

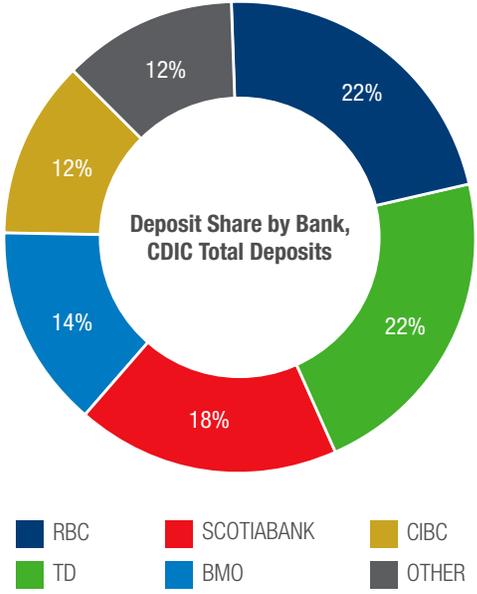
CAPGO

AN IMMINENT THREAT FOR CANADIAN BANKS

Canadian banks cannot rely on incremental improvements and the current regulatory environment as a source of long-term success. Banks must begin their transformations now to stand a fighting chance against new entrants.

Canada holds more spots in the world's largest 50 banks than the U.K., India, France, and Japan¹ but contains a fraction of the population. Regulations make it nearly impossible for international financial institutions (FIs) to compete in Canada and have allowed the largest five banks ('Big 5') to dominate the Canadian market.

Exhibit 1: The Big 5 holds firm control over Canada's banking market, for now²



As a result, the regulatory environment has allowed them to maintain strong earnings even with inefficient operating models creating a historical resistance to change. One 2018 study showed that Canadian banks are significantly less effective at generating income than their US counterparts when considering assets and employees³.

Deregulation in Canadian financial services may be on the horizon. The Canadian Bankers' Association is supporting open banking and other innovations in the Canadian financial sector⁴. The OCS's LaunchPad provides FinTechs and other new entrants with a regulatory sandbox to launch banking products in Canada⁵. As competitors and potential entrants eagerly await their opportunity to steal market share, banks cannot continue to resist change. With a rapid and significant shift in strategy, the Big 5 can maintain their positions as global and domestic leaders and ward off new market entrants.

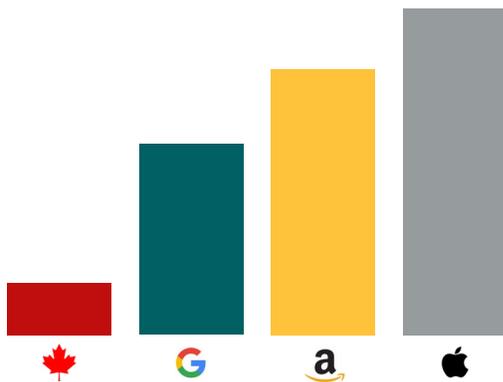
1. <https://www.advratings.com/banking/worlds-top-banks-by-market-cap>
2. <https://www.cdic.ca/newsroom/cdic-articles-and-updates/highlights-of-deposit-trends-in-cdics-membership/>
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AS REGULATIONS EASE, 'BIG TECH' WILL PROVE TO BE THE BIGGEST THREAT

Big technology firms have begun to make significant inroads into financial services abroad and are at Canada's doorstep. Their integration into Canadians' lives and wallets presents an entry point into the market as they lead the world in customer intimacy and understanding of our needs. In addition, their access to large amounts of capital will allow them to enter the market quickly through acquisitions.

Exhibit 2: Amazon's market cap is five times bigger than the Big 5 Canadian banks combined⁶

Big 5 Canadian Banks vs. Big Tech
Market Capitalization (USD)



With an abundance of capital, a strong level of trust among consumers, and deep integration into our lives, offering banking products is a natural adjacency for tech firms. Unsurprisingly, they have already entered this space in more deregulated markets like the US and the UK.

- Apple Pay is the largest of its kind in the Canadian and US market, beating out Google Pay and Samsung Pay. Apple has partnered with Goldman Sachs for its 'Apple Card' product, a zero-fee immediately delivered credit card with a complimenting money management app and more. As of March 2020, about 3.1 million Americans own this product, and 60 percent of them use it as their primary credit card⁷.
- Amazon is offering small business loans to vendors on their platform⁸. Shopify, a little closer to home, offers a similar banking product to its vendors⁹. Amazon has already tested student loans and is rumored to introduce a checking account with JP Morgan¹⁰.

As financial markets are strongly regulated today, Google, Amazon, and Apple have been avoiding the regulatory burden with established financial partners' help. In just over a year since its August-2019 release, the Apple Card is one of the most widely used credit cards in the US. Canadian Banks cannot continue to rely on the uncertainties of regulations to grow.

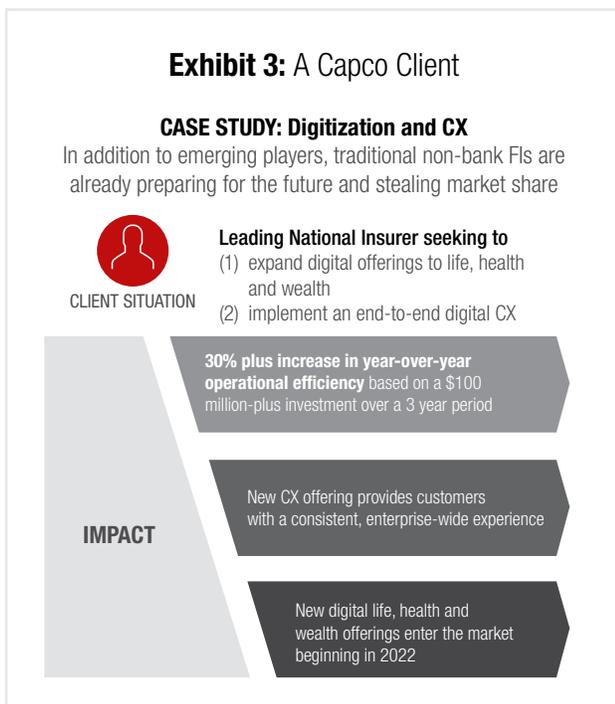
6. Financial information retrieved 2020-10-30. Dollars are in \$USD.
7. <https://www.forbes.com/sites/ronshevlin/2020/03/09/if-tim-cook-wont-tell-the-world-how-the-apple-card-is-doing-i-will>
8. <https://sell.amazon.com/programs/amazon-lending.html>
9. <https://www.shopify.ca/capital>
10. <https://www.cbc.com/2018/03/05/amazon-in-talks-with-jp-morgan-other-banks-about-branded-checking-account-wsj.html>

AN ENTRANCE BY BIG TECH CAN HAPPEN AT ANY MOMENT, BUT NON-BANK FIS HAVE ALREADY MOBILIZED THEIR ATTACK

Non-bank Canadian FIs represent a smaller but more immediate threat. Examples include leading wealth providers white labeling banking and lending products (e.g., mortgages), and property and casualty (P&C) insurers are transitioning into a holistic product offering, including life and wealth insurance. PC Financial, a division of a Canadian supermarket chain Loblaw's, is leveraging its extensive client base to provide everyday banking solutions¹¹. The list goes on.

There is a common theme among the products that tech companies, and non-bank FIs are introducing. In short, they are all creating customer-centric product-agnostic experiences. No-fee services are undoubtedly a highly attractive value proposition; however, this is not their only competitive advantage. Their platforms house a unified customer experience (CX) with a high-quality user interface (UI) and user experience (UX). Their everyday products feature superior value-add perks.

Banks looking to copy these efforts must approach this carefully because their high operating costs and duplicate back-end systems can make launching a new product futile. Banks need to undergo a large-scale transformation of their legacy operating model and infrastructure to remove inefficiencies and reinvent their CX if they wish to compete.



11. <https://www.pcfincancial.ca/en/pc-money-account/>

A DIGITAL PRECEDENT HAS BEEN SET. IT IS TIME TO CHANGE

A big tech entry into the Canadian market will look very different than the non-bank FIs that are already making headway. They don't face the restrictions of legacy operating systems. With some of the world's best talent, they are very nimble in responding to changing consumer preferences and competitive behaviors. Additionally, with over a trillion dollars in market capitalization, they will not be shy to incur short-term losses in the name of long-term revenue gains across their offerings.

The Big 5 are expected to experience both near-term and long-term risks due to these emerging competitors. To address the competitive and inefficient operating environment, banks must assess their position to identify opportunities to drive incremental and transformative value. Delaying the assessment does not make it any easier and will only result in a smaller window of opportunity as competitors define and test their strategies in the market. To stand a fighting chance, banks must act now.

Exhibit 4: The Big 5 must be proactive to fend off near-term risks and prepare for long-term risks

	NEAR-TERM RISK – MAJOR THREAT – 		LONG-TERM RISK – GAME OVER – 
	NON-BANK FIs	BIG 5 CANADIAN BANKS	BIG TECH
INFRASTRUCTURE	Legacy operating model and backend infrastructure	Legacy operating model and backend infrastructure	Unencumbered by legacy operating model and systems
INVESTMENTS	Significant investments in revamping operating model and new products/ markets	Band-aid investments on top of legacy systems and operating model to maintain status quo	Prioritizing excellence in customer offerings and servicing to fuel growth and market share
PLAN OF ATTACK	Redesigning operating model and adopting end-to-end customer-centric approaches for CX design	Focusing on specific needs of LOBs at the expense of customer needs	Force entry by leveraging scale to attack; substantial war-chest and large customer base

In our next post, we will look at how Canadian banks can leverage their dominant positioning to create a sustainable growth strategy and defend their market share.

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