Disruption: Are We Next?

CUNA Mutual Growth Symposium
Austin, TX – April 14, 2015

John Lass, President
Lass Advisory Services, LLC

John P. Lass
Lass Advisory Services, LLC
Seattle and Madison
April 2015
(608)609-9478
johnlass108@gmail.com
The Essence of Strategy

“Everyone has a plan - until they get punched in the mouth.”

-Mike Tyson (Quoted in The History of Strategy)
“Our real competition is convenience.”

Credit Union Executive, March 2015
Agenda

• What is Disruptive Innovation?
• Disruption in Retail Financial Services
• Potential Responses to Disruption
Section I
What is Disruptive Innovation?
Creative destruction is the "process of industrial mutation that incessantly revolutionizes the economic structure from within, incessantly destroying the old one, incessantly creating a new one."

Joseph Schumpeter, 1942
Innovation Is Nothing New

Printing Press: 1440
Wheel: 3340 BC
Light Bulb: 1800
Two-Way Telephone: 1876
Airplane: 1903
Antibiotics: 1928
Microwave Oven: 1955
Internet: 1969
Steam Engine: 1698
Steamboat: 1873
Radio: 1900
Television: 1925
Nuclear Power: 1954
Laser Beam: 1958
GPS: 1978
Paper: 200 BC
Anesthesia: 1842
Smart Phone: 1994

Today
Incumbents’ Challenge

“It is not the owner of stage-coaches who builds railways.”

Joseph Schumpeter
“An innovation that is disruptive allows a whole new population of consumers at the bottom of a market access to a product or service that was historically only accessible to consumers with a lot of money or a lot of skill.”

Clayton Christensen, 1997
## Disruptive Innovation: Automobile Examples

<table>
<thead>
<tr>
<th>Incumbents</th>
<th>Disruptors</th>
</tr>
</thead>
<tbody>
<tr>
<td>Duesenberg</td>
<td>Ford Model T</td>
</tr>
<tr>
<td>Ford Fairmont</td>
<td>Honda Civic</td>
</tr>
<tr>
<td>Honda Accord</td>
<td>Kia Optima</td>
</tr>
</tbody>
</table>

Source: BDU Analysis
Big Bang Disruption is “an innovation that, from the moment of its creation, is both better and cheaper than the products and services against which it competes. Using new technologies in the Internet, cloud-based computing, and increasingly powerful and ubiquitous computing devices, Big Bang Disruptors can destabilize industries in record time, leaving incumbents and their supply chain partners dazed, and, soon after, devastated.”

*Big Bang Disruption*, Larry Downes & Paul Nunes, 2014
Successful Disruption: Smartphones

Source: BDU Analysis
## Successful Disruption: GPS Devices

<table>
<thead>
<tr>
<th>Year</th>
<th>GPS Device/GPS App</th>
<th>Cost</th>
</tr>
</thead>
<tbody>
<tr>
<td>2004</td>
<td>Garmin StreetPilot 2620</td>
<td>$1,516</td>
</tr>
<tr>
<td>2009</td>
<td>TomTom iPhone Navigation App</td>
<td>$100</td>
</tr>
<tr>
<td>2014</td>
<td>Google Maps App</td>
<td>Free</td>
</tr>
</tbody>
</table>

Source: BDU Analysis
Successful Disruption: GPS Devices

GPS Device Manufacturers Struggle; Smartphone Sales Grow

Source: TomTom International BV and Apple Inc. financial reports
Successful Disruption: Uber

Source: “Clarifying Prices When You Hail a Cab with Uber, Other Apps”, WNYC.org, 1/10/2013
Uber Flattens The Competition

Source: “Uber/Lyft vs. taxis: Let the market decide, not taxi cartels and their government enablers — bureaucrats and legislators”, Carpe Diem Blog, 7/12/2014
Big Bang Market Adoption

Innovators
Early Adopters
Early Majority
Late Majority
Laggards

Source: Big Bang Disruption, Larry Downes & Paul Nunes, 2014; Crossing the Chasm, Geoffrey Moore, 1991, CUNA Mutual Group analysis
Strategy Options: Classic Approach

Product Innovation Leadership
We win because the market perceives our brand as having the cutting-edge (often overkill) products with superior features - justifying premium prices. 
*Example: Apple Computer*

Operational Efficiency Leadership
We win because the market perceives us as having the lowest prices. Based on cost and process efficiencies that still allow us to return profits. 
*Example: Dell Computer*

Customer Solutions Leadership
We win because we are so customer-intimate that we are already there when the customer need arises. We offer tailored solutions before the customer feels like shopping around. 
*Example: IBM w/ enterprise customers.*

Middle ground of mediocracy: Trying to lead on all fronts

To compete, a business needs to perform in all three disciplines. 
To become a market leader, it must outperform competitors in one discipline.

Source: *The Discipline of Market Leaders*, Michael Treacy & Fred Wiersma, 1995
Case Study: Specialty Coffee Retailers

Product Innovation Leadership

Customer Solutions

Operational Efficiency Leadership
Strategy Options: What About eBay and Google?

Product Innovation Leadership
We win because the market perceives our brand as having the cutting-edge (often overkill) products with superior features - justifying premium prices.
Example: Apple Computer

Operational Efficiency Leadership
We win because the market perceives us as having the lowest prices. Based on cost and process efficiencies that still allow us to return profits.
Example: Dell Computer

Customer Solutions Leadership
We win because we are so customer-intimate that we are already there when the customer need arises. We offer tailored solutions before the customer feels like shopping around.
Example: IBM w/ enterprise customers.

Middle ground of mediocrity: Trying to lead on all fronts

To compete, a business needs to perform in all three disciplines.
To become a market leader, it must outperform competitors in one discipline.

Source: The Discipline of Market Leaders, Michael Treacy & Fred Wiersma, 1995
Not All Disruptors Are Successful

Microsoft

web tv

Mobile RFID Payment Fob

Laserdisc

Oakley Thump Sunglasses

Segway

Sony Betamax

Source: CUNA Mutual Group Analysis
Some Disruptors Were Ahead Of Their Time

**MP3 Players**
- 1998 Diamond Rio
- 2000 Archos Jukebox
- 2000 Creative Nomad Jukebox
- 2001 Apple iPod

**Tablets**
- 2001 Compaq Tablet PC
- 2006 Toshiba Portege
- 2009 Archos 9 PC Tablet
- 2010 Apple iPad

Source: CUNA Mutual Group Analysis
Section II
Disruption in Retail Financial Services
The Battleground

Financial Institutions
Non-Bank Competitors
Retailers
Card Companies
Financial Services
Payments
Savings
Lending
Investments
Insurance
Platform Players
Telecoms
New Entrants
Alternative Payments
Key Competitors - 2014

Financial Institutions

Non-Bank Competitors

Card Companies

Telecoms

Retailers

Platform Players

New Entrants

Source: BDU Analysis
FinTech Investments Have Tripled In Five Years

Global financial technology investments hit $3B in 2013

FinTech Investment: Moving Beyond Payments

Source: CUNA Mutual Group Analysis
Case Study: New Entrants

Lending Club

• Leading P2P lender
  • Provides loans to prime* consumers that are funded by investors at the time of origination
  • Loans originated by WebBank, a Utah-based ILC

• Google took a $125M stake in the company in May 2013

• Majority (82%) of borrowers using their loans to consolidate debt / pay off credit cards

• Facilitated $258M of new loans in January 2014

*FICO score of 660+

Source: Lending Club, lendacademy.com
Lending Club Leverages WebBank’s Bank Charter

- Investor Member
- Investor Member
- Investor Member

Promissory note and monthly payments

Funds to purchase notes + 1% service charge

No Bank Charter

Lending Club

Utah-chartered* Industrial Bank

Borrower Member

Promissory note

Monthly payments of principal and interest

Promissory note

Loan proceeds

Promissory note

Loan funding

Utah has no usury laws

Source: Lending Club; CUNA Mutual Group analysis
Case Study: Retailers

Ambitious Plans

Speed Bumps or Deal Breakers?

Source: MCX, BDU Analysis
Case Study: Alternative Payments

"We challenged ourselves to find a better experience than swiping a credit card. We figured the only better way to pay would be to do nothing. Just walk in a store, and, like magic, when you're ready to pay, money is transferred securely. No wallet. No card. Not even touching your phone."

- David Marcus, President, PayPal
Kabbage Tries To Disrupt Small Business Lending

Get the funds you need to grow your business in minutes!
The world's fastest and easiest way to get a line of credit.

Apply Now
See how much you qualify for today

You could have $500 - $100,000 in your account by 9:04 am.

7 Minutes
SoFi: Expands Beyond Student Loan Consolidation

Cut the cost of your student loan debt
Members average $11,783² in savings

Find My Rate

**UNPARALLELED SAVINGS**
Our members save $11,783², on average. *Variable rates* starting at 2.66% APR (w/Autopay)³

**FEDERAL + PRIVATE STUDENT LOANS**
Refinance and consolidate federal and private loans. Easily.

**UNEMPLOYMENT PROTECTION²**
If you lose your job, we’ll pause your loan payments and help you find a new job.

**CAREER SUPPORT**
Need help reaching your career goals? Complimentary coaching for SoFi members.
Wealthfront: Small But Growing Quickly

It took Schwab six years to reach its first $1 billion in client assets. It took Wealthfront less than 2.5 years.
Acorns: Start Investing A Penny At A Time

Micro investing made possible.
Metromile: Per Mile Insurance Coverage

NEW Per-mile insurance now available in California!

The smart approach to car ownership

Metromile gives you information, advice, and options that make owning a car easier, more convenient, and less expensive.

Sign up free
Direct Auto: Leaderboards For Safe Driving

Log Trip

Start Trip

Weekly Leaderboard

Your Current Rank | Points
--- | ---
#1 Oswell C. | 68
#2 Rick W. | 55
#3 Jackie P. | 50
#4 Trisha N. | 46
#5 Greg M. | 25
#6 Brian H. | 3

Point Breakdown

+1 Smooth Braking
+1 Driving at Lower Speeds
+1 Register this application by upgrading your account

Trip Overview

Distance: 4 miles
Duration: 6 minutes
Max Speed: 54 mph

Top 20 | Points
--- | ---
#1 Oswell C. | 68
#2 Rick W. | 55
#3 Jackie P. | 50
#4 Trisha N. | 46
#5 Greg M. | 25
#6 Brian H. | 3
Friendsurance Peer-to-Peer Insurance

1. How do they make money?
Friendsurance works as a broker between Policy Holders and existing Insurance Partners. They’re letting customers share risks with friends, allowing them to lower prices due to reduced fraud & process costs, better risk pools, ...

2. Other companies with similar business model.
- http://prosper.com
- http://gym-pact.com

3. Business Model characteristics
- P2P-model
- broker Model
- refunds
- common money pool

- Loss or damage by policy holder
- Loss or damage by policy holder’s friend
- No loss or damage
### Themes In Retail Financial Services Disruption

Disruptors seek to:

- Use technology-driven business models, e.g., platform strategies
- Have a lower cost structure
- Find ways to bypass relevant laws and regulations
- Utilize low cost ways of moving money
- Aggregate customer data and monetize it
- Enter a single financial service before moving to other categories
Section III
Potential Responses to Disruption
How To Fight Disruption

Rule 1: Be Alert

Rule 2: Pay Attention to the Clock

Rule 3: Use Defensive Strategies to Buy Time

Rule 4: Build an Offensive Strategy
Be Alert

Consult Your Truth-Tellers

Confront the Brutal Facts

Determine What is Signal vs. Noise

Distinguish Between Sustaining vs. Disruptive Technologies

Source: CUNA Mutual Group Analysis
“Most successful companies are so focused on maintaining their core business that when push comes to shove, the core will almost always kill off the disruptive innovation - the new thing.”

Kodak Could Have Been The Disruptor

George Eastman with an early Kodak camera model

First digital camera developed by Kodak in 1974

But Fear Got In The Way

Kodak “was afraid the new invention would cannibalize its foundational film business — and they were right. But instead of controlling the cannibalization, Kodak allowed other manufacturers to steal its thunder.”

“20 Years Ago, Apple and Kodak Launched the Digital Camera Revolution”, Mashable.com, 6/21/2014
Pay Attention To The Clock

Still Camera: USA

Annual Shipments (M Units)

Source: futuresource consulting
Demise Of Kodak

Demolition of Eastman Kodak’s Buildings 65 & 69
Cannibalize Your Own Business

“If you don’t cannibalize yourself, someone else will.”  Steve Jobs

Source: “Chart of the Day: Tracking iPhone, iPod sales”, CNBC.com, 1/4/2014
Use Defensive Strategies to Buy Time

Possible Defensive Strategies

- Mount Blocking Challenges
- Acquire the Disruptor
- Be a Fast Follower
- Know When to Exit a Business
Position Yourself Carefully on the Adoption Curve

Source: *Crossing the Chasm*, Geoffrey Moore, 1991, CUNA Mutual Group analysis
Know When To Exit The Business

The Inflection Curve

Business goes on to new heights

Inflection Point

Business declines

Source: Only the Paranoid Survive, Andrew S. Grove, 1996
Look for Platform Solutions: Crédit Agricole

Applications

Account Info
Are you "in the green" or "in the red"? With account information, immediately see the status of your ...

My overdraft
What surprised you reserve your balance at the end of the month? ... With My Discovered, y ...

Bankly
With Bankly, view your billing information in a clear, fast and aesthetic! The design ...

I was where?
The application will automatically locates and presents a record of your expenses, enriched quotidienne ...

GeoFacto
A question about your last transaction? With GeoFacto, geotag your invoice slips!

Expenditure analysis ...
With expenditure analysis, cost savings has never been easier! Fon ...

Source: Credit Agricole
Final thoughts

“I am dying to fund a disruptive bank.”

- Marc Andreessen, 2/9/2014
Discussion Points

• Are we prepared to defend our market position versus a truly disruptive bank?
• Will our current value proposition still resonate with our members ten years from now?
• Do we have a clear vision of what retail financial services will look like in ten years?
• What can we do to remain relevant to Millennials?
• Where should we position ourselves on the technology adoption curve?
Be Alert: Confront The Brutal Facts

“You must maintain unwavering faith that you can and will prevail in the end, regardless of the difficulties, AND at the same time have the discipline to confront the most brutal facts of your current reality, whatever they might be.”

-Good to Great, Jim Collins, 2001
Channel Efficiency

Cost Per Transaction

- Branch Platform: $4.25
- Call Center: $2.40
- ATM Deposit: $1.70
- ATM Cash Withdrawal: $0.25
- Interactive Voice Response (IVR): $0.25
- Online Banking: $0.20
- Mobile Banking: $0.08