Digital players in the financial sector: between specialisation and diversification

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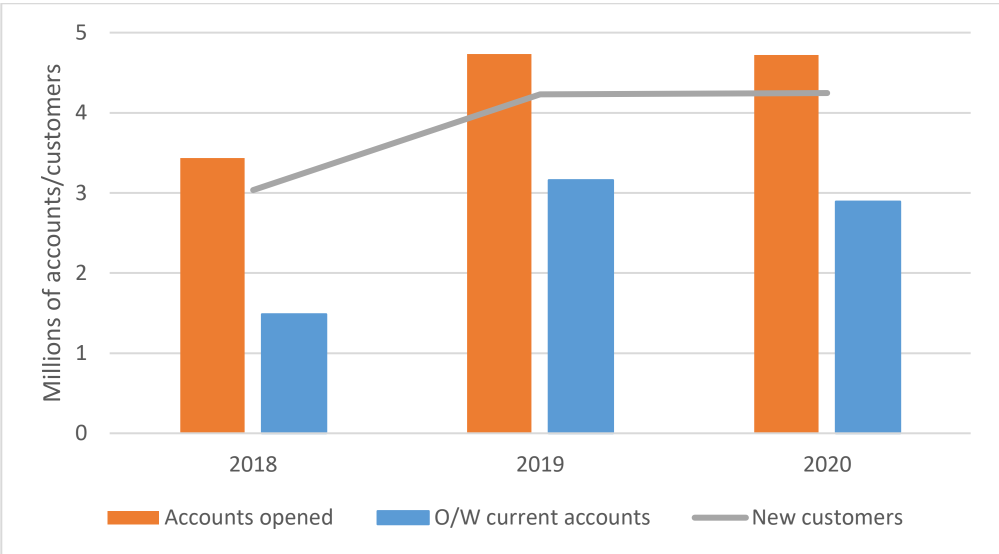
The customer base of digital financial players is rapidly expanding. The sector is characterised by a wide variety of business models. Among the players analysed over the 2018-20 period, the "100% digital" ones have become profitable because of their specialisation approach and their ability to develop strategic partnerships, while the traditional players have instead sought to diversify their customer base.

Chart 1 - New customers and number of accounts opened with digital finance players, 2018-20.



Source: ACPR, based on data from qualitative questionnaires submitted to a sample of 15 digital financial players providing banking services.

The market for digital financial players is booming (Chart 1). Who are their customers? How have their business models evolved and become profitable?

In a recent study, Clerc et al. 2022 analyse the development of the market for digital players in the French financial sector. This study is based on a survey conducted by the *Autorité de Contrôle Prudentiel et de Résolution* (ACPR) in 2021 among a sample of 15 financial players and intermediaries providing services that are 100% online or accessible via mobile applications.

The sample covers the main digital players engaged in credit intermediation (deposit taking and lending), both established entities and companies that have recently commenced operations in France. Thus, digital players that perform only one of these roles (e.g. FinTechs specialising in consumer credit, which do not take deposits) or whose core business does not involve these activities (e.g. AssurTechs) are not included in the sample.

This rapidly-growing market (see below) is still in its maturation phase. Some players have ceased activities because they have not achieved their customer base or profitability targets. For the remaining players, a distinction can be made between:

i) Generalist players, who offer a wide range of financial products to a diversified customer base;
ii) Specialised players, which focus on a limited number of products and services aimed at a narrower customer base, but which operate in market segments that are considered more profitable.

Digital players in finance: a rapidly growing market share

The digital financial sector players included in the study saw a significant increase in their market share in 2020 compared to previous years.

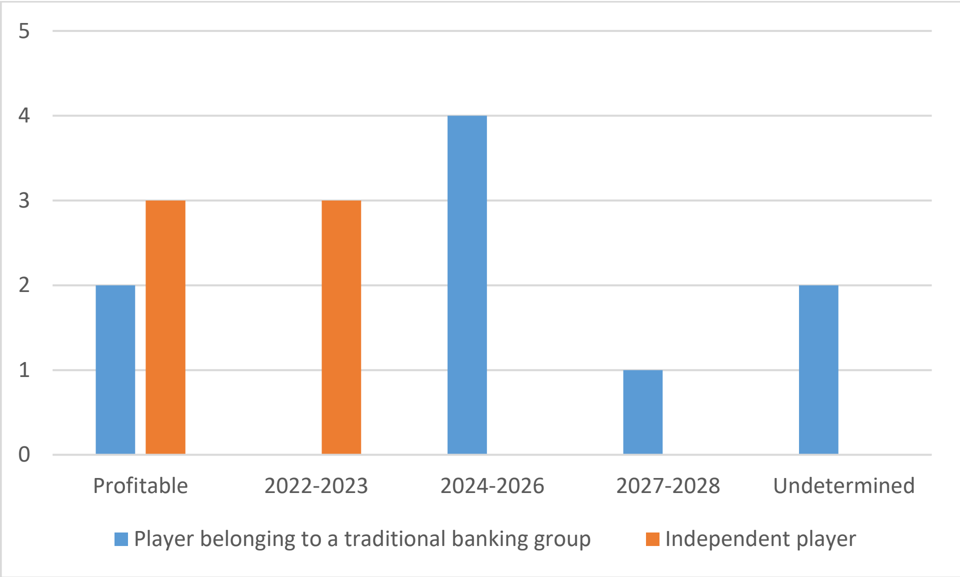
At the start of 2018, around eight million customers (exclusively individuals and SMEs) had an account with one of the institutions in our sample. This figure rose to 11.5 million at the beginning of 2019 and reached about 16 million in early 2020, i.e. an increase of 100% in two years. In comparison, the total number of retail accounts of the six major "traditional" French banking groups amounted to 74 million in early 2020, a figure that is stable compared to previous years.

Digital finance players have succeeded in increasing their market share thanks to increasingly comprehensive product offerings that encourage customer autonomy in the areas of everyday banking and savings products. As regards the opening of new accounts in the institutions included in the sample studied, 4.7 million accounts were opened in 2020, of which 2.9 million were current accounts (Chart 1). If we add this figure to the 5.5 million new current accounts opened by retail customers in the six major French banking groups in the same year, we find that in total, around 35% of new current accounts opened in 2020 were with one of the digital players included in our sample.

The elusive search for profitability

There are significant differences between digital players when it comes to breaking even. Without exception, the players in the study sample that do not belong to a traditional banking group claim that they are already profitable or will be profitable by the end of 2023 (Chart 2, orange bars). In particular, 100% online mobile players are the most profitable due to their low operating costs and specialisation in specific market segments.

Chart 2: Number of profitable players and break-even horizon depending on whether or not they belong to a banking group



Source: ACPR, based on data from qualitative questionnaires submitted to a sample of 15 digital financial players.

In contrast, among the players belonging to a traditional banking group, only two appear to be already profitable. For these players, reducing overheads and acquisition costs appears to be a winning strategy in the medium term. One of these players based its business model on a mixed distribution network, which combines online access and a physical network ("phygital" model), with high volumes and paid services. The other, an established market player, is characterised by effective cost control and a particularly stable customer base.

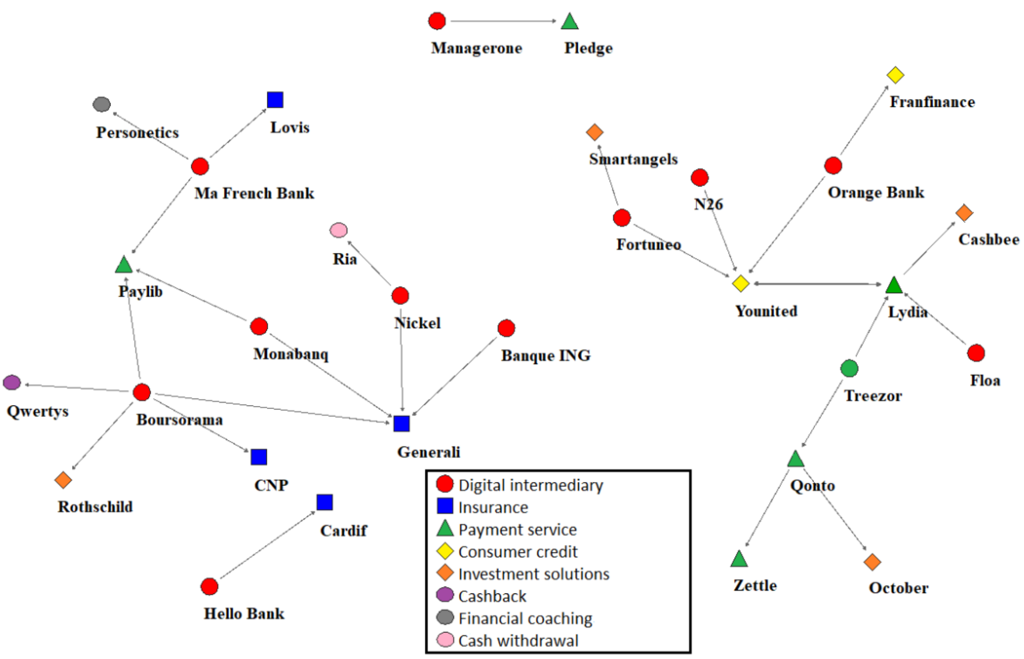
Other online banks have not made profitability an immediate objective, focusing mainly on attracting new customers by offering financial services at a reasonable cost - or even for free - in order to generate network effects. Lastly, some players were not able to become profitable due to low interest rates until 2021 or expensive IT investments.

Towards new strategic partnerships

One of the main developments in the market in recent years has been the diversification of the products offered through the development of strategic partnerships. The subsidiaries of large banking groups can offer their customers a wide range of banking and financial services developed within their group and equivalent to those offered in branches. The new digital players (payment institutions, etc.) face constraints due to their legal status at the time of authorisation.

In order to grow in this highly competitive environment, they have forged strategic partnerships with companies with complementary licenses, allowing them to expand the range of services offered. This has resulted in a network of interdependencies and complementarities not only within groups or between business partners, but also between competitors. Chart 3 shows the structure of this network, reconstructed from publicly-available sources.

Chart 3- Overview of the network of digital finance players' partnerships



Source: This chart was produced using only publicly-available data. In this overview, we have excluded intra-group partnerships, credit card partnerships and partnerships with BigTechs.

Chart 3 is not exhaustive, however, as it is based on data published by market participants and does not take into account intra-group partnerships (notably links with parent companies) or those established with bank card networks or BigTechs. In the latter two cases, as the offers are concentrated among a few key players (Visa, Mastercard or American Express) or among the payment systems offered by BigTechs (such as Apple-Pay or Google-Pay), these services are included in almost all the offerings. This chart shows that a digital intermediary (red dot) can be affiliated with a payment institution (green triangle), offer credit insurance to its customers (blue square) and, at the same time, offer investment solutions (orange diamond), financial advice (grey ellipse) or consumer credit products through a partnership with a specialised institution (yellow diamond). The transformation of the banking landscape is therefore continuing to unfold with the emergence of a new trend that consists in offering a diversified range of banking and financial products and services on a single digital platform.