COMPETING WITH GOOGLE PLEX AND DIGITAL BANKS:

How Community-Based Financial Institutions Can Regain Their Mojo

CORNERSTONE ADVISORS

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INTRODUCTION

When the first so-called “challenger banks” like Simple and Moven appeared on the scene around 2010 they were heralded as “disruptors” that were going to put traditional banks and credit unions out of business. Why? The asserted logic was that they provided a better customer experience, were more customer-friendly in terms of pricing (i.e., no fees), and had a lower cost structure (as a result of being branchless).

That didn’t come to pass, did it?

You don’t get sunburned by being out in the hot sun for just five minutes. Give it a few hours, though, and… well, you know what happens.

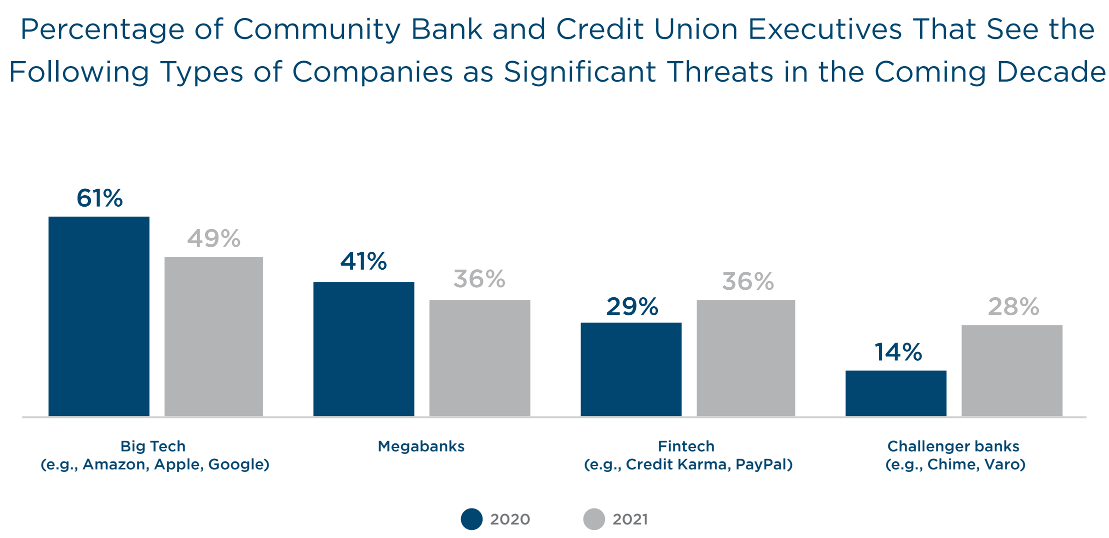
It’s a good analogy for what’s taking place in the banking market of 2021. Challenger banks aren’t putting community-based financial institutions (FIs) like community banks and credit unions out of business—but they are giving them “sunburns.”

Challenger banks aren’t necessarily causing an increased attrition in traditional institutions, however. They’re creating new consumer behaviors and attitudes that threaten the roles that community-based FIs play and the relationships these institutions have with their customers and members.

In addition to the threat from challenger banks, the last decade saw an increase in growth and power among Big Tech firms, including Amazon, Apple, Facebook, and Google. This threat of Big Tech is no stranger to bankers: roughly half of executives at community-based FIs see Big Tech firms as significant threats.

There’s a shift in perceptions going on, however. The percentage of execs viewing Big Tech as a threat is declining—from 61% in 2020 to 49% in 2021. Meanwhile, the percentage seeing challenger banks as a threat has doubled from 14% in 2020 to 28% in 2021 (Figure 1).

FIGURE 1: Threat of Big Tech and Fintech to the Banking Industry



Source: Cornerstone Advisors survey of 260 community-based financial institution executives, Q4 2020

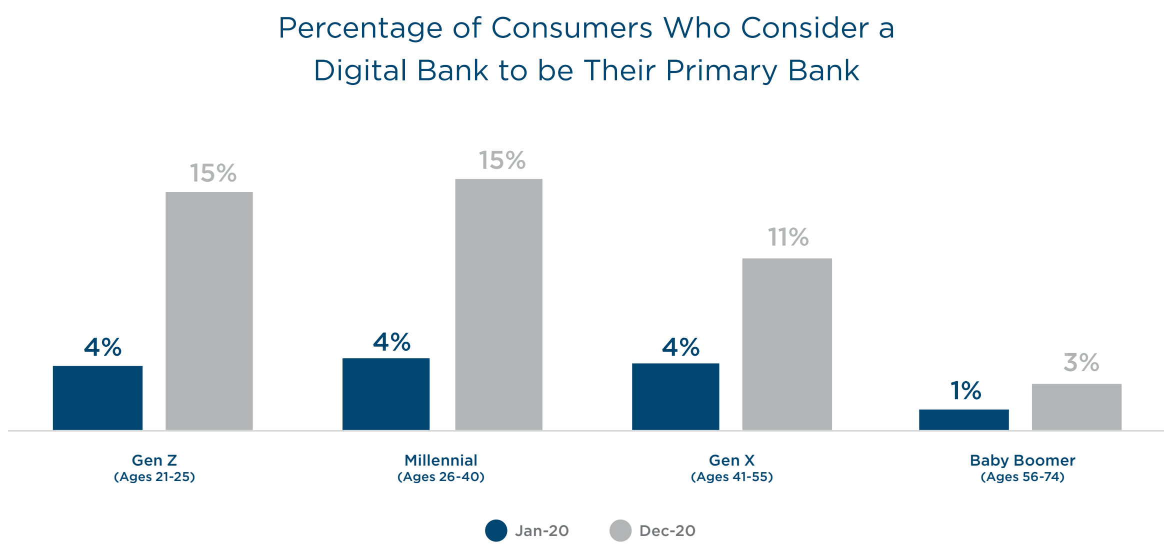
What's causing this shift in perspective? Drawing on a survey of 3,898 U.S. consumers (representative of the overall U.S. adult population in terms of age, gender, and race) fielded by Cornerstone Advisors in December 2020, this report will look at consumers' banking attitudes and behaviors to make sense of why challenger banks are gaining in popularity. In addition, we'll explore the banking forays of the Big Tech firms. Most importantly, we'll identify the tactics and strategies community-based FIs can deploy to take on the challenger banks and Big Techs.

THE DIGITAL BANK INSURGENCY OF 2020

The pandemic should get a lot of the credit for this, but 2020 was a good—no, make that a great—year for challenger banks and the broader group of digital banks.[1]

At the beginning of 2020, just 3% of U.S. consumers considered a digital bank to be their primary bank. By the end of the year, that percentage had grown nearly fourfold to 11%. The breakdown by generation is astonishing. In January 2020, just 4% of consumers between the ages of 21 and 55 (i.e., Gen Z, Millennials, and Gen X) called a digital bank their primary institution. By December, that percentage nearly quadrupled for Gen Zers and Millennials and nearly tripled for Gen Xers (Figure 2).

FIGURE 2: Digital Bank Share of Primary Institution Status by Generation

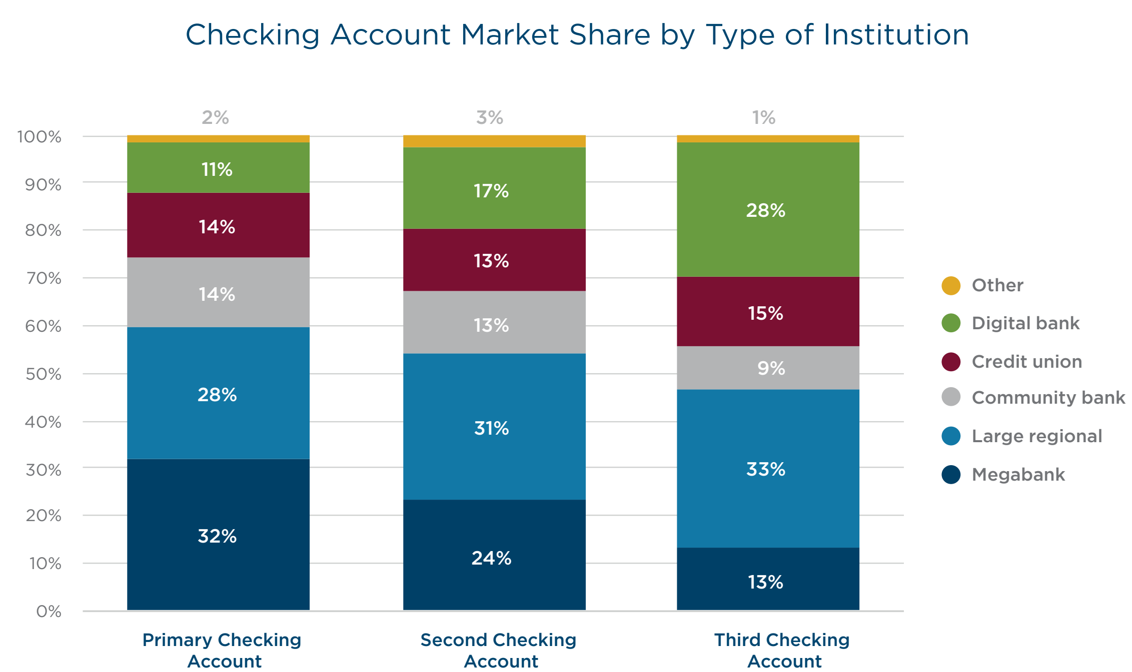


Source: Cornerstone Advisors surveys of U.S. consumers, Q1 2020 and Q4 2020

[1] Throughout the report, we refer to challenger banks (i.e., fintechs like Chime, Varo, Aspiration) as a subset of a broader set of firms we refer to as "digital banks." We've identified somewhere between 70 and 80 digital banks operating in the United States. Not all could be considered as "challenger" banks because some are owned by, or are spin-offs from, established (i.e., traditional) banks.

The growth in primary account status belies the extent to which digital banks have permeated the market. Although digital banks have just 11% share of primary accounts, they've captured 17% of accounts that consumers consider to be their secondary account, and 28% of the checking accounts consumers call their third-most important checking account (Figure 3).

FIGURE 3: Share of Account Type by Type of Institution

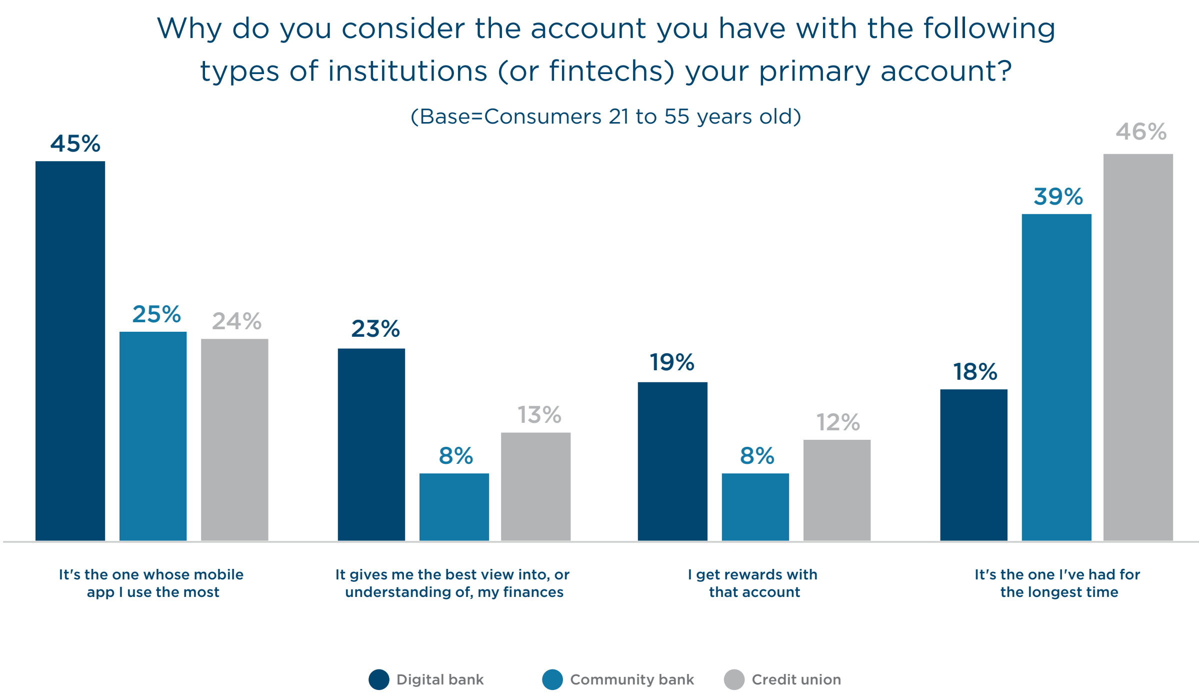


Source: Cornerstone Advisors survey of 3,898 U.S. consumers, Q4 2020

Why do consumers consider their primary account their primary account? Direct deposit and primary debit card are at the top of the list across all types of institutions (or fintechs). But less than half of consumers between the ages of 21 and 55 cited those two factors as reasons.

The more significant differences in determining primary status are: 1) mobile app usage, 2) insights into finances, 3) rewards, and 4) tenure. Not surprisingly, consumers who consider a digital bank their primary account did not do so because they've had an account there for a long time (Figure 4).

FIGURE 4: Differentiating Factors Determining Primary Status



Source: Cornerstone Advisors survey of 3,898 U.S. consumers, Q4 2020

THE RISE OF THE MULTI-ACCOUNT CONSUMER

The numbers don't mean that traditional banks and credit unions lost customers and members, however. Having more than one checking account has become more popular. This is true especially among Millennials, of whom 42% have two or more accounts (Table A). In fact, among consumers who consider a digital bank to be their primary bank, 42% have more than one checking account, and half of them have additional accounts with traditional banks and credit unions.

TABLE A: Number of Checking Accounts by Generation

How many checking accounts do you have?

(Base=Banked consumers)

	Gen Z (Ages 21-25)	Millennial (Ages 26-40)	Gen X (Ages 41-55)	Baby Boomer (Ages 56-74)
One	72%	58%	65%	67%
Two	23%	32%	26%	27%
Three or more	5%	11%	9%	6%

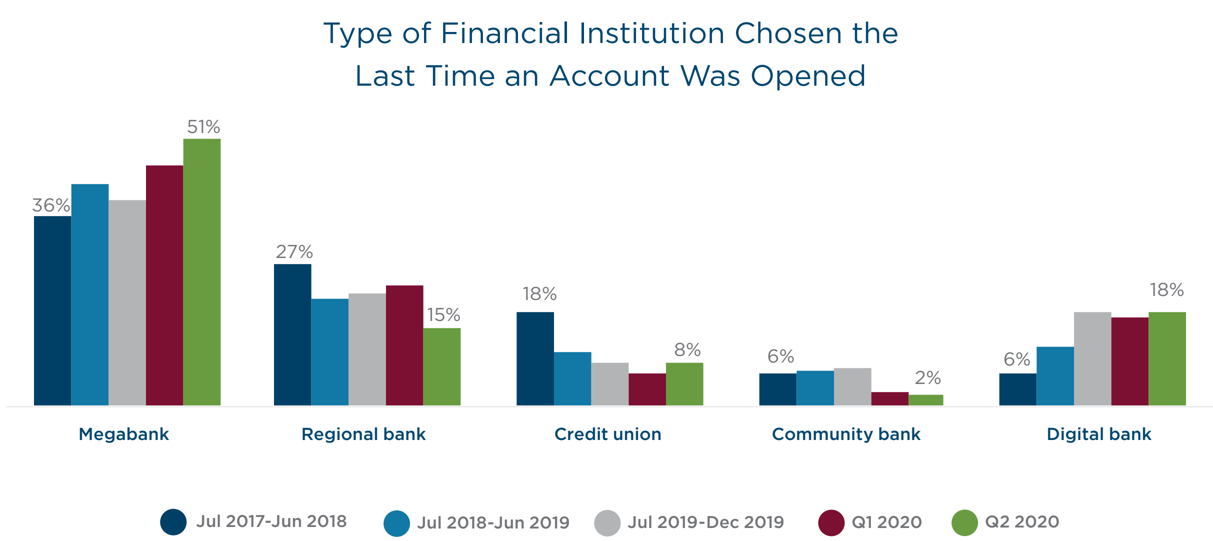
Source: Cornerstone Advisors survey of 3,898 U.S. consumers, Q4 2020

SO WHAT

As consumers increasingly look to digital banks as their primary bank, they're relegating their existing checking accounts with community banks and credit unions to second- and third-most important account status.

Over the past three years, the percentage of consumers opening an account with a digital bank has grown from 6% in 2017 to 18% in the second quarter of 2020. Credit unions' share of accounts declined from 18% to 8%, and among community banks, the drop was from 6% to 2% (Figure 5).

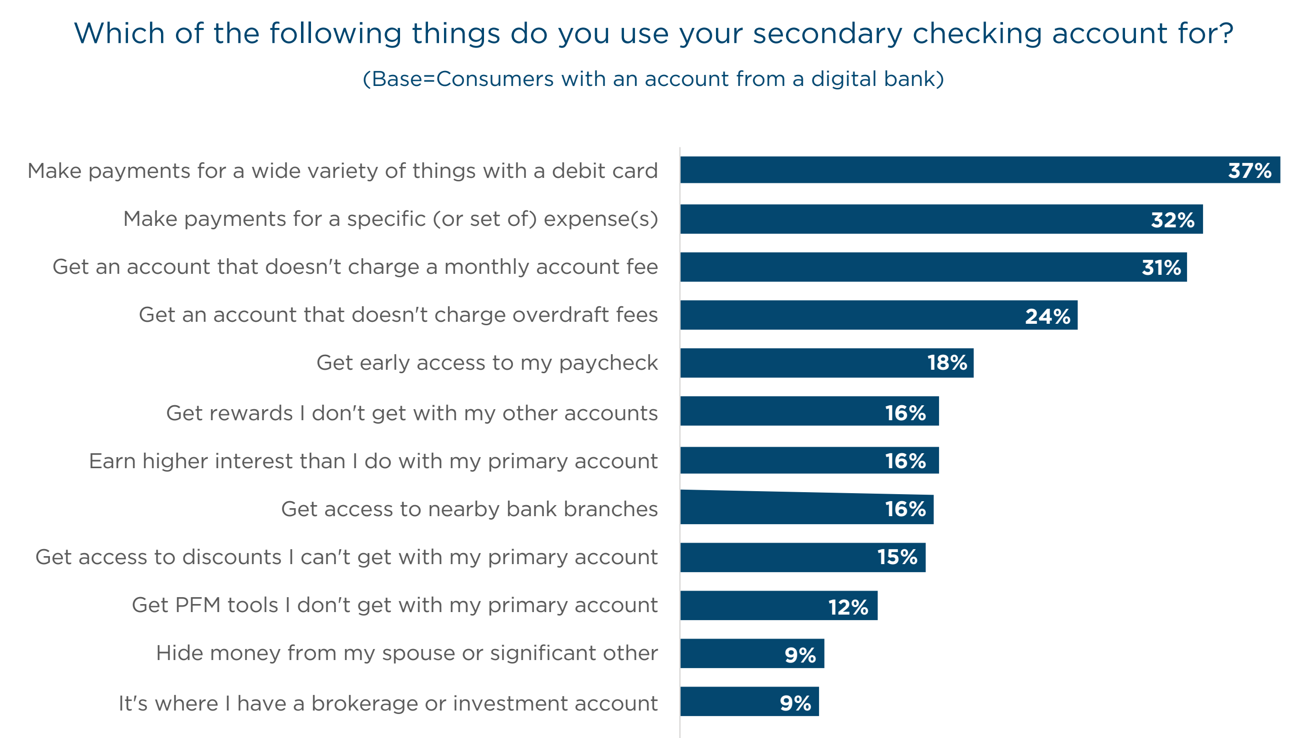
FIGURE 5: Type of Financial Institution Chosen the Last Time an Account Was Opened



Source: Cornerstone Advisors survey of 3,005 U.S. consumers, Q3 2020

Why are consumers opening these accounts with digital banks? Payments and avoiding fees top the list. While roughly three in 10 consumers with an account from a digital bank said they wanted an account that doesn't charge a monthly fee and a quarter are looking to avoid overdraft fees, 37% said it was to get a debit card to pay for a variety of things, and roughly a third said it was to make payments for a specific expense or set of expenses (Figure 6).

FIGURE 6: Uses of Secondary Checking Accounts from Digital Banks



Source: Cornerstone Advisors survey of 3,898 U.S. consumers, Q4 2020

Don't overlook the generational differences here, however, as they relate to (Table B):

- **Monthly account fees.** Nearly half of Baby Boomers with a second account from a digital bank were looking to avoid paying a monthly fee, versus a quarter to a third of the members of the other generations.
- **Overdraft fees**. Many more Millennials and Gen Xers than Gen Zers and Boomers were looking to avoid overdraft fees.
- **Account related rewards**. About a quarter of Gen Xers were looking for rewards in contrast to just 3% of Baby Boomers.
- **Early access to paychecks.** One in five consumers between the ages of 21 and 55 were looking for early access to their paychecks.
- **Interest rates**. About one in five Gen Xers with a secondary account from a digital bank was looking for higher interest rates, more than the other generational cohorts.

TABLE B: Uses of Secondary Checking Accounts from Digital Banks by Generation

Which of the following things do you use your secondary checking account for?

(Base=Consumers with an account from a digital bank) (Shading=Top 5 answer)

	Gen Z (Ages 21-25)	Millennial (Ages 26-40)	Gen X (Ages 41-55)	Baby Boomer (Ages 56-74)
Pay for a wide variety of things with a debit card	36%	41%	31%	32%
Pay for a specific (or set of) expense(s)	29%	31%	41%	24%
Get an account that doesn't charge a monthly fee	25%	28%	33%	46%
Get access to nearby bank branches	23%	12%	19%	19%
Get early access to my paycheck	21%	19%	19%	8%
Get an account that doesn't charge overdraft fees	16%	28%	29%	14%
Earn higher interest than I do with my primary account	13%	16%	21%	8%
Get rewards I can't get with my primary account	13%	16%	26%	3%
Get discounts I can't get with my primary account	13%	15%	17%	16%
Get PFM tools I don't get with my primary account	9%	14%	16%	3%
It's where I have a brokerage or investment account	9%	9%	13%	0%
Hide money from my spouse or significant other	5%	12%	4%	11%

Source: Cornerstone Advisors survey of 3,898 U.S. consumers, Q4 2020

SO WHAT

Consumers are opening second and third checking accounts to avoid fees (like nuisance fees and penalties) and to get features, rewards, and value.

DIGITAL BANKS ARE WINNING WITH PRODUCT DIFFERENTIATION

Digital banks are winning business for other—and more strategic—reasons, however. Conventional wisdom—and even some of the challenger banks' own advertising—holds that fintechs are winning customers because they provide a superior customer experience and have better mobile banking tools.

But it's more than that. Digital banks are competing successfully with two additional strategies: 1) product featurization, and 2) segment specialization.

Chime is a good example of a challenger bank competing with a "featurization" strategy. The fintech certainly offers a good user experience and touts no fees to attract consumers in the low- to middle-income brackets. But there are three features of the company's product offering that are key to its success:

1) **Early access to money.** Nearly a quarter of Chime customers said they chose the fintech as their primary bank because it offers two-day early access to their direct-deposited paychecks, as well as to government stimulus and tax refund checks.

2) **Spot Me**. This product feature lets Chime customers make debit card purchases that overdraw on their accounts with no overdraft fees. Chime customers with monthly direct deposits of $500 or more are eligible to enroll. According to Chime's website, "limits start at $20 and can be increased up to $100 or more by Chime, based on factors such as account activity and history."

3) **Credit-builder credit card**. Chime's predominantly low- to middle-income consumers aren't in the crosshairs of the big credit card issuers' marketing efforts. According to Cornerstone's research, 15% of Chime's primary banking customer base either has the card or is on the wait list for the card—all within six months of launching the card. To get the card, a consumer must have a Chime Spending Account and have set up their direct deposit with the company.

The second strategy is segment specialization. There are a growing number of challenger banks that focus on serving specific, often narrow, segments of consumers. These fintechs compete by identifying the specific (and often underserved) needs of their target markets (Table C).

TABLE C: Segment-Based Challenger Banks

Challenger Bank	Segment Focus
Aspiration	Environmentally conscious
First Boulevard	African-Americans
Daylight	LGBT
Qwil	Gig workers
Panacea Financial	Doctors
Purple	Disabled
TAB Bank	Truckers

Source: Cornerstone Advisors

SO WHAT

In some ways, both strategies are similar in that they attract a subset of consumers—not the broad market. As a result, in any one geographic area, they're not likely to be very large (with perhaps the exception of Chime, because low- to moderate-income consumers are everywhere). The result is that digital banks are chipping away at community-based FIs' account base without a physical presence in the community.

THE BIG TECH THREAT (OPPORTUNITY?)

In November 2019, Google announced that it was going to launch a checking account. The announcement elicited the typical frenzy in the press about how the Big Tech company and its fellow Gigantosauruses were going to put traditional banks out of business.

But—surprise, surprise—that wasn't the game plan. The plan was to partner with established financial institutions, and throughout the course of 2020, Google announced 11 partners for the Google Plex account. The new account is expected to launch sometime in 2021.

Details about the account were sketchy for a while, but in late 2020, Google released information about the Plex account. The details are pretty juicy. The new checking account will be integrated into the Google Pay app, which re-launched just before Thanksgiving. The updated Google Pay app has three new or redesigned components:

1) **Pay.** The redesigned Pay tab has two pieces: person-to-person (P2P) payments and retail payments. The new P2P features represent Google's attempt to be like Venmo. Users will be able to set up group payments, put multiple people in a chat, and let them send and request money from each other. It will also track who has and hasn't paid their share and let the user tap a button to pester them.
   The app will still let users make tap-to-pay payments to merchants. But Google has added two new buttons to the app: "Get gas" and "Order food." Google claims that the food ordering system will work with more than 100,000 restaurants. The company also says that users will be able to pay for gas or parking directly from the app in 30,000 locations.

2) **Explore.** This tab is where Google aggregates merchant offers. The default option lets users see generic offers but gives them an option to receive customized offers based on their spending activity. Users can associate an offer with any credit card stored in Google Pay. To redeem the offer, users simply need to use that card. If users redeem a cashback offer, the money goes directly into a Google Pay account.
   In addition, the new Explore tab has a QR and bar code scanner enabling users to scan a product in a store and use Google Shopping to buy it somewhere else.

3) **Insights.** The third tab, Insights, provides Google's version of personal financial management (PFM) tools available in many banks' digital banking platforms today—with some important differences. Insights scans through transactions rather than requiring users to manually enter and/or categorize them.
   And the redesigned Google Pay app can access users' Gmail and Google Photos accounts to automatically scan for receipts. With Photos, it uses optical character recognition (OCR) to automatically read receipts and associate them with the correct transaction.

Among Gen Zers and Millennials, interest in seven of the eight features ranges from mid-30 to high-40 percent across the two generational segments. The feature they're least interested in: generic offers from merchants (Table D). Big surprise, eh?

TABLE D: Interest in Google Plex Features by Generation

How interested are you in each of these Google Plex features?

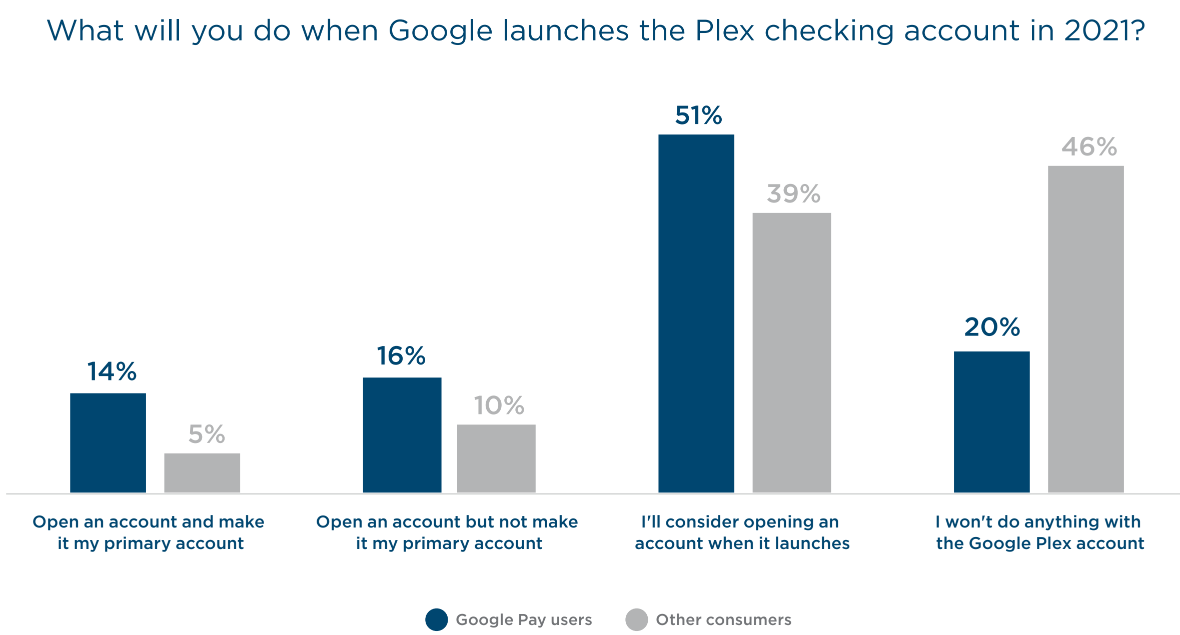
(% responding "very interested")

	Gen Z (Ages 21-25)	Millennial (Ages 26-40)	Gen X (Ages 41-55)	Baby Boomer (Ages 56-74)
A "Get gas" button that will find the nearest gas station and automatically pay for the gas	48%	41%	30%	13%
Person-to-person (P2P) payments	45%	45%	33%	13%
A "Get food" button that will find a restaurant and automatically pay for the order	43%	42%	28%	11%
Insights into spending activity that automatically scans transactions rather than requiring manual entry	42%	41%	27%	9%
Group P2P payments	40%	38%	24%	7%
Personalized offers from merchants based on payments and search history (which can be opted out of)	36%	35%	25%	10%
The ability to access users' Gmail and Google Photos accounts to automatically scan for receipts	36%	39%	27%	9%
Generic offers from merchants NOT based on payments and search history	29%	30%	21%	8%

Source: Cornerstone Advisors survey of 3,898 U.S. consumers, Q4 2020

Will Google Plex make a dent in the market? Quite possibly. Existing Google Pay users—who account for one in four smartphone owners—are the most likely candidates for the account. Among Google Pay users, 30% intend to open a Plex account—of which almost half plan to make it their primary account (Figure 7).

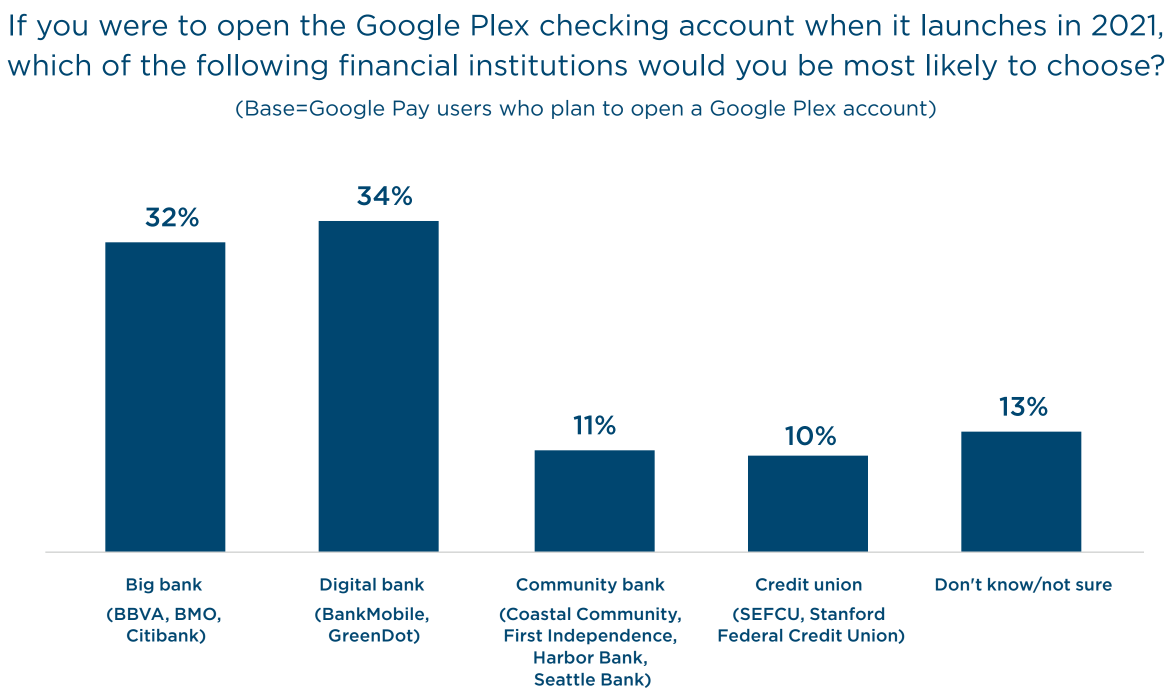
FIGURE 7: Choice of Financial Institution with Google Plex



Source: Cornerstone Advisors survey of 3,898 U.S. consumers, Q4 2020

Applicants for the Plex account will be asked to choose which of the financial institutions Google has partnered with to associate the account with. This could be good news for community banks and credit unions, of course, if they partner with Google to offer the Plex account. But among prospective account holders, just 21% anticipate selecting a community-based financial institution (Figure 8).

FIGURE 8: Choice of Financial Institution with Google Plex



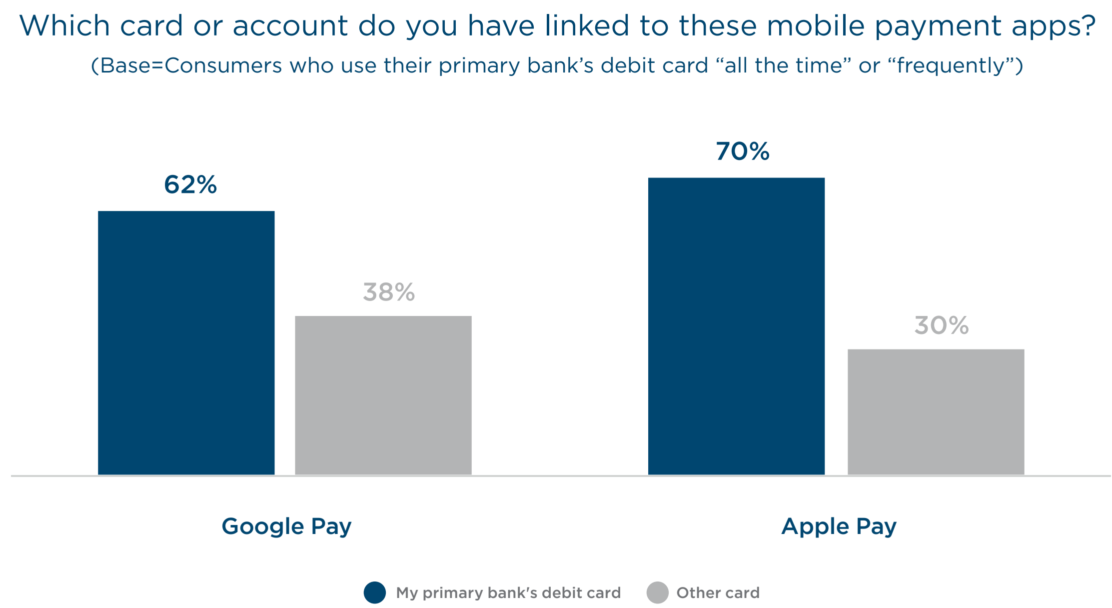
Source: Cornerstone Advisors survey of 3,898 U.S. consumers, Q4 2020

MOBILE PAYMENTS' IMPACT ON COMMUNITY-BASED FIs' PAYMENTS INCOME

Speaking of Google Pay… the Plex account isn't the only Big Tech threat to community-based financial institutions. The rapid growth of mobile payments was another result of the pandemic of 2020 as consumers switched to contactless forms of payment. This wasn't all good news for banks, however.

Among consumers who use their primary bank's debit card "all the time" or "frequently" and are Google Pay users, nearly four in 10 don't have that card linked to their Google Pay account. Among Apple Pay users who are frequent users of their primary bank's debit card, 30% link another card to the mobile payment app (Figure 9).

FIGURE 9: Cards Linked to Mobile Payment Apps



Source: Cornerstone Advisors survey of 3,898 U.S. consumers, Q4 2020

With the data we have from the survey, it's impossible for us to estimate the interchange loss that community-based institutions experienced from this behavior, but we can conclude that there are a lot of consumers "cheating" on their primary institutions.

THE BIG TECH THREAT IN CREDIT CARDS

Loss of debit interchange isn't the only threat Big Tech firms pose to community banks and credit unions. In 2019, Apple launched a credit card. It's hardly the first retailer or merchant to do that, but the Apple Card is not your father's affinity card. It's intended to be a full-service credit card, designed to compete with whatever Capital One, Chase, or any other big issuer has in the market.

To date, Apple has penetrated roughly 4% of the credit cardholder base in the United States with about 5.3 million cardholders. That pales in comparison, however, to Amazon, which has put its credit card in the hands of 22.6 million consumers, roughly 16% of the overall cardholder base.

COMPETING WITH THE GIGANTOSAURUSES AND DIGITALBATROSSES

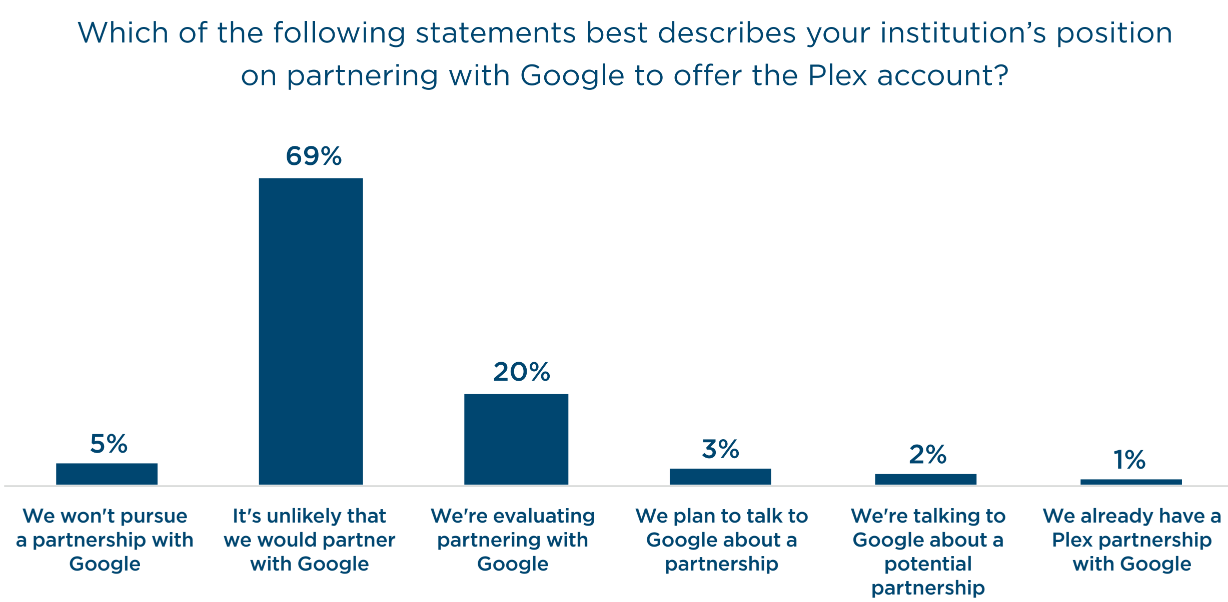
I know you're thinking that this isn't a great analogy because dinosaurs are extinct, and an "albatross" is a psychological burden that feels like a curse. But gigantosauruses are (OK, were) huge, powerful animals (like the Big Tech companies) and albatrosses are one of the fastest species of animals, flying at nearly 80 miles per hour (and the challenger banks do move fast).

So how can (and should) community-based financial institutions respond to these competitive threats?

If you're Jamie Dimon at JPMorgan Chase or the EVP of strategy at Visa, you could just acquire one of the fintech upstarts and shut them down. Not much of an option for a community-based FI, though.

Even Chase and Visa are in no position to buy out Google or Amazon, but community banks and credit unions could partner with them. Few plan to do so, however. Roughly three-quarters said they won't partner with Google on its new Plex account or say that they're unlikely to do so (Figure 10).

FIGURE 10: Intentions to Partner with Google



Source: Cornerstone Advisors survey of 260 senior financial institution executives, Q4 2020

The Google Plex account is intended to become the hub for accountholders' payments and financial management activities. Community-based FIs are in no position to replicate what Google is planning to do. But they can rethink and reinvent the current checking account to become more of a hub for a set of services that consumers want and need—and will pay for—and get from their bank or credit union.

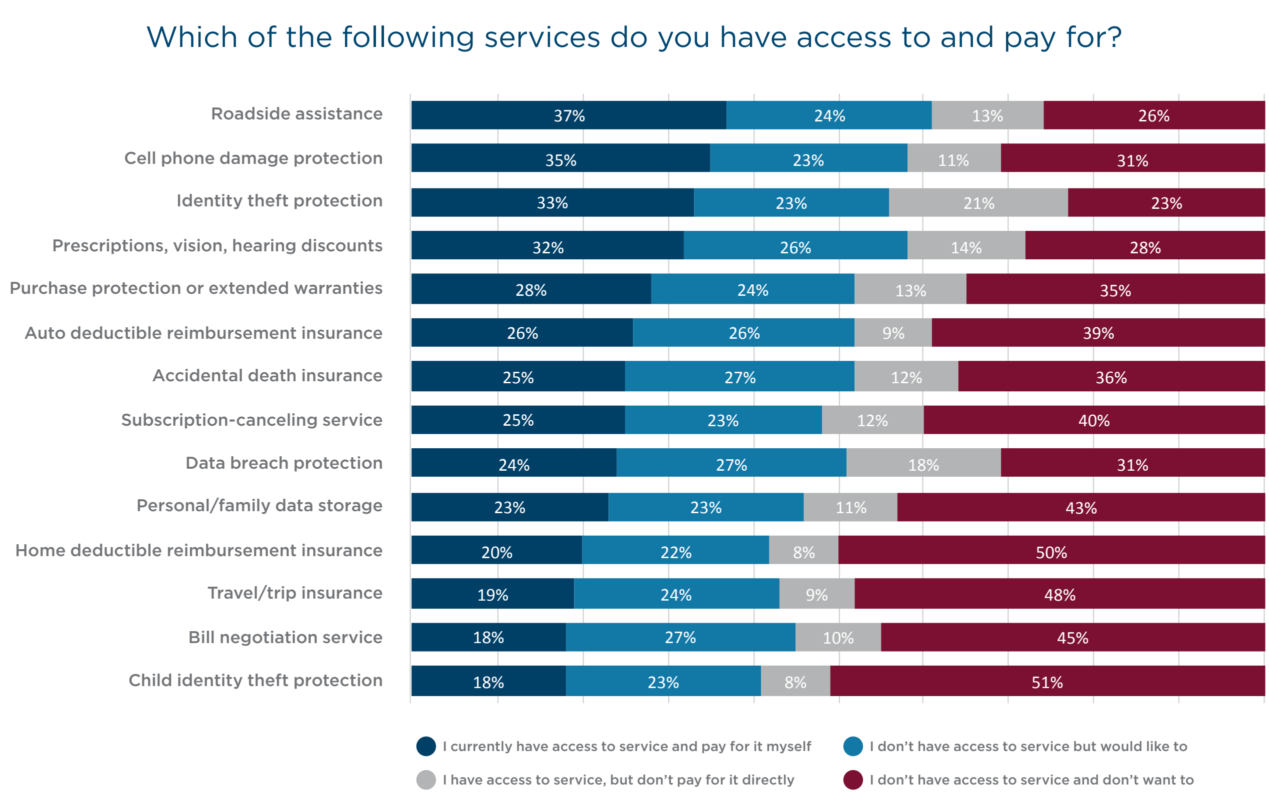
BUNDLING VALUE-ADDED SERVICES

Becoming a hub for value-added services doesn't mean creating a section or tab on the mobile app or online banking platform and offering coupons for discounts on services—it means bundling various sets of services directly into the checking (or payment) account product structure.

What kinds of services are we talking about? Over the past two years, we've asked consumers about 14 different types of services including insurance products like accidental death insurance and travel insurance, protection services like cell phone damage and identity theft protection, and payments-related services like subscription canceling, bill negotiation, and purchase protection.

We think of the demand for the products as the percentage of respondents who said: 1) they have access to the service and pay for it themselves, plus 2) those who don't have access to it but would like to. With this definition, we found strong demand (about half or more of all consumers) for nine of the 14 products, led by roadside assistance, cell phone damage protection, identity theft protection, and health-related discounts (Figure 11).

FIGURE 11: Access to Value-Added Services



Source: Cornerstone Advisors survey of 3,898 U.S. consumers, Q4 2020

Demand for the most popular services—roadside assistance, Rx discounts, and cell phone damage protection—has been relatively consistent over the past two years, with roughly six in 10 consumers either owning or desiring the products. The remaining 11 products have seen big jumps in demand from 2019 to 2020, and all 14 products are in demand among 40% or more of consumers (Table E).

TABLE E: Change in Demand for Value-Added Services, 2019 to 2020

	2019	2020	Change
Subscription-canceling service	32%	47%	16%
Bill negotiation service	31%	46%	15%
Data breach protection	37%	51%	14%
Personal/family data storage	34%	46%	12%
Auto deductible reimbursement insurance	42%	53%	11%
Purchase protection or extended warranties	42%	52%	10%
Travel/trip insurance	32%	42%	10%
Child identity theft protection	32%	41%	9%
Identity theft protection	49%	56%	7%
Accidental death insurance	45%	52%	7%
Home deductible reimbursement insurance	36%	42%	6%
Cell phone damage protection	56%	58%	1%
Prescriptions, vision, hearing discounts	58%	58%	0%
Roadside assistance	61%	60%	-1%

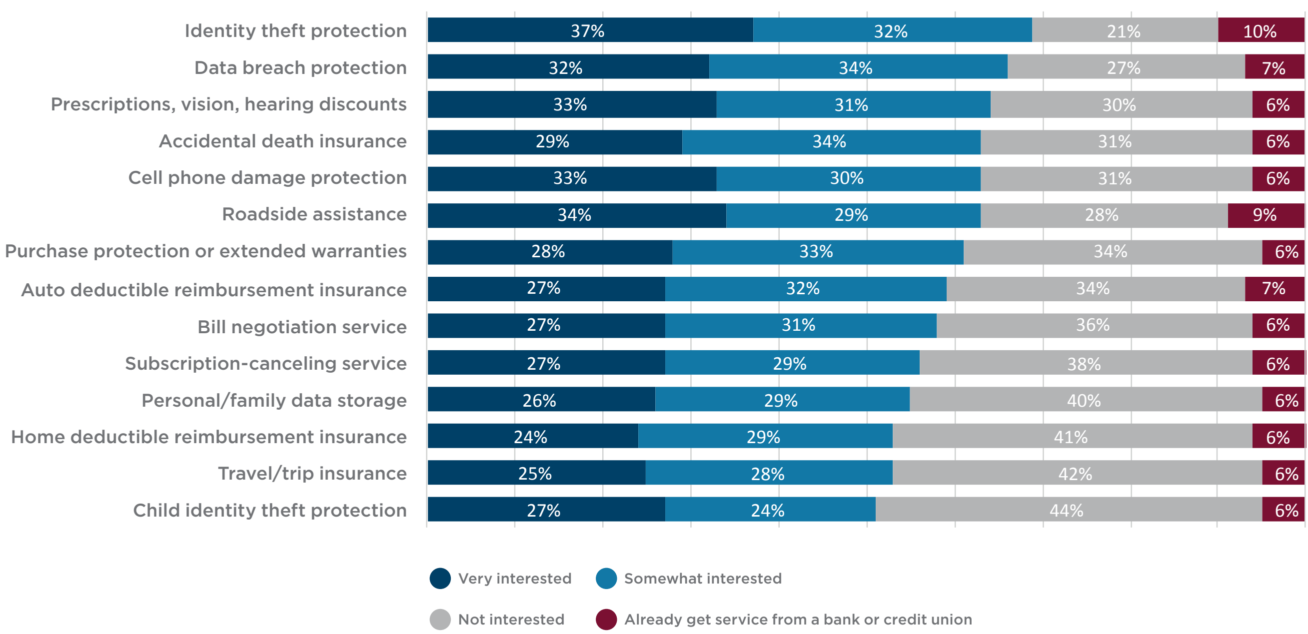
Source: Cornerstone Advisors surveys of 3,898 U.S. consumers, Q4 2020, and 2,596 U.S. consumers, Q2 2019

Many consumers are interested in obtaining many of these services bundled with a checking account from a bank or credit union. Roughly one-third of consumers between 21 and 55 years old, for example, are very interested in getting identity theft protection, data breach protection, and health-related discounts from a financial institution (Figure 12).

FIGURE 12: Interest in Getting Value-Added Services from a Bank or Credit Union

How interested are you in getting these services from a financial institution bundled with a checking account? (A monthly fee, dependent on the number of services you chose, could apply.)

(Base=Consumers between 21 and 55 years old)



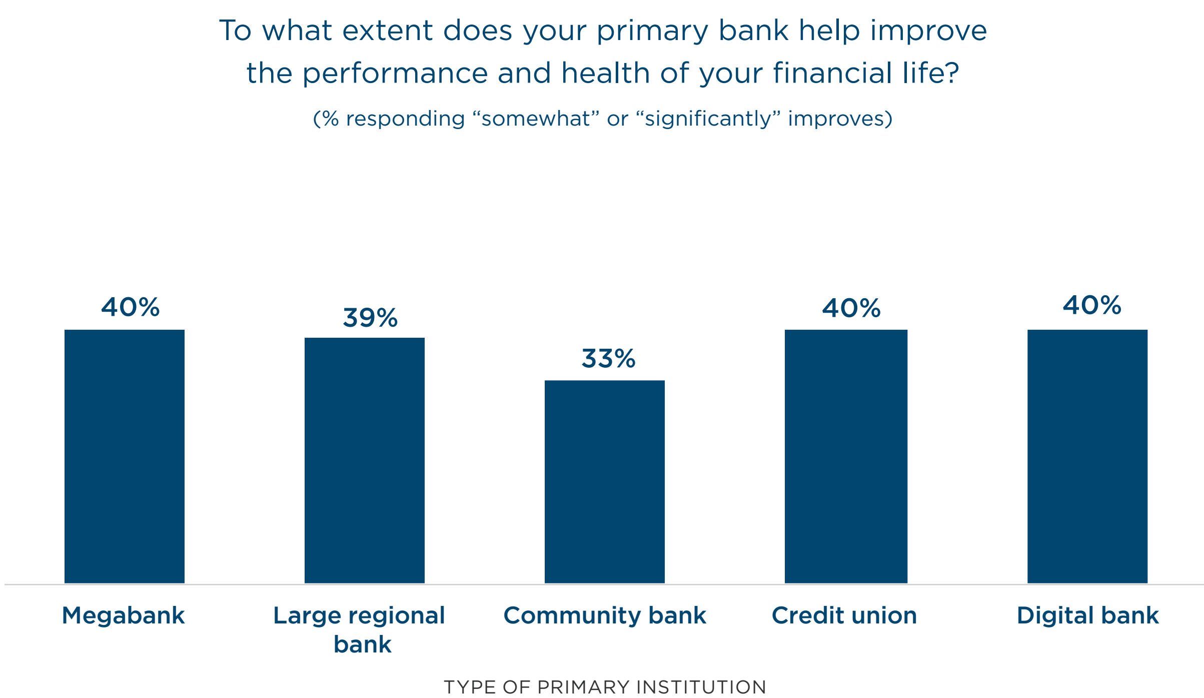
Source: Cornerstone Advisors survey of 3,898 U.S. consumers, Q4 2020

PROVIDING FINANCIAL HEALTH SERVICES

While there's likely to be little disagreement that we have a financial health crisis in the United States, the overlooked aspect of this crisis is the misperception industry providers have about their contributions to dealing with the problem. Or maybe we should say "lack of contributions."

Among consumers who consider a megabank, large regional bank, credit union, or digital bank their primary provider, only four in 10 said those institutions had any positive impact on the performance and health of their financial lives. Among customers of community banks, that percentage drops to 33% (Figure 13).

FIGURE 13: Financial Health Impact



Source: Cornerstone Advisors survey of 3,898 U.S. consumers, Q4 2020

The problem isn't that consumers say their primary banks *detract* from their financial performance and health. It's that they say their primary providers *have no impact* on their financial health and performance.

SO WHAT

Community-based financial institutions have an opportunity to carve out an overlooked—and largely misunderstood—strategic position in the market by competing on financial health. Google Plex and megabanks are competing on "convenience," leaving the financial health position open.

Community-based providers may not have long to fill this void, however.

The Community Reinvestment Act was enacted with the intent of encouraging FIs to help meet the credit needs of low- and moderate-income neighborhoods. Two emerging issues: 1) What "neighborhood" does a digital bank serve? and 2) It's not just low-to-middle income consumers that need help, and those who do need more than just credit.

As a result, look for a future administration or Congress to require banks and credit unions to quantify, monitor, and improve their customers' and members' level of financial health.

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Ron Shevlin heads up Cornerstone Advisors' fintech research efforts and authors the firm's commissioned studies. He has been a management consultant for more than 25 years, working with leading financial services, consumer products, retail, and manufacturing firms worldwide. Prior to Cornerstone, Ron was a researcher and consultant for Aite Group, Forrester Research and KPMG. Ranked #2 on Bank Innovation's list of 30 Innovators to Watch, Ron is frequently quoted in major industry outlets and is in great demand as a speaker.

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After 20 years in this business, Cornerstone Advisors knows the financial services industry inside and out. We know that when banks and credit unions improve their strategies, technologies and operations, improved financial performance naturally follows. We live by the philosophy that you can't improve what you don't measure, and we help financial institutions use laser-focus measurement to develop more meaningful business strategies, make smarter technology decisions, and strategically reengineer critical processes.

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