



The Future of Digital Banking

03.31.2024

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Overview of Digital Banking

Introduction:

In the ever-evolving landscape of global finance, digital banking has emerged as a transformative force, reshaping traditional banking paradigms and redefining the way consumers engage with financial services. As Lilypad consultants, we embark on a comprehensive exploration of the digital banking market, delving into key metrics and strategic insights that underpin its growth, competitiveness, and value proposition in an increasingly digitized world.

At the heart of financial performance analysis lies the metric of Return on Equity (ROE), a fundamental measure of a bank's ability to generate profits from shareholders'

Revenue per User:

In the pursuit of sustainable growth and customer-centricity, revenue per user emerges as a pivotal metric, encapsulating the monetization potential and customer value proposition offered by digital banking platforms. This metric serves as a testament to the effectiveness of revenue generation strategies and the depth of customer engagement, illuminating the path to long-term profitability and market leadership.

Leading digital banks in established markets, such as Ally Bank and Revolut, demonstrate prowess in revenue per user metrics. For example, Ally Bank boasts an average revenue per user of >\$550, while Revolut achieves \$57 per user. These banks leverage innovative product offerings and personalized experiences to drive customer loyalty and unlock new revenue streams. Conversely, in emerging markets

equity. ROE serves as a barometer of operational efficiency and value creation, offering profound insights into a bank's competitive strength and ability to deliver sustainable returns to its stakeholders.

Across regions, we uncover a rich tapestry of ROE dynamics. For instance, in burgeoning markets like China and Russia, digital banking pioneers such as WeBank and Tinkoff Bank exhibit exemplary ROE figures, with WeBank boasting an ROE of 30.1-35% and Tinkoff Bank showcasing an impressive 33.50%. These figures are driven by robust profitability and prudent capital allocation strategies. Conversely, in mature markets like the United States, the landscape is nuanced. Standout performers like Chime demonstrate commendable ROE metrics at 24.77%, amidst a backdrop of intensifying competition and regulatory scrutiny.

like India, players like Paytm navigate the complexities of revenue generation per user, with revenue per user ranging from \$0 to \$25. This highlights the need for tailored monetization approaches and market-specific value propositions to resonate with diverse consumer segments.

Market Coverage, Growth, and Asset Size:

Beyond financial metrics, strategic imperatives such as market coverage, revenue growth year-over-year, and asset size play pivotal roles in shaping the competitive landscape and growth trajectory of digital banking providers. Market coverage denotes the breadth and depth of geographical reach, reflecting the scale of market penetration and opportunities for expansion. Revenue growth year-over-year signifies the pace of market adoption and the efficacy of growth strategies in capturing market share and driving top-line growth.



Asset size, on the other hand, serves as a testament to the financial strength and resilience of digital banks, underpinning their capacity to invest in innovation, withstand competitive pressures, and deliver sustainable value to stakeholders. For instance, Rakuten Bank in Japan boasts assets of 149 billion USD, reflecting its

robust market presence and financial prowess.

In this context, digital banking leaders adeptly navigate the intricate interplay of market dynamics, strategic imperatives, and operational excellence to forge a path toward sustainable growth and enduring success in an ever-evolving landscape.

The Future of Digital Banking

Consumer Demand: A McKinsey survey indicates a strong preference for digital banking. In developed Asian markets, over 80% of respondents would consider switching to a bank with a compelling digital offering. This demand is also evident in emerging markets and progressive regions.

Digital Banking Benefits: The COVID-19 pandemic played a crucial role in accelerating the adoption of digital banking. With physical branches closed, consumers turned to mobile apps and online platforms for transactions. This highlighted the importance of robust digital channels for banks.

Rise of Fintech and Bigtech: The data mentions Fintech (financial technology) companies and Bigtech (major technology companies) as potential competitors to traditional banks. These players often have a strong digital presence and are known for innovation.

Examples of Digital Banking Leaders:

The list provides details on various successful digital banks and Fintech companies across the globe. These institutions offer features like mobile-first banking, a wide range of financial services online, and integration with other platforms.

The Major Risks

For Digital Challenger Banks:

1. **Limited Financial Services:** Many challenger banks focus on a specific niche or product area, such as mobile payments or money transfers. This can limit their ability to compete with traditional banks that offer a wider range of financial products and services¹.
2. **Customer Acquisition Costs:** Attracting new customers in a crowded market can be expensive, especially for challenger banks with limited marketing budgets².
3. **Data Privacy Concerns:** Digital challenger banks rely heavily on customer data to provide personalized services and make informed decisions. They need to ensure they are collecting and storing data responsibly and by regulations³.

¹<https://www.mckinsey.com/capabilities/mckinsey-digital/our-insights/ech-forward/winning-in-digital-banking>

²<https://www.mckinsey.com/capabilities/mckinsey-digital/our-insights/ech-forward/winning-in-digital-banking>

³<https://gemini.google.com/%3C0%3Ehttps://www.mckinsey.com/industries/financial-services/our-insights/best-of-both-worlds-balancing-digital-and-physical-channels-in-retail-banking>



For Traditional Banks:

1. **Legacy IT Systems:** Many traditional banks struggle to adapt their outdated IT infrastructure to keep pace with the rapid advancements in digital technology. This can hinder their ability to offer innovative digital products and services.
2. **Cultural Resistance:** Shifting to a digital-first approach may require a significant cultural change within traditional banks. Employees may resist changes to their work processes or lack the necessary digital skills.

Overall Risks for Digital Banking:

1. **Technological Disruption:** New technologies, such as blockchain and artificial intelligence, could disrupt the entire financial services industry. Banks need to be prepared to adapt to these changes.
2. **Economic Downturn:** An economic downturn could lead to increased loan defaults and reduced consumer spending, which could negatively impact the profitability of digital banks.

Fixing the Risks of Digital Banking: A Multi-Pronged Approach

For Digital Challenger Banks:

1. **Strategic Partnerships:** Collaborate with established financial institutions for loan origination, wealth management services, or insurance

products. This allows challenger banks to offer a broader suite of services without the regulatory burden of becoming a full-fledged bank.

2. **Open Banking APIs:** Leverage open banking APIs to seamlessly integrate third-party financial products and services within their platform. This creates a "marketplace" feel and caters to diverse customer needs.

Customer Acquisition Costs:

1. **Niche Marketing:** Focus marketing efforts on specific customer segments where challenger banks offer a clear advantage. This could be unbanked populations, young professionals, or those seeking eco-friendly financial solutions.
2. **Referral Programs:** Implement referral programs to incentivize existing customers to spread the word. Partner with relevant businesses to offer co-branded debit cards or cash-back rewards on everyday purchases.
3. **Community Engagement:** Build community by sponsoring local events, partnering with financial literacy initiatives, and fostering an active social media presence.

Data Privacy Concerns:

1. **Data Minimization:** Collect only the data necessary for specific purposes and offer customers the option to opt out of non-essential data collection.
2. **Zero-Knowledge Proofs:** Utilize encryption techniques like zero-knowledge proofs to verify customer identity without directly accessing sensitive personal information.
3. **Transparency and Control:** Communicate data-sharing practices, provide easily accessible



privacy policies, and empower customers to manage their data permissions within the app.

For Traditional Banks:

1. **Cloud Migration:** To benefit from scalability, security updates, and cost efficiencies, migrate core banking functions to the cloud. Explore hybrid cloud solutions for a gradual transition.
2. **API Integration:** Develop APIs to connect existing legacy systems with new digital platforms, enabling a more flexible architecture.
3. **Phased Modernization:** Prioritize modernization efforts based on business needs. Start by upgrading critical customer-facing systems and gradually modernize back-end infrastructure.

Cultural Resistance:

1. **Change Management Strategy:** Develop a comprehensive change management strategy that addresses employee concerns, provides clear communication channels, and offers training programs to equip staff with digital skills.
2. **Leadership Support:** Executive leadership needs to champion digital transformation and create a culture of innovation. This includes celebrating successes, encouraging experimentation, and rewarding employees for embracing new technologies.
3. **Incentives and Recognition:** Offer incentives and recognition programs that reward employees who actively participate in digital initiatives and demonstrate digital fluency.

Overall Risks for Digital Banking:

Technological Disruption:

1. **Innovation Labs:** Establish dedicated innovation labs to explore emerging technologies like blockchain, artificial intelligence, and quantum computing. Partner with universities and research institutions to stay at the forefront of technological advancements.
2. **Fintech Collaboration:** Collaborate with Fintech startups to leverage their agility and expertise in developing cutting-edge financial solutions. Consider acquisitions or joint ventures to accelerate innovation.

Economic Downturn:

1. **Data-Driven Risk Management:** Utilize data analytics to develop sophisticated credit scoring models and assess borrowers' creditworthiness more accurately.
2. **Diversification Strategies:** Diversify loan portfolios across different industries and customer segments to minimize risk concentration.
3. **Contingency Planning:** Develop and regularly update contingency plans for economic downturns. This should include scenarios for ⁴ managing liquidity risks, capital adequacy requirements, and potential loan defaults.

⁴<https://www.mckinsey.com/capabilities/mckinsey-digital/our-insights/tech-forward/winning-in-digital-banking>
<https://www.mckinsey.com/capabilities/mckinsey-digital/our-insights/tech-forward/winning-in-digital-banking>
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