

A BETTER KIND OF BANKING

BY CHARLES LEADBEATER AND ANTONY ELLIOTT,
THE FAIRBANKING FOUNDATION | NOVEMBER 2013

www.thersa.org

BARROW  CADBURY
TRUST

 thefairbanking
foundation

RSA
Action and Research Centre

Contents

Foreword	1
Acknowledgements	2
About the authors	2
Executive summary	3
1. A once in a lifetime opportunity	8
2. Getting away with it	10
3. A new recipe	13
4. Radicals in the margins	15
5. On the road to Damascus	24
6. The better bank	30

Foreword

Throughout its 250-year history the RSA has been guided by the belief that creative ideas can come from anywhere not just from those in authority. That is why the RSA's very first initiatives were Premiums – the offer of cash prizes to anyone who could find solutions to pressing economic and social problems no matter what their background.

It is this spirit that continues to inspire the RSA today and explains why we are proud to partner with the Fairbanking Foundation and the Barrow Cadbury Trust on this publication.

The report reveals, in very practical terms, how the deeply troubled financial sector could be transformed by learning from the commercial insurgents banging on the gates of the banking fortress. These companies and initiatives are tiny when compared financially to the behemoths controlling global banking but they are giants in terms of creativity and customer care.

As the report states, banking has a once in a lifetime opportunity to change for the better. By learning from the newest players and by allowing them to grow, that change can be built around an inspiring vision of the future with the customers' interests at its heart.

Adam Lent

Director

RSA Action and Research Centre

Acknowledgements

We would like to thank all the people who organised and took part in the many interviews we conducted at banks and financial institutions in the Autumn of 2013. We could not have done so without Janet Walker's organisational skills.

The project was made possible by the support of Sara Llewellyn and Clare Payne of the Barrow Cadbury Trust, and Adam Lent at the Royal Society for the Arts.

About the authors

Charles Leadbeater is a widely published author and member of the Fairbanking Mark Assessment Panel. His next book, *The Frugal Innovator* will be published in March 2014.

Antony Elliott, FCIB is the Founder and Chief Executive of the Fairbanking Foundation. Antony was formerly Group Risk Director at a major bank for more than 10 years. He has published research on financial well-being and behaviour relating to personal finance.

Executive summary

Britain's banks are still in a mess. Their finances are recovering but their reputation with their customers is in tatters. The people leading Britain's main banks have a once in a lifetime opportunity to turn them into different organisations: ones which make money by working for the good of the customers, businesses and communities who depend upon them. In the past, too often banks have preferred to take advantage of their customers and put the banks profits ahead of their customers' interests.

This report is about how the people who lead the banks can change their industry for the better. They need to start by facing up to the fatal mix which caused the mess: a flawed business model combined with questionable culture and values.

Banks need to develop alternatives to the flawed 'free banking' business model

Business models

The banks' business model is based on 'free banking': customers who keep their accounts in good order are not charged for having a current account. One consequence of free banking is that banks tend to make their money by selling their customers other products, mainly insurance and loans (which are sometimes mis-sold); through less than transparent business practices (such as charging interest on customer balances held up in the clearing system) and hidden charges (for example on unauthorised overdrafts). Banks need to develop alternatives to the flawed free banking business model.

Culture and values

For too long the culture and values of the banks encouraged managers to pursue profits at the expense of their customers' interests. Banks have an asymmetrical relationship with customers: bankers know a lot more than their customers about the complex products and services they offer. An inappropriate retail culture meant bank staff were rewarded for selling customers products they neither fully understood nor needed. Banks will not change fundamentally unless they resist exploiting this asymmetry and instead treat their customers with greater restraint, responsibility and respect.

Treat their customers with greater restraint, responsibility and respect

Nothing is fixed in stone. There are alternatives to this dominant but flawed approach. These alternatives show banks can make a decent commercial rate of return with very different approaches, in which they work with customers to enable them to manage their money more carefully and intelligently.

Radical innovation starts in margins

Some of these alternative models have emerged from smaller players with only a few hundred thousand customers between them. It should be no surprise that radical innovations develop in niche markets. Innovation that changes an industry rarely starts in the mainstream. Executives in large, powerful companies tend to be rationally short-sighted, focusing on the markets and products they already know rather than the ones they do not.

We looked at four smaller, nimbler innovators with models that could reshape the mainstream industry were they taken to scale.

thinkmoney has very high customer satisfaction scores

thinkmoney

thinkmoney's 100,000 customers pay £14.50 per month for a service which guarantees they will not go overdrawn. As a result they avoid the charges that many customers of mainstream banks end up paying for unauthorised overdrafts. thinkmoney doesn't dictate to customers how they should spend their money, but its Money Managers give common sense budgeting advice when customers call to transfer money from their dedicated 'bills' account – used to make regular payments for rent, utilities and debt repayment – into their 'spending' account. (These two accounts are held at RBS but managed by thinkmoney with an agency arrangement.) Customers are sent regular text updates on the state of their accounts and a simple system of smiley faces communicates the state of their finances, so they know exactly how much they have available to spend and can budget accordingly. thinkmoney has very high customer satisfaction scores.

Secure Trust Bank

Secure Trust Bank is another agency bank. Secure Trust has an agency arrangement with Barclays to enable customers' transactions to flow through the banking system and it gives them access to branches for paying in. Secure Trust Bank helps its customers to set up a current account into which they pay their income. This account is used to pay direct debits and standing orders for regular bills, but no debit card is provided. Instead, spending money is uploaded to a prepaid MasterCard, which can be used for cash withdrawals and in shops. Customers can only spend what is on the card. Secure Trust's 20,000 current account customers pay £12.50 a month for the service.

thinkmoney and Secure Trust Bank show that it is possible for banks to make a commercial return while helping their customers on modest incomes stay out of debt and build up their savings. The fee both charge for the service is well below the amount many customers would pay in overdraft charges with mainstream banks. Other customers who would not go overdrawn seem to regard the fee as good value for the service they receive.

Saffron Building Society

The Saffron Building Society, which has just 120,000 accounts, meanwhile shows that it is possible to encourage people on modest incomes to save. The online Goal Saver service is based on the principle that people will save more when they: are saving for goals that matter to them, such as a holiday, wedding or car; can easily track progress towards the goal; put money in separate savings pots and get regular encouragement to do so. Saffron's Goal Saver service was three to four years ahead of its time when it was launched in 2008.

Capital One

Capital One, the credit card company, has developed a new approach to debt management. Its Progress Card rewards people with a lower interest rate on their debt as they pay more off. Customers are praised for improving their credit standing over time. Capital One's approach to people in

Saffron's Goal Saver service was three to four years ahead of its time when it was launched in 2008

arrears used to be to recoup as much of the debt as possible before writing off the rest, an approach that didn't really benefit either the customer or the company's profit and loss account. Now Capital One aims to work with these customers to 'cure' them of debt through a plan agreed with the customer. The company eventually gets its money back and the customer enhances their credit rating.

Make aspects of this infrastructure – such as the shared payments systems – available to smaller, innovative players, much as in other utility industries

Better banking: a recipe

These two tiny agency banks, a minuscule building society and a monoline credit card issuer show that financial services designed to help people make better decisions, stay out of debt and start saving, are commercially viable.

These products and services offer a different model of basic banking:

- A current account with no overdraft and a money manager service which never allows people to get into debt, paid for with a monthly fee
- A savings plan to help people put aside money for the things that matter to them
- A credit card and borrowing facility designed to prevent people running up unsustainable debts and which helps them to work their way out of debt when they do.

The trouble is that these innovations have emerged on the margins of mainstream banking. To reach scale they would require not only marketing but an infrastructure for distribution and payments on a mass scale. Where might that come from?

Innovators need infrastructure to scale

One route to scale might be for these niche players to build their own infrastructure, most likely for telephone and digital services. Some are contemplating that, but this is an expensive and risky option, especially given the big banks' domination of the market.

The mainstream banks already have a heavy-duty and costly infrastructure of branches and ATM machines, mainframe computers to process payments and call centres for telephone banking. This infrastructure is a significant deterrent for new entrants into the industry.

So another possibility would be for regulators to force the banks to make aspects of this infrastructure – such as the shared payments systems – available to smaller, innovative players, much as in other utility industries, such as telecommunications and energy, where larger players resell capacity to smaller, new entrants. This change would help more agency banks such as thinkmoney and Secure Trust Bank, which depend on infrastructures owned by RBS and Barclays, come into the market. This change would be risky and difficult. Yet banks increasingly present themselves as utilities and this model has been developed to introduce much needed competition into utility markets for energy and telecommunications. It's an option that should be explored.

The most likely route to scale is through the mainstream banks themselves taking up these innovations. Here the outlook is becoming more promising.

The most likely route to scale is through the mainstream banks themselves taking up these innovations

The reformers take charge

Change is afoot in the upper echelons of British banks. Reformers preaching a version of glasnost and perestroika are in charge. The question is how fast and how far they will go.

Banks are atoning for past sins and bankers are exercising moral muscles withered by years of underuse. British banks now have some of the best language in the world to describe their sense of moral purpose. An industry-wide programme of stable door slamming is still in progress. Banks are becoming skilled at apologising for and disavowing practices that got them into trouble at great cost. More skeletons may yet be found in cupboards, for example through the Financial Conduct Authority's (FCA) inquiry into the foreign exchange market.

On a more positive note, banks are paying more attention to customers. At RBS/NatWest the executive responsible for customer experience – a new post – sits alongside peers in marketing and operations on the executive committee. At Barclays senior executive performance is judged on the bank's 'net promoter score': the difference between those customers who recommend the bank and those who would not. Barclays sends 40,000 text messages each week to alert customers to put more money into their account to avoid incurring charges.

More importantly new products and services, which point the way to a different kind of banking, are starting to emerge. Perhaps the most exciting example, which captures the mood of the times is RBS/NatWest's savings goals planner, which is very similar to the prototype developed by Saffron Building Society in 2008. At the end of 2013 about 200,000 customers were using the product and saving on average about £189 per month more than those without the goal-related features. The bank has plans to get one million savers using the tool in the course of 2014. This is socially useful, commercially sustainable innovation at scale.

At Lloyds the money manager platform – which helps people manage their bills and spending online much as thinkmoney does over the phone – is seen as critical to the bank's future. Barclays is not alone in investing in new mobile banking services such as Pingit and its version of an apps store which allows customers to reconfigure their accounts.

As yet these are isolated examples of innovation. Banks need to follow through and revamp their business models. RBS/NatWest is promoting higher saving yet it would be relatively simple to apply the same methodology to help people pay off debts. Barclays sends thousands of texts to customers warning they are about to go over their overdraft limit. Yet the real problem is that overdraft charges are still a complex minefield. Banks make large sums of money by keeping their customers in the dark, for example by earning interest on customer balances held in the clearing system. None has yet made a move to stop this.

Compared with other retail industries the steps the mainstream banks have taken to date are modest. Moreover, there is no guarantee that the banks will not create another calamity for their customers. As the economy picks up so interest rates will rise and so will demand for borrowing. The moral compass that has only recently been installed in some banks might be sent back to the storeroom. Many of the executives we interviewed for this report are decent, well-intentioned, serious and competent. If anything goes wrong with the banks it will not be because

*Socially useful,
commercially
sustainable
innovation
at scale*

*Compared
with other
retail industries
the steps the
mainstream banks
have taken to date
are modest*

the people at the top have questionable intentions. Much of the change in the industry depends on this band of reformers. How should policy-makers strengthen their hand?

The banks need to be pressurised to continue to change. That means more competition, switching and account portability for customer accounts, with measures to promote new entry from providers who offer alternative models. This should include exploring how to open up the payments infrastructure so more agency banks can enter the market. Nor must banks be let off the hook of public scrutiny. Only if banks feel they are working in a goldfish bowl will they resist the temptation to resort to questionable business practices. The FCA has a critical role to play in setting a higher floor for business practices and punishing behaviour which threatens a return to the bad old days. The FCA should push banks towards more open, transparent and less exploitative relationships with their customers. The Fairbanking Foundation can play a role as a standard-setting body, using its research to encourage the banks to adopt proven innovations. The Foundation can ensure that banking institutions are delivering on their promises by the rigorous testing involved in the Fairbanking Mark certification.

The Fairbanking Foundation can play a role as a standard-setting body, using its research to encourage the banks to adopt proven innovations

It is not hard to see how a different kind of banking could emerge based on expecting banks to adopt higher standards and even being paid to help customers manage their money more successfully. Many of the ingredients for such a bank are already available: the savings tools designed by Saffron Building Society and RBS/NatWest; the current accounts offered by Secure Trust Bank and thinkmoney; the money manager service at Lloyds; the mobile banking and overdraft services being developed at Barclays and the debt management approach at Capital One. Such a bank – The Better Bank – would do exactly what it says on the tin and exactly what most consumers want: a basic banking service, which helps people make better decisions about their finances, by saving sensibly for the future and using debt intelligently.

The banks are at the heart of British society. Households and businesses in their millions depend on them. For too long the banks have taken advantage of this position of power. They need not just to make amends for past wrongs. But that will count for little unless they also change their spots and develop a more stable, balanced and responsible way of working with customers. This reformation will take years of sustained, hard work. But none of it is rocket science.

1. A once in a lifetime opportunity

British banks ... they all want to be helpful, simple, customer focused, transparent, respectful, honest stewards of people's money

The people leading Britain's main banks have what is probably a once in a lifetime opportunity to turn them into completely different organisations, at the heart of the British economy, making money by working for the good of the businesses, families and customers who depend upon them. This report is about how the people who lead the banks can rise to the challenge of remaking them.

The banks are slowly recovering from the largely self-inflicted crises that have struck them down only thanks to support from the UK taxpayer. New leaders are setting out visions that seem bold if only in contrast to what has gone before. British banks now have some of the best language in the world to describe their values and mission: they all want to be helpful, simple, customer focused, transparent, respectful, honest stewards of people's money. The senior executive corridors in central London echo to the murmur of *mea culpa*. Everyone involved seems to have been somewhere else when banking lost its way, or if not they underwent something akin to a religious conversion in the last two years. All this soul-searching is slowly starting to make itself felt in how banks market and communicate the products and services they offer (and have withdrawn) and how they treat their customers.

Yet despite this change in tone and language, people remain deeply distrustful of banks they have little option but to rely upon. A significant gap remains between the banks people want and the banks they have to put up with. The banks want to make a break with the most flagrant forms of abuse associated with the past. But they must go much further than that. Consumers want banks that provide them with convenient, simple and helpful services, with information and advice to help them make better decisions about their money, including how to stay clear of unsustainable debt while encouraging sensible saving. The challenge is to find practical ways to make this new approach work at scale.

Doing so will require innovation across a number of fronts in: basic products and services, from overdrafts and current accounts to savings and mortgages; how banks communicate and inform customers, to avoid obfuscation and promote transparency; business models, how banks make money; governance, and to whom they are held accountable. Perhaps most important of all it will require far-reaching innovation in the relationships banks have with their customers. For too long banks have appeared not just to take a large part of their customer base for granted, but often to take them for a ride. Banks have cynically made money at the expense of their customers. Banks need to find new ways

to make money by working responsibly with their customers to make them more financially secure. Thankfully some seem to be taking this task seriously.

This report is about where some of the needed innovations will come from and crucially how it might be taken to scale. Before exploring that, however, we need to understand how banks got into such a mess in the first place.

2. Getting away with it

Every bank has its own set of skeletons in the cupboard. All banks were destabilised by the boom and bust of the financial crisis of 2008. But for high street banks that crisis came amidst a string of other scandals from the rigging of Libor, to the mis-selling of payment protection insurance and endowment mortgages, the irresponsible extension of personal lending and credit card debt, excessive charging of fees for unauthorised overdrafts and skimming interest from customer balances deliberately left idling in the clearing system. The banks do not face a single problem of inadequate assets or risky lending, but multiple challenges. They may not be out of the woods yet. More scandals may yet emerge from the Financial Conduct Authority and other international regulators are inquiring into whether prices in the foreign exchange market are set collusively.

The common source of all these issues is the asymmetrical relationship at the heart of banking: bankers know a lot more about the products and services they sell than their customers, especially when those products are packaged together – a current account with an overdraft and various forms of insurance – with interest rates expressed in percentages that change over time, under different conditions. The fundamental issue in high-street banking is how banks deal with this asymmetry.

Over the past thirty years as Britain became less prudent and more viscerally consumerist, it became all too easy for the banks to exploit this asymmetry to their advantage, pushing products that customers barely understood, may not have needed and which turned out to be bad for them. Banking is not the only industry to struggle with this kind of asymmetry. Doctors are in a similar position, armed with more sophisticated knowledge and greater power than their patients. The recent scandals in the NHS, exemplified by the poor quality of care delivered by the Mid Staffordshire Hospital Trust, are testimony to how the public sector can fail to protect people against professionals who exploit their superior knowledge. It is a mistake to think all of the problems in banking go back to excessive bonuses. Even industries which operate without such bonuses can suffer from scandals.

In banking it has been too easy for too long to make money at the expense of customers. As one senior executive involved in compliance at Barclays put it: “The culture was that you did what you could get away with.” Banks became systematically self-interested, more concerned with their own financial success than the financial health of their customers or the wider economy.

Bankers may have become greedily aggressive in the last decade thanks to the culture of investment banking associated with the likes of Bob Diamond, former chief executive of Barclays. Yet questionable intentions are just the most obvious and superficial problem with the high street

As one senior executive involved in compliance at Barclays put it: “The culture was that you did what you could get away with”

...the culture and values of the banks, combined with their flawed business models led them to push products and services which too often were bad for their customers

banks. Banking is not full of rogues who should be in a Casino. Steven Cooper, Head of Personal and Business Banking at Barclays remarked: “People do not come to work to do bad things.” Yet if banks are full of fundamentally decent people, trying to do a good job, why have so many bad things emerged from banks in the past few years?

The explanation lies in how the culture and values of the banks, combined with their flawed business models led them to push products and services which too often were bad for their customers.

Take the cultural issue first. From the 1990s the banks took on a retail sales culture that meant that staff were incentivised to create, push and sell products to customers, almost it seems regardless of whether the customers wanted or needed them. One executive now running a large high street branch network described this as like: “blanket bombing selling, one day we would be pushing mortgages, the next insurance.” The head of customer data and analytics at another leading bank candidly remarked: “We used customer data to work out how to get customers onto a higher APR and to take on more credit so we could make more money. I could use the same data to target more savings but we wanted to target more credit.” This culture of pushing products at customers and getting away with charging as high a margin as possible has not been completely expunged. A compliance executive at one bank described assessing an insurance product which would cost the bank about £2 a month per customer. The business plan for the product suggested charging customers £15 a month. When she challenged the proposer to justify a margin she described as “choppy” the team explained they thought £15 was what they could get away with.

This aggressive retail sales culture, designed to shift high volumes of credit and insurance encouraged the banks to see their customers not so much as people but as accounts, yielding a flow of transactions. The customers meanwhile, often introduced to superficially attractive products with few apparent downsides, had little interest in asking too many questions and if they did they were given pages of terms and conditions in very fine print. They assumed the banks knew what they were doing.

It was as if both sides of the transaction were hoping to get away with it. Too many customers were hoping to get away with more debt than they could afford. Too many bankers were hoping to get away with charging too much for risky, complex products that they knew might be bad for a significant share of their customers. Neither side to this toxic pact had a strong interest in asking uncomfortable questions of the other.

Yet it was not simply a question of questionable values. The banks’ behaviour was driven quite rationally by their business models, which many in the industry admit are flawed if not rotten to the core.

The wobbly cornerstone of British high-street banking is the free current account. People who keep their account in credit are not charged for basic banking services. Britain is not alone in having this model yet nor is it the norm around the world. Yet the costs involved in providing “free” banking have to be paid for by someone. That creates an incentive for banks to make money not by being paid for delivering a decent service but by doing other things, often in ways that are designed to obfuscate and confuse.

One approach is to sell customers other products – especially loans, mortgages and insurance products – packaged up with their main current account. It is often hard for customers to work out whether they are being

charged a fair rate for these additional products. That is not helped by the widespread use of so called “teaser rates” which attract people to a product or service with an initially attractive deal that is later withdrawn. A loan might be virtually interest free for a few months before an aggressive interest rate kicks in. Another practice has been to hide charges from customers, especially in relation to overdrafts. As a result customers can easily fall into the trap of suddenly being charged not only for exceeding their authorised overdraft limit but also for payments from their account that cannot be made. These charges can quickly mount up. It is as if a motorist gets a parking ticket for going two minutes over their allotted time and finds themselves charged £150. Those on modest incomes who find themselves struggling pay fees which cross-subsidise free banking for customers who are better off, with higher and more regular incomes. That’s not all: banks make very large sums from interest earned on their customers’ balances as money passes through (some would say is held up) in the clearing system.

To pay for “free banking” banks have grown used to pushing complex, opaque, packages of products at customers, which often come with hidden charges. This is not a recipe for an open, honest, trusting and productive relationship between banks and their customers. When this flawed business model was combined with the “get away with it” culture, it was a recipe for products, services and behaviour which brought scandal, frustration and disappointment in their wake.

The mess that British banking finds itself in is not due to a handful of roguish city traders with doubtful ethics overseen by foppish and complacent boards. The problems are more deep-seated: a combination of culture and business models which has meant the industry regarded it as normal practice to come up with products and services which were designed to help the banks more than their customers. As Patrick Jenkins, the *Financial Times*’ banking editor puts it: too often financial markets seem to be run by people who are sharp, clubby and greedy.

In the three decades from 1945 banks played a cautious, restraining role in British society. Excessive borrowing was frowned upon. Savings were encouraged. Bankers were slightly paternalistic and staid. Bankers were conservative and not especially dynamic, but they did not set out to exploit the asymmetry of knowledge and power they had over their customers. In the three decades that followed financial services came to play a much larger role in British society, credit became more widespread, the banks more aggressive, companies more entrepreneurial and the economy more financialised. Yet this apparent dynamism came at a very high price: the excessive lending and complicated products that led to the financial crash of 2008. High-street banks took on the appearance of becoming more profitable by lending more and taking on more risk.

If British banking is to restore its reputation, create a sustainable business model and regain a trusted place at the heart of society, then it needs to get out of the mess that it is still in. That means wholesale, sustained change over a very long period of time to create products and services, sustained by business model and infrastructure, guided by culture and values, which have a sense of responsibility to customers at their core. Where will radical and comprehensive innovation of that kind come from?

Where will radical and comprehensive innovation of that kind come from?

3. A new recipe

Though food retailing is dominated by a handful of players there has been widespread innovation in the kinds of products those retailers sell

Innovation that changes an industry rarely starts in the mainstream, for good reason. Large, incumbent businesses have strong incentives not to go for radical, risky and uncertain investments with technologies that are embryonic and markets that are uncharted. Incumbents prefer innovations that sustain and develop existing products, designed for existing customers and which yield predictable, incremental income. The culture of large, powerful companies tends to make executives rationally short-sighted, focusing on the markets and products they already know rather than the ones they do not. The executives at the top of large organisations often have a strong, vested interest in preserving the status quo. As a result large companies have an inbuilt tendency to carry on doing whatever it was that made them successful in the first place. Threatening to overturn the status quo is not the way to get promoted.

Successful businesses are often too big to see opportunities for radical innovation that are just in front of them. Instead these opportunities are more likely to seem attractive to smaller, nimbler, younger companies with fewer sunk assets and more open minds. Innovations that might seem mad, bad or dangerous in a large company, might seem obvious and straightforward to a smaller one, operating in a distinctive niche. That might be because they are: dealing with customers with particular and sometimes extreme needs; working without the resources of large companies and within tighter constraints; exploiting new technologies that big companies are slower to adopt and adapt. In financial services a prime example of how an outsider exploited all these advantages to come up with a radically different service is M-Pesa, the ultra-low cost and easy to use mobile phone based payments and money transfer system, which is now used by 17m Kenyans. M-Pesa has created the bare bones of a banking system, by skilfully adapting the mobile phone network so people can transfer money to one another by phone and collect the cash from a local shop.

An instructive comparison is the way the food retailing industry has innovated in the last few years. Food retailing and financial services are both vital parts of modern life, dominated by a few large players. Food has had its own conduct scandals to contend with, particularly around meat, from Mad Cow Disease to horsemeat in lasagne. The effect of food on our diets and so on our health is the subject of relentless public debate, as is our reliance on credit and debt. Both industries have been blamed for pushing products that are bad for us.

Yet though food retailing is dominated by a handful of players there has been widespread innovation in the kinds of products those retailers sell. Much of that innovation has come from niches where innovative suppliers and adventurous customers have found one another, from organic and fair trade, to local and artisan products. A classic example is the

... a revolution in tastes, expectations, standards of quality, products and services ...

way that Ben & Jerry's made luxury ice cream an everyday item starting from a tiny, ramshackle store in Vermont. Organic bagged salad was first created on a tiny farm near Carmel California, Earthbound, by two unemployed students Drew and Myra Goldman. Their innovation grew to scale when they teamed up with Costco. Now they run 137 farms and Earthbound is one of the biggest names in the organic food business.

These changes in what we buy from supermarkets, and now have delivered to our doors, is part and parcel of a much wider shift in our culture with an expanding array of tastes and higher expectations of quality, from high street coffee shops, to pop-up restaurants and farmers' markets. Bookshops groan with cookbooks from celebrity chefs who have become guides to better ways to live.

There has been enormous stability and continuity in the food retailing industry, and yet there has also been a revolution in tastes, expectations, standards of quality, products and services, all driven by more informed, inquisitive and creative consumers. Much of the innovation in the industry has come from upstart new entrants such as Innocent drinks and Jamie Oliver. But their impact has depended on working through the scale made possible by the big retailers. Earthbound started life on 25 acres outside Carmel. It started to expand when Costco asked to buy its bags of washed organic lettuce. Innovation that transforms industries often comes about when radical ideas from outsiders are taken to scale by operators who command large resources and infrastructures.

What are the prospects for something similar happening in banking?

4. Radicals in the margins

British high-street banking is dominated by a handful of household names with vast but expensive and ageing branch networks: Barclays and Lloyds, HSBC and RBS/NatWest. Yet frustration with the banks, combined with the spread of new technologies is opening up possibilities for new entrants, from supermarkets such as Marks and Spencer's to brands such as Virgin. More controversially pay-day lenders such as Wonga which use mobile phone and internet as their network have also emerged in the last few years. Meanwhile new players hover in the wings. Jack Dorsey, one of the founders of Twitter is developing a mobile payments application called Square which uses the mobile phone networks as its basic infrastructure. These developments may draw on the spread of parallel, online, open source currencies such as Bitcoin, which has attracted interest and controversy in equal measures. Out of all of this an entirely new approach to payments and money transfers could emerge, built around tablets, smartphones and apps rather than banks, counters and ATMs. These approaches might take to scale the peer-to-peer lending systems created by the likes of Zopa in the UK and Progress in the US, which disintermediate banks. Banks may be able to accommodate to these changes and some may aspire to lead them, for example through the spread of contactless payments, which are commonplace in South Korea but still novel here. Yet the banks could be hit by a wave of disruption. Amazon is moving into payments systems and Apple already runs a vast commercial ecosystem linking consumers, music publishers and app developers.

... they see the asymmetry at the heart of banking as a reason for acting responsibly on behalf of customers ...

Yet some of the most potent and intriguing innovations have been pioneered by smaller players in the British financial sector that have doggedly pursued very different models from the mainstream banks. These dissidents are to be found in niches away from the mainstream; often working with clients in debt whose finances need careful handling; operating with very different business models from free banking; with cultures that are more like family-run, community-based businesses. These innovators show that it is possible to run commercially successful financial businesses by working responsibly with customers to help them manage their money more carefully, avoiding unsustainable debts and building up their savings. Taken together these smaller innovators provide a working model for a very different kind of British banking industry. The common feature is that they see the asymmetry at the heart of banking as a reason for acting responsibly on behalf of customers rather than taking advantage of them. Lets take a look at what they do.

Whilst thinkmoney doesn't dictate to customers how they should spend their money, they do give common sense budgeting advice

thinkmoney

thinkmoney is not a bank. It does not hold deposits. Nor does it offer its customers a current account with an overdraft facility. In fact thinkmoney deals with customers who banks often find too costly and complex to deal with. thinkmoney specialises in customers with average and in many cases multiple incomes, often involving some form of benefits, who may lead somewhat stressed and chaotic lives, which are reflected in the state of their finances. thinkmoney grew out of a debt advice and solutions business. A fifth of its approximately 100,000 customers are engaged in paying off debts. Yet most of its customers, and especially those it has recruited recently, are simply households whose finances are under strain, people who want extra help managing their money and those who worry about falling into debt. thinkmoney's service is explicitly designed to prevent that happening. This is how it works.

thinkmoney sets up for its clients two bank accounts with Royal Bank of Scotland that are known as trustee accounts. (These were originally designed for people who traded in stocks and shares but they serve thinkmoney's customers equally well.) One of the accounts receives all of the customer's incomes and is used to pay all their regular bills: rent or mortgage, utilities, and other direct debits and standing orders. Remaining funds are automatically swept into the second account – the card account – which the client can use for their spending or to withdraw cash from using a debit card. The two accounts are like jam jars. If a customer wants to use some of their designated “bills money” by transferring some into their card account then they contact thinkmoney and talk the transaction through with a Money Manager. The Money Manager will try and rejig their budget to make the transfer possible without missing a bill payment, although that isn't always possible. Whilst thinkmoney doesn't dictate to customers how they should spend their money, they do give common sense budgeting advice. Very often once the customer realises what bills they will miss they decide not to make the transfer. The tone of these calls, which is often about someone with a few pounds on their card wanting to transfer a small amount to get them through the following five days, is calm, mature, considerate and responsible. The aim is to encourage the client to make sensible decisions. The call centre takes around 5,000 calls a day. Customers are sent regular text updates on the state of their accounts so they know exactly how much they have available to spend and can budget accordingly. When a customer is in a critical position they might text for their balance a number of times a day as they monitor their spending on food, fuel and so on.

thinkmoney takes people who are poor at money management, or in debt, get their finances back on an even keel and puts them back in control of their money. But it only does this by itself exerting much more responsibility for the customer's well-being and working intensively with them to make sure their finances are in good order.

All of this is based on a business model which is very different from free banking. thinkmoney is a paid for service. Customers pay £14.50 (£21.25 for a joint account) for the service but thinkmoney gives them a guarantee that they will not go into overdraft (none is available) and they will be better able to pay their bills. Were these customers able to get a mainstream bank account – and many would not – it's likely they would

“I am not sure if what we do is innovation, or a throwback to old fashioned values, that help us deliver a 21st century service”

constantly incur fees for unauthorised overdrafts or to cover bounced payments. A couple of those charges in a month might cost between £40 and £50 pounds, enough to tip a person with fragile finances over the edge.

As Stephen Stylianou, thinkmoney’s chief executive puts it: “People who need extra help with managing their finances often get the least from high street providers. Our focus is really on meeting the needs of these customers, which means thinkmoney offers a personalised service, rather than a product. I am not sure if what we do is innovation, or a throwback to old fashioned values, that help us deliver a 21st century service.”

thinkmoney does not just have a different business model; the culture and values underlying the service is also very different. The atmosphere in the company is cohesive, egalitarian and above all down to earth. thinkmoney invests heavily in training and models its customer service on First Direct and South West Airlines.

They like to keep everything simple. When customers log on to view the state of their account it either comes with a green smiley face, indicating everything is fine; or a red, sad face which means urgent action is needed. This simple, colloquial, down-to-earth style of communication makes sense for thinkmoney’s customers. An emoticon with a “frowny” face will have more impact than a lengthy, formal letter.

thinkmoney shows that it is possible to make a respectable commercial return by repurposing the existing banking infrastructure with a different business model (a paid for service rather than “free” banking) and a different culture (help customers manage their money better). The service seems perfectly designed for Britain’s large, squeezed middle and for low income households who want help maintaining their financial discipline. Stylianou and his team estimate the potential market for their service could be anywhere between 7m and 8m customers.

Secure Trust Bank

Secure Trust Bank started life in 1952 as Secure Homes, a household budgeting service for West Midlands’ factory workers paid weekly in cash. They would pay a fixed sum each week to Secure Homes – a representative would set up shop with a table in a factory every Friday – and Secure Homes would pay their regular bills for them: rent, gas, electricity, water, hire purchase, telephone. It was a way for people to budget for household bills and make regular payments before the days of direct debits. To this day about 25,000 people still use the service. On a regular basis the Secure Trust headquarters in Solihull is flooded with paper bills from utilities that are paid on customer’s behalf.

In 2008, just before the financial crash, Secure Trust Bank, as it had become, decided to explore a super simple current account that would help people to stay debt free. Like thinkmoney, the Secure Trust Bank solution makes use of the existing banking infrastructure but puts it to use for quite different ends and is enabled by a different business model.

Secure Trust Bank helps its customers to set up a current account into which they pay their income. An agency arrangement with Barclays is how customers’ transactions flow through the banking system and it gives them access to branches for paying in. This account is used to make direct debits and standing orders for regular bills, but it comes with neither a cheque book or debit card. Instead spending money can be uploaded

thinkmoney and Secure Trust Bank show how it is possible to provide a basic bank account to help people ... manage their finances so they stay out of debt

from the Secure Trust current account to a prepaid Mastercard, which can be used for cash withdrawals and for purchases in shops. The account is simple to use for customers: they can only spend what is on the card. Most tend to transfer money by contacting the call centre or online: some call five times a day to check their balance and make small transfers. Yet the service is also relatively simple for the bank. There is no credit facility and STB is not selling loans to these clients so there is no need for credit checks and no risk the bank will be caught mis-selling anything.

Instead of making money selling insurance and loans, current account customers are charged £12.50 a month for the service. STB argues the fee is more than worth it. On any one day 10% of items being paid out of its customers' accounts bounce. STB does not charge for these bounced items but a mainstream bank would at a cost equivalent to several times the monthly fee. In addition if customers use the card to do their shopping in a clutch of approved retailers they get rewarded with discounts which combined can be worth the same amount.

Allied to this business model Secure Trust Bank's small team has a deeply ingrained culture of customer service. David Nield, Chief Operating Officer, pointed out: "We could easily have skimmed off a bit of the discount that the retailers give our clients for shopping with them. But we pass on every last penny." Staff in the call centre are not given an "average handling time" for each call: they are told to take as long as they need to sort out a problem for a customer and some call five times a day to check their accounts. All this seems to work: Secure Trust Bank's net promoter score among its customers stands at +63%.

thinkmoney and Secure Trust Bank show how it is possible to provide a basic bank account to help people on modest and variable incomes manage their finances so they stay out of debt. They handle the asymmetry at the heart of banking quite differently from most banks: they exercise responsibility on behalf of and with their customers. They do not push financial products their customers do not need. They operate a business model quite different from free banking: they are paid for the service they provide. For their customers this makes sense because with a so-called "free" bank account they would constantly run up charges for unauthorised borrowing. These small organisations are almost like family businesses: cohesive, close and genuinely customer focused.

What about other aspects of banking, like savings, credit and loans? Can they be provided in ways very different from the standard, discredited operating model of British banking? They can.

Saffron Building Society

The town square of the Essex market town of Saffron Walden is an unlikely place to look for radical innovation. Saffron Walden is a comfortable and sensible place; unflashy and down to earth. Although there are the odd signs of modern urban culture – a Starbucks café – the town seems at ease with itself and unmoved by passing fads.

The Saffron Building Society, which has its offices on the market square embodies the town's spirit. It has just 120,000 accounts, with about 60,000, mainly local households. Although the building society has a new call centre on the edge of town, the Society's head office is anything but flash. The senior executives occupy a warren of offices along a narrow

Saving is a bit like going to the gym: it's easier when you have a personal trainer ...

corridor up in the loft space of the main branch. Like Secure Trust Bank and thinkmoney, the Saffron Building Society feels like a family business, with close ties to its customers. Each week staff carry out 200 customer account reviews – face to face conversations with customers – to check they are getting what they want. Each year they have 9,000 conversations covering 15% of the households they deal with. The atmosphere in the main branch is friendly and conversational.

When the rest of the financial services industry was busy lending people more money, the Saffron decided to stick to what it was doing: promoting saving and responsibility. As Jon Hall, the chief executive, explained: “We just thought it was the wrong thing to do, for people and for the business, to push credit and debt at them. We didn't want any part of it.”

So in 2006 Hall, then the finance director, set out with a small team to create a revolutionary approach to help people do more with their money through saving. They embarked on a product innovation process which other larger banks are only now starting to emulate. First the team acted as ethnographers and spent time with customers trying to understand their lives and how savings might help them. They looked at other organisations working with their clients, like Citizens Advice. They commissioned focus groups and eventually an online community of consumers to advise them on product development. Consultants were brought in to help them chart how to change the organisation and a web team developed new software.

The result was an online “Goal Saver” planner, launched in 2008, which was three to four years ahead of its time. The planner is based on a few simple principles that emerged from the customer research. People will save more when they are saving for goals that matter to them. They like to put money into different pots for different goals. They save more when they have made a commitment to reach the goal by a set date and they can easily track progress towards the goal. Saving is a bit like going to the gym: it's easier when you have a personal trainer to get you into shape and then into good habits.

The Saffron Building Society goal saver gives people a simple tool to start saving for goals such as buying a car, going on holiday or getting married. Jon Hall remarked: “The trouble with financial services is that we talk our own language. When people say they want to save, we start talking about cash ISAs and equity ISAs and we lose them. We have to speak to them in language they understand.”

Saffron Building Society has produced a radical idea from a conservative place. thinkmoney and Secure Trust Bank, developed innovative products because their customers on debt recovery programmes had extreme needs. The Saffron went against the grain because its customers did not need more debt. They wanted better ways to save.

Hall admits his ambitions for the planner to become a way for people to start planning their savings around their lives, have not yet been fully realised. It has been tucked away on the building society's website as a “product”, whereas Hall wants it to form part of the basic interface all customers use. To grow faster, further, would have taken greater resources and commitment, of the kind that perhaps only big banks and building societies can provide.

... the organisation's mission was to "help people succeed with credit" ...

Capital One

Capital One says it takes a considered approach to acquiring customers, only opening accounts with those who look able to handle credit sensibly. Each month, as a result, it turns down many thousands of people applying for credit. Jaidev Janardana, Chief Marketing Officer said the organisation's mission was to "help people succeed with credit", recognising that if Capital One did not "help" them, customers would seek credit elsewhere, potentially turning to non-regulated or even more unscrupulous ways of accessing credit. According to Janardana Capital One offers "clear and transparent products" that will not channel customers onto higher rates of interest once they have started using the card. Many customers complained about these fees in the past, but these complaints have come down as a result of significant fee reductions, as much as 50% over the last 3 years.

New products have been developed, such as the Progress Card, which rewards people with a lower interest rate on their debt as they pay off more of it. In the past Capital One, along with the industry, relied heavily on so-called "teaser rates", introductory, no interest, offers to get people using their card or to transfer a balance before higher rates kicked in later. Now it believes that the rest of the industry is using practices that are not in customers' best interests, like putting up a customer's interest rate if they miss a payment during an introductory offer. Instead of joining the price war of offers of super-long teasers, Capital One says it prefers to offer cards that reward cardholder loyalty. Customers are actively encouraged to use direct debits to pay for their cards which reduce the number of missed payments. Alerts and messages are used to make customers more aware of what they can do to save them money. A radical new metric is being introduced that encourages customers to "graduate" with credit: improving their credit standing over time. This may even have the potential for the customer to leave Capital One to another credit card company when their credit rating improves or to develop a credit history to help with a mortgage application, for example.

Despite these efforts a significant share of Capital One's customers still get into difficulty with their repayments. Some simply forget to make a regular payment and need reminding. Others are thrown off course by a crisis – the loss of a job, a car breakdown. But many find themselves stuck in a cycle where their borrowings rise because their spending outstrips their income.

Historically, Capital One's approach to these people was to try to recoup as much of the debt as possible before writing off the rest, an approach that didn't really benefit either the customer or the company's profit and loss account.

Over the past three years Capital One has developed a quite different approach to working with customers with debt problems: to "cure" them of debt. That means taking a long-term view of the relationship, establishing a joint plan to pay off the debt, with regular updates to keep on track. Where the collections and recovery team at Capital One were expected to deal with people in arrears quickly now they are encouraged to have a calm, grown up conversation with people to create a plan in which the company gets its money back and the customer enhances their credit rating.

[Capital One] shows that quite radical innovation can be compatible with significant scale

Graham Robinson, the head of the collections and recovery team which works with customers in arrears explained: “What we have found is that there is no trade-off between customer service and better returns for the business. In fact the two are closely related. By looking in detail at the performance of the call centre, tracking customer feedback on the calls, we can see that the staff who get the best ratings from customers, also get the most money back for us. That is not about just being nice and doing what the customer wants. It’s about having an honest conversation with the customer to create a realistic plan to pay off their debt. When they have a conversation like that they are both grateful and more likely to stick with the plan.”

The call centre teams are organised so that the staff who get the best combination of customer service scores and repayments train the rest of the team. Robinson and his team constantly innovate new approaches to their calls to see what works most effectively. It is less a collections and recovery service and more like recuperative care for people with heavy debts.

Like much of the industry Capital One is trying to clean up after the financial equivalent of a very nasty toxic spill. The organisation’s senior leadership talk of wanting to create products and services that are “unasailable” in the court of public opinion. Vicky Mitchell, who became chief operating officer of the UK business three years ago remarked: “We are a commercial organisation, we want to make a commercial return but we believe we now have a way to build a business for the long term, through better relationships with our customers.”

Although Capital One is a fairly small player in terms of the British financial services industry, it shows that quite radical innovation can be compatible with significant scale.

A recipe for responsible banking

Taken together these two tiny agency banks, a minuscule building society and a monoline credit card issuer show that it is possible to sustain commercially viable alternative models of financial services, which are designed to help people make better decisions, stay out of debt and start saving. All have done so by swimming against the tide of the last decade in which banks pushed more products at people and customers took on more debt.

Were these products and services to be clicked together, like Lego bricks, then they would make up the bare bones of a genuinely different, basic form of banking:

- A current account with no overdraft facilities, which never allowed people to go into debt, paid for with a monthly fee.
- A savings plan to help people put aside money for the things that matter to them.
- A credit card and borrowing facility designed to prevent people running up unsustainable debts and when they do works with them to cure them of the condition.

Many people do not need much more than this – other than a mortgage – from their bank, most of the time.

These organisations feel more like cohesive, family businesses

These four innovators have created different products and services, because they have different cultures and values, and a different business model, from mainstream banks and financial institutions. What thinkmoney, Secure Trust Bank and Saffron Building Society lack is infrastructure to take their products and services to scale. Indeed thinkmoney and Secure Trust Bank operate at the disadvantage of having to work through the infrastructure of other banks and yet despite this they have successful businesses. Were this basic banking infrastructure available to smaller, innovative banks, at reasonable rates then the industry might generate much more socially useful innovation. The mainstream banks have heavy-duty infrastructures which are in need of new products and services aligned with new cultures, values and business models. These innovative banks have new products and services, aligned with different cultures, values and business models, which are in search of infrastructures to take them to scale.

The features are at the heart of these alternative approaches, which set them apart from the mainstream banks.

First, they have quite different business models. Whereas mainstream banking relies heavily on cross-selling a complex mix of products and services to customers who have bank accounts that are notionally “free”, these organisations sell simple contained products which are easy to understand. Rather than charge people with chaotic finances fees for unauthorised borrowings, they charge their clients a fee for a service to stay out of debt.

Second, they have a different culture, at least compared with the headquarters of the mainstream banks. These organisations feel more like cohesive, family businesses. They go to considerable lengths to get feedback from their customers and to attend to their needs. This is perhaps most evident in the down-to-earth language they use, epitomised by thinkmoney’s smiley faces and Saffron Building Society’s savings goals. But the difference is more than just customer service. They deal with the asymmetry at the heart of banking in a quite different way. The watchword for these organisations is responsibility on behalf of customers. Providing better customer service is not simply about being nice to customers, providing them with choice, selling them products which appear to give them what they want. For these organisations customer service is built on a sense of responsibility to customers, to help them make better long-term decisions.

These differences are evident in the offices these organisations’ headquarters inhabit. When we asked a senior executive at Barclays why the bank had got into such a mess, due to conduct many in the bank were ashamed of, she gestured around her to the air-conditioned offices looking down on Canary Wharf: “Working here is like working in a bubble. Everyone is affluent and financially literate. When you go out for lunch you are surrounded by the same kind of people. It’s very easy working here to get cut off and to imagine that the entire world looks like this.”

There could hardly be greater contrast between Barclays’ five star, headquarters, all glass and steel, from which bankers look down on all they survey, where doormen usher you into a vast lobby furnished with corporate slogans urging staff to be respectful, honest, stewards, and the unpretentious offices of thinkmoney in a nondescript red brick

The watchword for these organisations is responsibility on behalf of customers

*They provide
a model for
mainstream banks
imagining a future
where almost all
banking is digital*

building on a trading estate next to the tramline from Manchester to Salford; Secure Trust Bank's headquarters in a unit on an industrial estate in Solihull, close to the factories where it got started and the Saffron Building Society offices on a market square that looks like it belongs in Britain from the 1950s.

thinkmoney and Secure Trust Bank, moreover, manage to maintain this sense of connection with their customers without having a physical branch network. They are banks that exist almost entirely over the telephone and online. Their weakness – the lack of a proper banking infrastructure, including a branch network – may yet prove to be a strength. They provide a model for mainstream banks imagining a future where almost all banking is digital.

These smaller innovators make a decent commercial return. Yet if these kinds of products and services could be provided at scale to millions of customers then they would make a return for shareholders on a par with current, mainstream approaches based on the “free” banking model.

It would not be hard for the mainstream banks to pick up the products, services, software and routines used by these innovators. That kind of imitation would not be hard. What will be much harder to adapt will be the bigger shifts in culture, values and business models that underpin those products and services. That would mean shifting from managing accounts to working with customers; from short term, opportunistic transactions to longer-term relationships; leadership through values rather than driving margins; conversation with customers to educate and help them rather than selling them products they do not need; a culture of taking responsibility for customers rather than taking advantage of them; organisations which went out of their way to get honest customer feedback and insight.

Is such a transition possible for the mainstream banks? Could they take some of these niche innovations to scale to change the entire industry?

5. On the road to Damascus

Change is definitely afoot in the upper echelons of British banks. Reformists preaching a version of glasnost and perestroika are now in charge. The question is how fast and how far the reform drive will go. For despite brave words and attempts to make good past misdemeanours the reformers have only just got started and they could quickly find themselves bogged down, diverted or simply exhausted.

What kinds of innovation are starting to emerge in the banks and what more are needed?

The road to Damascus has been busy with converts as banks atone for past sins and renew their faith in values they lost touch with. Bankers are learning to exercise moral muscles withered by years of underuse. The fact that virtues as obvious as honesty, integrity, respect and stewardship should need reasserting is itself a sign of how far the banks strayed from the straight and narrow. At all the main banks, senior executives are leading “values” programmes. The most impressive, sustained and serious among the banks we talked to was Barclays where two days of interviews with a string of senior executives resembled an extended moral philosophy seminar. Executives at Barclays give the impression that they routinely debate the bank’s conduct, products and services, to interrogate whether it will be good for customers. One compliance executive, for example, talked at length about a debate among senior managers over the treatment of 300 Icelandic customers on a special mortgage product that was being phased out. Most powerfully Ashok Vaswani the charismatic CEO of Retail and Business Banking, told us: “I want people to do the right thing for the customer. Not because that is the best way to make money in the long run, although that may be true but just because it is the right thing to do. This is belief-based banking. Do what you believe to be right.” Less flatteringly another senior executive at Barclays commented: “My perception was – this bank was all about making money, which is why I wouldn’t have worked here before.” One example of that change is the programme led by Steven Cooper, head of Personal and Business Banking, in which he ran six 24-hour-sessions, each involving 1,200 middle managers, to get them to rethink their priorities by putting customer service first. Lloyds and RBS/NatWest may not be approaching these challenges with the same missionary zeal, but there too, senior executives talk about the need for a new set of values.

All this means that British banks, with the aid of skilled spin doctors, now have some of the best language in the world to describe their sense of moral purpose. It is always worth bearing in mind that when energy

Bankers are learning to exercise moral muscles withered by years of underuse

“My perception was – this bank was all about making money, which is why I wouldn’t have worked here before”

trader Enron went bust it did so armed with a mission statement the Pope could have signed up to. Barclays’ moral rearmament programme will be a success when it no longer needs to remind its employees to be honest as they pass through the turnstiles when they come into work.

A related development is an industry-wide programme of stable door slamming. Banks are becoming skilled at apologising for and disavowing practices that got them into trouble. One of the most striking examples is the way Lloyds bank has openly and proactively taken on its liabilities over the miss-selling of payment protection insurance. At many banks staff rewards based on product sales have been withdrawn in favour of incentives to reward better service, often judged collectively. Lloyds has been at the forefront of that change, according to Philip Robinson, the director in charge of personal current accounts. Staff at the bank are not rewarded for selling products but on a balanced scorecard which takes into account customer satisfaction, regulatory compliance and financial performance. Complex and confusing product lines and processes have been slimmed down: by 2011 RBS/NatWest had no fewer than 22 savings products; now it has just five. Like many banks RBS/NatWest is gradually revamping the way it communicates with customers: for example it now sends savers simpler messages celebrating their savings record.

These are serious efforts to right past wrongs and to make sure they do not happen again. However it is a mark of our low expectations of banks that these steps are considered worthy of note. There is also a danger that banks become very good at fighting the last war. As one middle manager at a large bank put it: “We are busy trying to become the bank we should always have been. That does not leave a lot of time to develop new ways to become a better bank.”

On a more positive note, banks are putting in place processes for vetting and developing products that pay more attention and give more weight to customer needs. Senior managers at banks talk wistfully of being compared to brands such as Apple and retailers such as John Lewis. Everyone is setting out to offer simpler, helpful banking. This is more than talk. At RBS/NatWest the executive responsible for customer experience – a new post – now sits alongside peers in marketing and operations on the executive committee. At Barclays Ashok Vaswani’s performance is judged on a simple measure of customer satisfaction, the bank’s “net promoter score”: the difference between those customers who recommend the bank and those who would not. At Lloyds, Simon Kenyon, the director of Everyday Banking explained: “The classic – business would focus on cross-selling products to as many customers as possible to increase its returns. Now our strategy, set from the top of the organisation, starts with customers and what they need rather than what the bank is trying to achieve. We want to be the best bank for customers.”

At Barclays new procedures are in place to make sure products are not merely compliant but work to the benefit of customers. Products which charge excessive margins are questioned. The bank is starting to do in-depth research with customers to understand their needs and to set up online forums so they can voice their views. This effort to engage with customers includes facing up to customer feedback and listening to complaints rather than, as one executive put it, “buying off people who complain”. Catherine McGrath, the no-nonsense head of current

accounts at Barclays is instilling a different approach to customer communications: if it wouldn't make sense to your mother, don't send it out. McGrath explained: "We have an obligation to the 15m households that bank with us that even if we do not make that much money from those accounts we have a responsibility to help them manage their finances better. We are not a social business but we definitely have social obligations to customers to have a fair exchange of value with them rather than a one-sided exchange which mainly benefits the bank."

These steps to make the customer's point of view a much more important part of the way banks make decisions is only to be welcomed. Banks find it all too easy to exploit their customers. Banks will be in a stronger position to guard against ethical corrosion only if customers have a much stronger voice in decision-making. Yet even so many of the steps banks are now taking to find out more about their customers, which are regarded as revolutionary, would seem rudimentary in more customer centric businesses. Once again banks are playing catch up.

Yet new products and services, which point the way to a different kind of banking industry, are starting to emerge. One of their common features is that banks are choosing to forego making money at the expense of their customers, at least some of the time and so they are also prepared to make a lower rate of return on equity, at least in the short run.

Perhaps the most exciting example of a new product which could capture the mood of the times, is RBS/NatWest's savings goals planner, which is very similar to the prototype developed by Saffron Building Society: it allows people to set simple goals; create different pots to put their savings into and track their progress against their goals. The online dashboard is simple, attractive, appealing, and it works. At the end of 2013 about 200,000 customers were using the product and saving on average about £189 per month more than customers using similar underlying products (like ISAs) but without the goals. Once savers have set up a goal, for example to save to buy a car, a house or a holiday, they then get regular updates and reminders from the bank, encouraging them to save and celebrating their achievements. The bank has plans to get 1m savers using the tool in the course of 2014. David Crawford, Head of Savings, Products and Marketing at RBS/NatWest explained: "As an industry we have devalued savings by focusing too much on debt and lending. As a business we cannot fund ourselves through wholesale money markets in the way we once did, so we need to take in more savings to fund lending. Savings is at the heart of a very different business model for the bank and for our customers."

The NatWest savings goals planner, combined with the constant updates and encouraging messages the bank sends out, gets rave reviews from customers contacted by Ipsos MORI on behalf of the Fairbanking Foundation. This is a snapshot of what customers who found the tool helpful had to say:

"It makes me more aware of my savings and what I'm saving for. It also encourages me to stick with my goal."

"Even though I haven't managed to save what I wanted to it's still great to know someone is keeping track of it and encouraging me to try and do it by constant reminders."

“You don’t get a lot of friendly emails from your bank”

“Normally messages in my online banking are trying to sell me accounts and products. This was just for me.”

“I found it encouraging that I am on target to achieve my goal much quicker than average. It helps motivate me to keep saving as much as possible.”

“It was a really good email. You don’t get a lot of friendly emails from your bank.”

“It’s only a small thing that I saw for saving for my last holiday but it made me really proud and goals are now an essential part of my life.”

“I got the message after I saved enough for a mulberry bag. It was like giving me permission to go out and spend my money.”

“Was fun :-) and it’s encouraging to have a reminder to save for something else.”

“Receiving this message is great encouragement! It makes you feel really good and excited about meeting your goal, more so if you have exceeded it or struggled to meet it. It’s great encouragement for when you set your next goal as you feel like someone is monitoring your progress and is behind you all the way in meeting your goal.”

“Happy that I had reached it, a personal touch for it to have noticed as well.”

(Ipsos MORI survey conducted with 1,188 RBS/NatWest customers who have a Your Savings Goal. Fieldwork was conducted online in October 2013.)

At Barclays Ashok Vaswani, points to a string of mainly digital innovations which he hopes will make banking more convenient, transparent and relational. Barclays sends 40,000 text messages a week to customers to alert them that they need to put more money into their account to avoid incurring charges. The bank has created a “features store” – with the look and feel of an apps store – so customers can click together the ingredients they want in their account rather than buying a pre-set package. Pingit, the mobile payments service, is an effort to bring to the UK elements of the model pioneered by M-Pesa in Kenya. Barclays customers can get their debit cards personalised, which helps with security and loyalty. Many have a pre-assessed loan facility which they can draw down at will, without going through lengthy checks.

At Lloyds meanwhile, where innovation is being approached more cautiously and incrementally, senior executives point to efforts to make sure that ancillary products – such as insurance – are priced to match the best in the market before being offered to customers as part of a package. Lloyds’ money manager platform – which helps people manage their bills and spending online much as thinkmoney does over the phone – is seen as critical to the bank’s future offer.

So there is evidence of real appetite for change among the big banks. At the end of 2013 Barclays seems to be the most concerted and articulate leader of the pack but RBS/NatWest’s approach to saving is arguably

Opportunities for innovation abound which as yet banks have been slow to follow through

the most tangible new product and service to have emerged. The pace of change at Lloyds is slower, and more cautious yet over the long run the Lloyds tortoise may yet outrun the Barclays hare. Philip Robinson, the Lloyds executive responsible for personal current accounts explained why sometimes going slower might be essential to better banking: “We want to be accountable to customers and to explain what we are doing and why. That might mean our internal procedures are slower, with more checks than in the past, but of course this wouldn’t affect our customers.” Robinson says Lloyds aim is to provide customers with safe, reliable and helpful banking: “We still offer customers packaged products but we make sure the elements in the package are the best in the market, so if we provide travel insurance then it has to be the best the customer could get. We are putting a lot more effort into simple alerts for customers in good time so they can correct a position like an overdraft which might incur charges.”

Better banking does not always mean faster, quicker, easier banking. The conversations that account managers at thinkmoney and Secure Trust Bank have with their clients are often longer than the average call centre precisely because they need to take the time to explain the consequences of different decisions and reach agreement with the customer on what should be done.

As yet these are isolated examples of innovation, some of which are used only by a tiny minority of customers and so they can seem to be for show, like Potemkin villages. Banks are yet to follow through the logic of these new approaches to revamp entire product lines and related business models. Opportunities for innovation abound which as yet banks have been slow to follow through. One explanation for this might be that banks are unwilling to give up old ways of making money which on the face of it they have disavowed. They are doing so at the margins but not where it really counts.

- RBS/NatWest is promoting higher saving through its successful savings goals product but it does not offer a similar service to help people pay off outstanding debts and overdrafts. Yet it would be relatively simple to apply the same savings tool methodology to paying off debts. Capital One’s innovative approach to “curing” people of debt could be applied much more widely.
- Barclays sends thousands of texts to customers warning they are about to go over their overdraft limit. Only 25% take action as a result. The next logical step would be to completely recast the way that overdrafts are charged for which means the 75% who do not or cannot respond are not charged disproportionately. Overdraft charges are still a complex minefield. Some banks have started to cap maximum charges but there is much further to go.
- Deliberately misleading teaser rates are still widely used to attract people to save (high rate to begin with which tapers off) or borrow (low rate at the outset, rising thereafter). A sign of the complexity, obfuscation and confusion around basic banking products is the length and density of the terms and conditions attached to them. Banks are not the only businesses that have complex pricing structures that seem designed to confuse and mislead customers: the mobile phone and utility industries do so as well. But that should be no excuse.

- Banks still make large sums of money by keeping their customers in the dark, for example by earning interest on customer balances held in the clearing system. It is difficult to see how these ingrained practices sit with the slogans in the banks' new mission statements.

The moral compass that has only recently been installed in some banks might be sent back to the storeroom

The innovations the banks have introduced to date are only noteworthy when set against their dismal track record. Compared with other retail industries and brands the steps the banks have taken to date seem quite modest.

Moreover, there is no guarantee that the banks will not create another calamity for their customers. Much of the change in the industry depends on a few people at the top of the banks. As the economy picks up so interest rates will rise and demand for borrowing. Opportunities to make money in new ways will open up as people start to spend more. The moral compass that has only recently been installed in some banks might be sent back to the storeroom. Business as usual might return. Banks still have a capacity to shoot themselves in the foot.

One way in which they might do so, is through the growth of mobile and tablet banking. Bankers seem to regard the advent of mobile and tablet banking as almost a clean slate, a way to restore relationships with customers through more timely, convenient services which are knitted into people's lives delivered by cool, shiny stuff connected to WiFi. Many banks with ageing, complex, legacy computer systems, often brought together inelegantly through many mergers, seem to regard the shift to digital platforms as a challenge and an opportunity in equal measure. Bankers dream of being given permission by customers to start using online and mobile data to help them manage their spending more effectively, perhaps even arranging discounts with retailers and other providers. Mobile banking gives the banks the opportunity to insert themselves more deeply into the everyday detail of people's lives, to be with them every step of the way, planning their transactions, alerting them to offers, making sure their accounts are in good order. The bank manager of the future might be someone sitting in a conveniently located coffee shop armed with an iPad and the right kinds of apps.

Mobile banking gives the banks the opportunity to insert themselves more deeply into the everyday detail of people's lives, ...

Yet the far more intimate, immediate relationship that mobile banking creates also carries risks. In the wrong hands the idea of being able to borrow at the press of a mobile phone button could become a recipe for irresponsibility and ill-discipline. The idea of banks teaming up with, say, utility companies to create a new generation of "packaged" accounts should set off alarm bells. The extent of the faith that bankers are putting in digital tools to give them a fresh start with their customers is more than a little unnerving. If those technologies can lead to more transparent, open and responsible banking, then it could be a big step forward. If instead they become a tool for banks to push products at consumers disinclined to ask inconvenient questions, then it could be another disaster in the making. Imagine full-on mobile banking had been available at the height of the "get away with it" culture of 2005: the outcome may have been even worse. Not all bankers want to occupy the high moral ground staked out by the likes of Antony Jenkins at Barclays.

The reformation banking needs has only just begun.

6. The better bank

Barnaby Davis joined Barclays bank at the age of 16, in the back office of the Barnstaple branch in Devon. It was 6 months before he was allowed to talk directly to customers. He saw that as a privilege. For Davis being a banker was a respectable profession, a person of local standing, entrusted to look after people's money for them. Over the following two decades Davis watched in dismay, almost it seems from the sidelines, as banking became disfigured by a sales culture which could incentivise the wrong behaviours. Davis is now head of Barclays' retail branch network and determined to restore some of the pride people felt in being a banker: "People do not come to work to do bad things. On the contrary people in the branch network come to work because they want to help people, they want to do a job they can be proud of rather than one they are faintly embarrassed by."

All across banking people like Barnaby Davis have begun to emerge as if they were hiding while banking was under the control of an occupying power made up of retailers and investment bankers. Many of the people we have interviewed for this report – Ashok Vaswani, Catherine McGrath and Steven Cooper at Barclays; David Crawford and Sureena Santos at RBS/NatWest; Simon Kenyon and Philip Robinson at Lloyds; Victoria Mitchell and Graham Robinson at Capital One – seem decent, well-intentioned, serious and competent. They want to change financial services for the better. If anything now goes wrong with the banks it will not be because the people at the top have questionable intentions.

All of us have a vested interest in their success as they try to wrestle with vast, complex organisations, which need to run efficiently, even as they clean up the mess of the past and try to chart their way into the future. As David Crawford at RBS/NatWest, ultimately responsible for £80bn worth of savings from 7m customers, remarked: "Those savings are really people's hopes and dreams. If we don't look after them we are letting people down badly."

One simple way to put the challenge for policy-makers, politicians, regulators and consumer advocates is how best to strengthen the hand of this group of responsible reformers who now sit at the top of the British banks. These reformers have to break up the power of the old business models and cultures which dominated an industry that was prepared to make money by "getting away with it." At the same time they need to build up a new alliance, within and across the banks, to create a better way to do banking. The industry as a whole needs a different centre of gravity: different business models and different culture and values which in turn provide customers with different products and services.

*Surely the time
is right for the
industry to rise to
the challenge*

How should the reformers be helped to build an alliance for change?

First, the banks need to be pressurised to continue to change. That pressure needs to come from a combination of competition and public scrutiny. That means more efforts to promote competition, switching and account portability among banks, with measures to promote new entry from providers who offer alternative models. The two must go together. Account switching may yield little change if customers are just switching between broadly similar products and services. Measures to promote competition need to be allied to measures to promote new entrants who bring alternative models of banking. Nor must banks be let off the hook of public scrutiny any time soon. Only if banks feel they are working in a goldfish bowl will they resist the temptation to resort to well-worn and questionable business practices. The point and purpose of banks needs to be constantly, openly debated, with increasingly informed and demanding customers pressing for better services.

Second, the FCA has a critical role to play in setting a higher floor for business practices; closing escape routes that banks might want to take to make money through the back door; punishing with significant penalties behaviours which threaten a return to the bad old days. Yet there are limits to what regulation can achieve. Instead of responding to customers banks are in danger of increasingly responding to the regulator. Bankers will hide behind regulation to go no faster and further than the regulator demands. Regulators should insist that banks are increasingly considering the effect they are having on customers. Importantly when they do not provide encouragement and make it easy for customers to do what would be in their best interests, for example, at the end of a bonus rate or when they can afford to repay some debt. The Fairbanking Foundation is setting standards in precisely this area; it is a first for financial products in the UK. Surely the time is right for the industry to rise to the challenge.

Third, the infrastructure for banking needs to be opened up to competitors offering alternative models. As we saw earlier niche players such as thinkmoney and Secure Trust Bank offer an alternative to mainstream banks but need access to the banking infrastructure to take them to scale. At the moment they are heavily dependent on mainstream banks who have an interest in confining them to be marginal players. The mainstream banks have industrial scale infrastructures with national reach for which they need different products and services. These niche players have innovative products and services but limited infrastructure. At the moment agency banks are hostage to the big banks which control this infrastructure. The single most important step to bring more innovative competition at scale into the industry would be for aspects of this basic banking infrastructure – the payments system – to be taken into a form of public ownership which would allow it to be resold and leased out to new entrant banks at attractive rates. If that were a step too far then the infrastructure should be regulated in a way which lowered the costs of new entry to make it possible for competitor banks to take new products and services to very large markets and so raise investment on the basis of much more ambitious business plans. Incumbent banks will fight this move to open up their infrastructure but in the long run it would be good for the industry and good for consumers.

It is not hard to see how a different kind of mainstream bank could emerge, based on a culture and business model in which banks are paid for helping customers to manage their money more successfully, including saving and staying out of debt. Many of the ingredients for such a bank are already available: the savings tools designed by Saffron Building Society and RBS/NatWest; the current accounts offered by Secure Trust Bank and thinkmoney; the money manager service at Lloyds; the mobile banking and overdraft services being developed at Barclays and the debt management approach at Capital One. Such a bank – The Responsible Banking Corporation – would do exactly what it says on the tin and exactly what most consumers seem to want: a basic banking service, which helps people make better decisions over their finances, by saving sensibly for the future and using debt intelligently without coming to rely on it excessively. None of this is rocket science.

The RSA: an enlightenment organisation committed to finding innovative practical solutions to today's social challenges. Through its ideas, research and 27,000-strong Fellowship it seeks to understand and enhance human capability so we can close the gap between today's reality and people's hopes for a better world.



8 John Adam Street
London WC2N 6EZ
+44 (0)20 7930 5115

Registered as a charity
in England and Wales
no. 212424

Copyright © RSA 2013

www.thersa.org
