RETAIL BANKING MARKET INVESTIGATION

Notice of intention to conduct international research on innovation in retail banking

On 12 November 2014 the Competition and Markets Authority (CMA) published an issues statement which sets out a number of hypotheses relevant to its investigation into the retail banking market.

On 26 February 2015 the CMA published a notice for comment on its proposal to engage a firm to carry out international research. This research is intended to assist the CMA in understanding the potential impact of ongoing and future innovations in the UK retail banking market and the possible implications for competition, by reference to international comparisons.

The CMA has now appointed Deloitte LLP, Athene Place, 66 Shoe Lane, London, EC4A 3BQ to carry out this research.

The contract under which the CMA has engaged Deloitte requires that Deloitte's work for the CMA be tightly controlled and segregated from any existing client business Deloitte is undertaking for other participants in the retail banking market. It also requires that the key Deloitte personnel undertaking the work for the CMA will not work for clients in the retail banking sector on matters relating to the retail banking market investigation or in relation to the areas covered by the terms of reference of the retail banking market investigation for a specified length of time, without the agreement of the CMA.

Deloitte's outline design for this research is set out in Appendix A. **The deadline for comments is Monday 13 April 2015.** To submit any comments on the proposed design for the research please send an email to retailbanking@cma.gsi.gov.uk or write to the team at:

Retail banking team
Competition and Markets Authority
Victoria House
Southampton Row
London
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The impact of innovation in the UK retail banking market: Methodology

Deloitte.

The impact of innovation in the UK retail banking market
Methodology

Introduction

On 6 November 2014 the CMA, having carried out an initial market study into the retail banking market, referred the market for a market investigation under the Enterprise Act 2002[1], to assess whether there are any features of this market which prevent, restrict or distort competition and, if so, what action might be taken to remedy them. The terms of reference cover current accounts provided to both personal customers (the PCA market) and those provided to SMEs (the SME market).

To support this investigation the CMA has commissioned Deloitte to carry out a study on the potential impact of ongoing and future innovations in the UK retail banking market. By reference to international comparisons the study will consider:

- The extent of innovation in the UK retail banking market compared to other countries
- The potential impact of ongoing and future innovations in the UK retail banking market, and the possible implications for competition.

This note describes the methodology that will be used to perform this study.

Approach

The study will be completed in the following three phases:

- Phase 1 : Scoping the innovations and case studies;
- Phase 2 : Data collection and analysis; and
- Phase 3 : Reporting.

The details of each phase are outlined below.

Phase 1: Scoping the innovations and case studies

Phase 1 is a scoping exercise that will investigate:

- what innovations should form the focus of the study; and
- what case studies should be used to inform the international benchmarking analysis.

The innovations that are in the scope of the study can be broadly categorised as follows:

- Innovations in the products and services available to retail banking customers. Examples of this include money management tools and linked accounts.
- Innovations in the distribution of products and services to retail banking customers. Examples of this include internet banking, banking applications on mobile phones and tablets, biometric ATMs and branch redesign for the digital age.
- Innovations in market participants and business models. Examples of this include payments and data analytics; alternative forms of SME lending; aggregation services and e-money accounts.

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[1] For more details please see: www.gov.uk/government/news/personal-current-account-and-small-business-banking-face-full-competition-investigation

- Innovations in the provision of operational services in retail banking. Examples of this include bank in a box solutions.

Within this broad categorisation we will consider what specific innovations should form the focus of the study. The rationale for inclusion will be based primarily on our assessment of their relevance to the UK and we will base our recommendations on a combination of desk research and consultation with our in-house experts. Of particular interest will be innovations which have had notable success and which have already been established in the UK.

We will also identify potential case studies for international comparison. Each case study will comprise an innovation and a country (for example, mobile money transfer in Australia). The merits of a particular case study will assessed according to the following criteria:
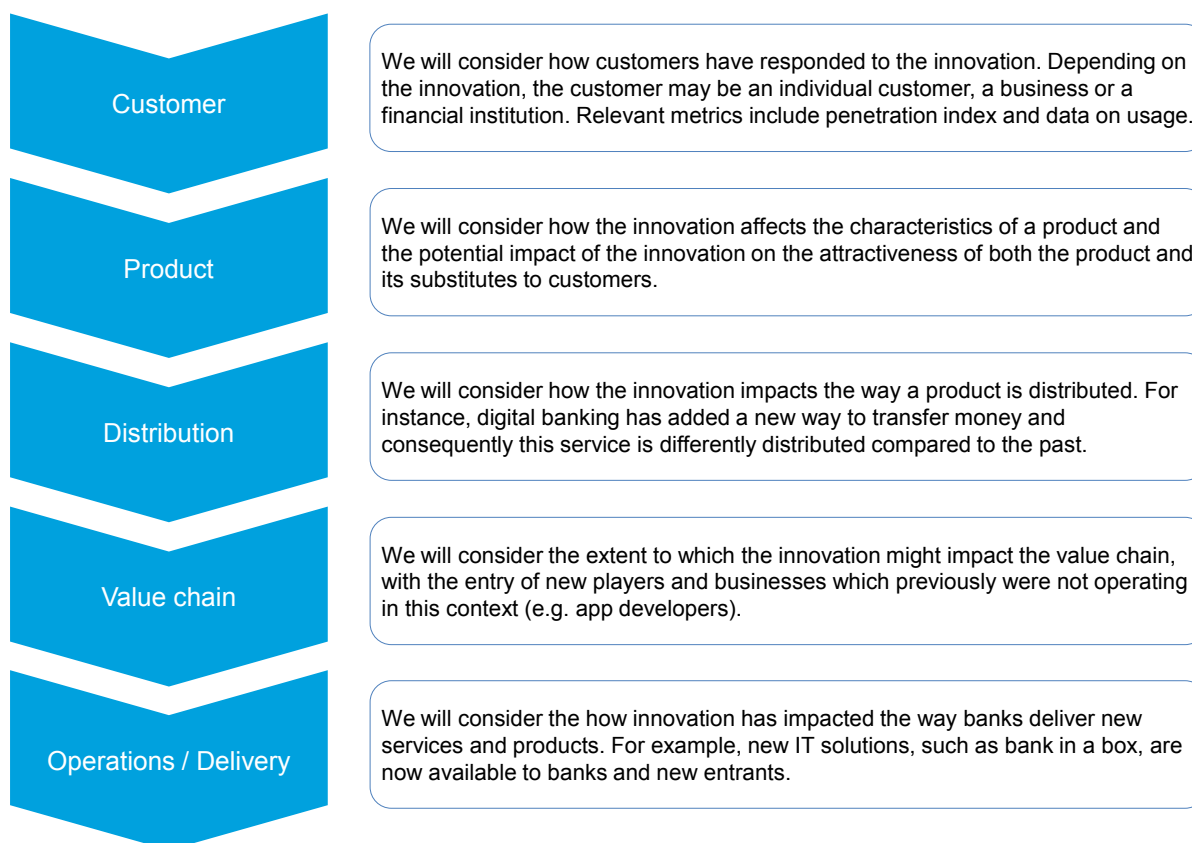
- Relevance of innovation: The innovation in a given case study should be relevant to our analysis of the innovations that have been selected as the focus of the overall study - where it is not identical to a specified innovation, it should have close similarities. Furthermore, taken as a whole the group of case studies should capture the range of innovations that have been specified as the focus of the study.
- Data Availability: Data availability will be a key limitation on the depth of analysis that will be possible for a given case study. As such it will be important to identify a rich source of relevant data available for each of the selected case studies. Where a large quantity of data is not available then we will still seek to include these countries but will be reliant on interviews with Deloitte financial services experts in those countries.
- Economic comparability: While variety in market conditions across the selected countries offers the potential for identifying lessons for the UK, the relevance of these lessons will depend on the general comparability of the countries with the UK. We will consider the extent to which a given case study can provide lessons for the UK., noting that even where countries are not strictly comparable, it may still be possible to make inferences provided that they are correctly interpreted and applied.

Based on this analysis, we will recommend a set of innovations and a set of case studies for more detailed analysis, which we will discuss with the CMA. Phase I will end with agreement on these sets.

Phase 2: Data collection and analysis

In Phase 2 we will perform the detailed analysis on the agreed case studies. The diagram below outlines the proposed framework for the case study analysis.

Figure 2: Example of analytical framework.

Customer	We will consider how customers have responded to the innovation. Depending on the innovation, the customer may be an individual customer, a business or a financial institution. Relevant metrics include penetration index and data on usage.
Product	We will consider how the innovation affects the characteristics of a product and the potential impact of the innovation on the attractiveness of both the product and its substitutes to customers.
Distribution	We will consider how the innovation impacts the way a product is distributed. For instance, digital banking has added a new way to transfer money and consequently this service is differently distributed compared to the past.
Value chain	We will consider the extent to which the innovation might impact the value chain, with the entry of new players and businesses which previously were not operating in this context (e.g. app developers).
Operations / Delivery	We will consider the how innovation has impacted the way banks deliver new services and products. For example, new IT solutions, such as bank in a box, are now available to banks and new entrants.

As an example of this analytical framework, consider the potential case study of mobile money transfer in Australia. For this particular innovation, we might look at the take up of the mobile service in Australia, how this has affected the use of money transfer and other related products, whether there has been an impact on the way other services are distributed over mobile, and the extent to which the IT solutions required to deliver the service affect potential entry.

In parallel to the case study analysis, we will also consider the evidence on the impact of each innovation in the UK to help inform a benchmarking analysis. The purpose of the benchmarking exercise will be to:

1. Understand the drivers of innovation and how innovation can manifest itself in structural changes to the retail banking market including its effect on potential entry and expansion; and
2. Compare the level of innovation in the UK to other countries, understanding why differences may have arisen.

Questions that we will be seeking to answer as part of the benchmarking analysis include:

• How does innovation in the UK retail banking sector compare to levels that are seen overseas?
• What are the key demand and supply side drivers of innovation – for example (demand side) level of GDP or other macro-economic factors, demographics, mobile phone penetration, access to high speed internet and (supply side) charging structure for accounts, level of market concentration, regulation?
• How has innovation changed the market structure for PCA / SME current accounts, for example has it reduced the cost to serve, changed the cost structure, changed the number of branches or ATMs or impacted market entry?
• What are the welfare enhancing and potentially decreasing elements of innovation. For example, whilst access and price may be improved, the FCA has identified some issues in terms of consumers' harm linked to M-

banking including represented by fraud that can arise from these services Digital banking also requires a robust and reliable broadband connection in order for customers to be able to readily access their accounts. The analysis conducted will be a mixture of qualitative interviews in the relevant markets and quantitative data, to the extent that it is available.

Qualitative interviews will be conducted with Deloitte experts, industry players (as considered appropriate by the CMA) and other relevant market stakeholders (such as financial regulators and academics). The quantitative analysis will draw on available data, bearing in mind that this is likely to have some limits. A number of potential indicators include:

• Macroeconomic factors ;

• Demographics (age, education, etc.) ;

• Internet and mobile penetration levels ;

• Penetration index ; and

• Service features.

Having identified the key factors driving particular innovations, the next step will be to assess their impact on the market. There are various indicators (which are again likely to have some limits) and measures that have the potential to reveal the impact of a certain service. Again, data will be used where it is available and appropriate on issues including:

• Switching rates ;

• Barriers to entry and expansion and on new entrants; and

• Customers' awareness and satisfaction.

Phase 3: Reporting

In Phase 3 we will bring together the findings of the analysis and prepare the report. The report will seek to highlight:

• The extent to which the UK PCA and/or SME retail banking market may be considered a leader or laggard internationally; the rationale for this assessment (e.g. metrics used) and possible drivers for this.
• The impacts of relevant innovations on the PCA and SME retail banking markets in other countries.
• Lessons learned from the research into innovations in other countries that might inform views on the potential impact of ongoing and future innovations in the retail banking market in the UK.