deposit growth - more than 25% of deposits will move to challengers by 2025**

- On average, more than 10,000 new customers are joining N26 everyday

**Stage 2 Tactics**

**Diversify revenue streams**

- Expand into new segments with personalized propositions for consumers and small-medium businesses
- Diversify revenues, with fees and service commissions (e.g., investment management, access to third party marketplaces, instant cash advances, lending, or freemium subscriptions)
- Build a high proportion of non-interest income

**Stage 3 Tactics**

**Grow business portfolio and lending volumes**

- Focus on growing the business segment and lending volumes
- Drive revenues predominately through business loans, mortgage loans, banking, or platform-as-a-service
- Secure recurring revenues with subscription services, and expand toward untapped customer segments, such as mass affluent and freelancers

**Challengers tend to have a lower non-interest income ratio, averaging at 30-40%**

- Monument, a UK Fintech challenger, is targeting wealthy clients (net worth £250K–£5 million) with a unique value proposition - being the “only bank that will offer an entirely digital lending experience of up to £2 million”

**Challengers tend to have a higher proportion of non-interest income, averaging up to 70-80%**

- In 2019, 80% of Stalingrad’s revenues came from non-interest income sources such as card & interchange, subscription, and other incomes
What do customers really desire from digital banking products and services?

We conducted a survey with more than 1,000 consumers across ages (18-45+) and income ranges ($50-150K+) to identify attractive digital banking products and services. Our research aims to uncover digital banking products customers would sign up for, digital banking features they prefer, and how much would they be willing to pay for those features. Our research yields six overarching insights.

01. Older and wealthier customers are more willing to digitally engage

Spending more time at home during the pandemic, customers tend to use their devices more frequently to interact with their banks. Our study found that since the early stages of COVID-19, wealthier customers are less willing to visit a branch. Customers are more willing to sign up for a digital banking product. The willingness to sign up for a digital banking product increased by 15% for customers in the 45+ age bracket. 64% of this segment adopted a digital deposit product since COVID-19, the highest adoption rate across age brackets and product types.

So what? Digital used to be for the “young & cool.” Now, it’s a need spanning across older and wealthier segments, increasing the pressure for incumbents to elevate digital experiences. Several challengers, such as Ellevest and Monument Bank, are already leading the way, targeting a more affluent segment.

02. COVID-19 has created new opportunities to invest and actively manage wealth

Digital investment and wealth management products gained popularity, especially in the younger segment below 45 years. The adoption rate of digital investment and wealth management services reached 39% in this segment, growing by 13% in less than a year. Wealthier customers with an annual income beyond $150K tend to invest more and exhibit the highest adoption rates of 53% on digital investment and wealth management services.

So what? Digital banking goes beyond creating online or mobile experiences for saving and lending; it encompasses smart propositions, to enable consumers to “make their money work smarter” and generate wealth.

03. Younger customers look to pay even more for banking services

Overall, 61% of customers are willing to pay for digital banking services. On average, customers are willing to pay a $13 one-time fee for their desired digital banking feature and a $9 monthly subscription basis. Younger customers between 18-24 years are willing to pay more for digital banking services, averaging $15 in one-time fee and $10 in subscription payment.

So what? Leveraging the strong demand of Gen Z and millennials for digital banking services creates monetization and growth opportunities for banks.
While 35% of customers chose loyalty and rewards as their top preferred feature, they have a relatively low readiness to pay for this service ($12 as a one-time payment and $8.50 on a monthly subscription basis). Challengers have been capitalizing on customers’ preference for rewards by leading new debit reward programs and using them to quickly build their young customer base.

Both Current and Point launched debit card rewards programs in 2020, anchoring their value propositions on simplicity and transparency.

So what? Customers are demanding trust, transparency, and value when it comes to their subscription service providers. A well-managed subscription banking service can help strengthen customer engagement and loyalty in the long term.

Customers in the age bracket 18-24 ranked social impact and environmental causes as a priority, choosing their digital bank. Given 57% of millennials are digital banking customers, the need to integrate offerings and experiences supporting these issues will grow.

For example, Aspiration provides a suite of planet-friendly benefits to customers who sign up for their Aspiration Plus subscription package, including a recycled debit card, carbon offsets for gas purchases, cashback from mission-focused merchants, a personal social impact score based on monthly spend, and an option to have a tree planted when purchases are rounded up to the nearest dollar.

So what? Banks targeting a Gen Z or millennial base can deepen engagement with customers by creating strong financial product value propositions centered on social impact and environmental causes.

So what? While loyalty and rewards programs require investment, it can also be used as an acquisition play to build a strong digital customer base. Debit rewards programs remain a largely untapped opportunity, especially when it comes to younger, digitally savvy customers who favor debit over credit.
How viable are digital banking business models?

Revenue can increase with engagement

As customers become more engaged and sign up for additional products, revenue per customer can increase exponentially. By following a similar path, incumbents can expect higher revenues and margins per customer, given their ability to capitalize on existing brand recognition, trust, and primary bank status.\textsuperscript{15,16} The graph below shows potential revenue and margin ranges for digital banking propositions across stages.

![Graph showing potential revenue and margin ranges for digital banking propositions across stages.]

### Average Revenue Per Customer ($)

<table>
<thead>
<tr>
<th>Stage 1</th>
<th>Stage 2</th>
<th>Stage 3</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Attract customers and build the brand</strong></td>
<td><strong>Diversify revenue streams</strong></td>
<td><strong>Grow business portfolio and lending volumes</strong></td>
</tr>
<tr>
<td>1-3 products from Stage 1 (Assuming 1st product is a checking account)</td>
<td>1-2 products from Stage 2</td>
<td>1-2 products from Stage 3</td>
</tr>
<tr>
<td>$75-$130</td>
<td>$200-$320</td>
<td>$320-$680</td>
</tr>
<tr>
<td>$130-$340</td>
<td>$340-$700</td>
<td>$680-$1400</td>
</tr>
</tbody>
</table>

*Above estimates assume a scenario where the max values represent: in Stage 1, a customer with checking, debit, and savings products; in Stage 2, a customer with stage 1 products + credit card and freemium subscription products; in Stage 3, a customer with Stage 1 and 2 products + large loan products.
Diversification secures revenues

Plummeting interest rates will continue to threaten the viability of deposit-based business models. Challengers with a diversified portfolio and customer segments achieve stable and growing revenues. For example, Starling Bank has been capitalizing on the growing demand from the small-medium business segment, and expanding into this segment has been the main driver of recent profitability achievements. Subscription and fee-based services offer predictability and hedge against the volatility of traditional deposit or credit related products, especially during economic downturns.

The exhibit above is a representative view of how the distribution of customer segments can differ across different stages of a digital bank’s business model. A customer who is a student, for example, may only be suited to more basic Stage 1 products, like a checking or savings account. Alternatively, a wealth management customer may opt for advanced subscription or loan products within Stage 3. Even though not all customers will sign up for Stage 3 products, the ability to offer diversified products across this spectrum will increase the bank’s potential revenue and efficiencies overall.
Targeting the mass affluent customer pays off

The average revenue driven from a mass affluent customer can be over 2x more than from the average mass customer. Challengers including Ellevest, Alpian and Monument\textsuperscript{18} have reported great success through strategically targeting wealthier segments.\textsuperscript{19} Alpian, for example, offers boutique investment products and face-to-face financial advisory services tailored to a more affluent customer base; the bank has reportedly secured 11.5 million pounds of Series A funding.\textsuperscript{20}

Profitability comes with sustainable growth

While revenues among challengers are strong, many of the current players are only a few years into their journey and have yet to become profitable. Mature challengers (e.g., Aldermore, OakNorth Bank, and Tinkoff Bank) with diversified portfolio and segments are beginning to see bottom-line success.\textsuperscript{21} Profitability is even shifting from a business priority to a regulatory requirement.

The UK regulator Prudential Regulation Authority (PRA) expects start-ups to be at least very close to profitability within five years of their existence, instead of relying on investor capital.\textsuperscript{22} The Monetary Authority of Singapore announced in 2019 that they would be issuing digital bank licenses, with one of its key criteria asking applicants to demonstrate that their proposed digital bank business model is sustainable.\textsuperscript{23}

This, coupled with customers’ growing demand for digital offerings, demonstrates that it is only a matter of time before US-based challengers become profitable. With desirable and viable propositions paired with efficient infrastructure, incumbents have a tremendous opportunity to successfully compete in the digital banking space.

DBS, a Singaporean incumbent bank who launched their digital banking services in 2016, reported only a year later that their digital customers were 42% more profitable than their “traditional” customers.\textsuperscript{24}
How can banks win with a desirable and viable digital banking offering?

The digital banking landscape is competitive, with a variety of challengers able to differentiate with attractive and profitable propositions. To win in the digital banking space, we recommend considering the following principles:

**Foster growth through engagement:**
Start by attracting customers with delightful and engaging experiences, at low-priced entry levels, to grow your platform.

**Expand beyond traditional deposit products:**
Elevate your platform proposition by providing innovative services customers are willing to pay for.

**Guide customers towards financial wealth:**
Help your customers find personalized opportunities to grow their money, leveraging data & insights capabilities.

**Design to delight the rising, socially conscious Gen Z cohort:**
Appeal to the next generation of digital bankers, with human language, empathy, and banking propositions centered around social impact.

**Play for long-term profitability:**
Define your success metrics carefully, acknowledging the time needed to transit from a growing customer base toward a profitable business model.
How Deloitte can help

To design and launch a winning digital banking proposition, you will need human-centered research tactics: in-depth interviews, contextual observations, and data analytics on human behavior. These extensive capabilities will uncover insights, challenges, and unmet needs used to build and design experience-led solutions. These solutions lie at the intersection of insights, design, technology, and business.

At Deloitte, it is our mission to elevate the Human Experience, bringing the user to the center of your ecosystem. We believe great experiences build connections and drive business results.
The age of the digital bank has arrived. Due to COVID-19, technological growth, and demographic changes, banks are understanding the benefits of digital transformation—and seeking to realize those benefits. However, this new wave of products and services requires understanding product differentiators for today's customers and what constitutes a viable digital banking business model. In this paper, Deloitte leverages our study of over 1,000 bank customers to answer the questions that every bank going digital should be asking.

Sources

1 N = 1,038 equally distributed from ages 18 – 45+ yrs. across $0-150K+ in income, Deloitte Digital Banking Survey, 2020
2 “Here’s When CEOs Think Their Businesses Will Have Recovered from Lockdown,” Deloitte + Fortune, 2020
3 Definition: Challengers are digital-only banks that offer online-only products and services with no physical branches
7 Insight: Average non-interest income and net interest income ratios were calculated based on challengers’ financial reports where available
8 Insight: Value-added features in our study covered 5 categories – 1. Advanced analytics and reporting, 2. Tailored financial guidance and advice, 3. Loyalty rewards (i.e. access to a rich loyalty program which rewarded customers), 4. Reduced / waived fees or better financial terms, and 5. Social impact and environmental causes, Deloitte Digital Banking Survey, 2020
10 “Fintechs Get More Aggressive and Creative Around Debit Card Rewards Programs,” Tearsheet, 2020
12 “Getting Ahead of the Curve: Reviving the Relevance of the Credit Card Business,” Deloitte, 2020
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14 "Welcome to Aspiration Plus," Aspiration, 2020
15 MacroMonitor Survey (representative of over 130 million U.S. economic households), Strategic Business Insights, 2019
16 See below - Illustration: Representative Distribution of Digital Customer Segments for an Incumbent Bank
17 “Monzo, Starling and the Lessons for Challengers Post-Covid,” Finextra, 2020
18 “Is Sallie Krawcheck’s Women-Centric Investment Firm, Ellevest, Another Example of the “Pink Tax?” Fast Company, 2017
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21 “Many Digital Banks Will Struggle Amid The COVID-19-Induced Slowdown, But A Handful Will Innovate And Thrive,” Forrester, 2020
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V1: The age of the digital bank has arrived. Due to COVID-19, technological growth, and demographic changes, banks are understanding the benefits of digital transformation—and seeking to realize those benefits. However, this new wave of products and services requires understanding product differentiators for today's customers and what constitutes a viable digital banking business model. In this paper, Deloitte leverages our study of over 1,000 bank customers to answer the questions that every bank going digital should be asking.

V2: COVID-19 is fundamentally altering the banking landscape, pressuring banks to reinvent themselves and accelerate digital transformation. However, shaping attractive digital offerings with sustainable economics and monetization is challenging. How can banks shape digital banking business models that are both attractive to customers and profitable long-term? Based on 1,000+ consumer market research, deep industry expertise, and insights from launching several digital banking propositions, Deloitte curated a study that outlines key winning principles in the digital banking space.
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