Lessons Learned From The Exodus Of Challenger Banks

by Steve Brown fintechs digital banking competition

Summary: A number of challenger and foreign banks have recently exited or scaled down their presence in the US. N26 is the latest casualty. What's behind these less-than-successful attempts to come to terms with the US retail banking landscape? We look at the lessons community financial institutions can learn from this apparent exodus.

Approximately 4.7MM LEGO pieces are produced every hour, and seven LEGO sets are sold by retailers every second. If all the LEGO bricks sold each year were laid next to each other, they would wrap around the world five times.

Building a brand as well-recognized, trusted, and successful as LEGO is no easy enterprise. This is a lesson that many foreign and challenger banks have learned when trying to enter the US retail banking market.

In November — less than 3Ys after launching in the US — German challenger bank, N26, announced plans to cease its US operations. N26 is not alone in finding it tough to crack the US market. HSBC, Monzo, Mitsubishi Financial, Leumi, and Banco Bilbao Vizcaya Argentaria (BBVA), have all exited or reduced their US retail banking presence in the last year.

These moves emphasize how difficult it can be to gain a foothold in the US market, given the regulatory challenges, costs, and scaling difficulties that many "outsider" brands face. Community financial institutions (CFIs) have been in this market for decades, some even a century. We explore these unsuccessful attempts by competitors, in order to determine lessons learned for retaining and growing CFI competitiveness.

A tough landscape for new entrants

Regulatory challenges. Foreign and challenger banks trying to enter the US market face a profusion of different governing bodies, licensing requirements, local and federal laws, and consumer protection rights. Our regulatory landscape is much more complex compared to that of the European Union and many Asian countries.

Some fintechs, in particular, have struggled to overcome regulatory hurdles. UK challenger bank, Monzo, for example, finally withdrew its application for a US banking license after almost 2Ys of trying. In fact, Varo Bank is currently the only challenger bank that has successfully applied for a full US banking license.

Scale to compete. New entrants to the US market not only have to compete with the established giants of American banking, such as Bank of America, JP Morgan Chase, and Wells Fargo, but also with rapidly growing US-based neobanks, such as Chime, Ally Market, and Varo Bank.

This intensely competitive marketplace, combined with pressures on profitability in the current environment and the need to invest heavily in technology, mean that many foreign banks don't have the scale or necessary financing required to compete effectively. This has led to the likes of HSBC, MUFG, and BBVA re-evaluating their US strategies.

Lessons learned

Although the pandemic and recent changes in consumer behavior might suggest that challenger and neobanks hold a competitive advantage in the "new normal", digital world, all the evidence doesn't necessarily back this up. N26's recent exit, along with moves by other challenger and foreign banks, provide some valuable lessons for CFIs, as well as larger US banks, to learn from.

1. **Trust and familiarity help to win hearts and minds.** A new PYMNTS and Optherium report based on a study of 2,225 US consumers has revealed that people "*tend to value companies with well-known, trusted brand names that have track records of providing excellent digital experiences and delivering products reliably and securely.*" Interestingly, the study identified the three most trusted digital 'banks' as Bank of America, Amazon, and Apple. This perhaps demonstrates the importance of trust, stability, and familiarity over a brand's banking track record when it comes to attracting customers, particularly in digital banking. CFIs should continue to build on their brand to ensure that these factors continue to resonate in the minds of their customers
2. **Understanding customers is key.** The success of some challengers, such as Daylight and Aspiration, is due in part to focusing on niche market segments. These banks have taken the time to understand and cater to specific customer groups' unique product needs. It can be much more difficult for foreign banks to understand potential US customers. They also face the hurdle of a completely different banking culture. As most CFIs appreciate, truly understanding your customers' needs is essential in operating successfully in the US banking space. CFIs have a core competency in this area, but don't rest on your laurels. As competition continues to evolve and spread, ensure you are exploring new niche market segments in your footprint with the customers' perspective.
3. **On-message marketing is crucial.** Alongside its innovative service offering and low fees, the dominant challenger bank in the US, Chime, puts a huge effort into its marketing. Its campaigns are creative, interactive, and strategic, and resonate with its core target market. By contrast, N26 reportedly struggled to build brand recognition. While social media, referral marketing, and other marketing technologies should play an important role in every bank's arsenal, good old-fashioned advertising in the right places can still help create awareness in a crowded market. CFIs should evaluate their marketing efforts to ensure that their brand is connecting as widely and deeply as it can with its target market.
4. **Product differentiation can provide a competitive edge.** Different offerings within the banking sector can often appear to be quite similar. CFIs should be asking themselves whether their products stand out from the crowd. As customer experience alone is no longer a sufficient differentiator, new entrants are increasingly having to develop extensive ranges of specialized or targeted products to succeed. Take Revolut, for example, one of the few non-US challenger banks still operating in the US. Its broad range of products and services, including currency exchange and cryptocurrency trading, may be contributing to some of its staying power. CFIs should review their own product offerings regularly to ensure they are differentiated enough to attract new customers and add value for all customers.

CFIs are well placed to succeed

CFIs have years of regulatory expertise, diversified portfolios, an established customer base, and brand recognition on their side — all of which put them in good standing compared to new entrants.

That said, challenger and foreign banks are unlikely to give up on the US market completely, given its scope and scale. So, make sure to take these lessons seriously.

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ECONOMY & RATES

Rates As Of: 01/11/2022 05:44AM (GMT-0800)

Treasury	Yields	MTD Chg	YTD Chg
3M	0.13	0.07	0.07
6M	0.28	0.09	0.09
1Y	0.46	0.07	0.07
2Y	0.94	0.21	0.21
5Y	1.55	0.28	0.28
10Y	1.78	0.26	0.26
30Y	2.09	0.19	0.19

FF Market	FF Disc	IOER (Interest on Excess Reserves)
0.08	0.25	0.15

SOFR	Prime	OBFR (Overnight Bank Funding Rate)
0.05	3.25	0.07