

# Retail banking market investigation

## Tesco Bank case study

**21 May 2015**

This is one of a series of consultative working papers which will be published during the course of the investigation. This paper should be read alongside the updated issues statement and the other working papers which accompany it. These papers do not form the inquiry group's provisional findings. The group is carrying forward its information-gathering and analysis work and will proceed to prepare its provisional findings, which are currently scheduled for publication in September 2015, taking into consideration responses to the consultation on the updated issues statement and the working papers. Parties wishing to comment on this paper should send their comments to [retailbanking@cma.gsi.gov.uk](mailto:retailbanking@cma.gsi.gov.uk) **by midday on 11 June 2015.**

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The Competition and Markets Authority has excluded from this published version of the working paper information which the inquiry group considers should be excluded having regard to the three considerations set out in section 244 of the Enterprise Act 2002 (specified information: considerations relevant to disclosure). The omissions are indicated by [✂].

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## **Case studies**

In previous investigations we have found that case studies on market entry and expansion can provide powerful insights into the practical difficulties that firms may face trying to enter and/or expand into particular markets. Such studies have contributed to the identification of possible adverse effects on competition (AECs) and where appropriate have helped us to develop remedies designed to remove or lower barriers to entry or expansion.

We have undertaken six case studies looking at examples of entry and expansion in the provision of personal current accounts (PCAs) and retail banking services to small and medium-sized enterprises (SMEs). We have in addition obtained information on a number of prospective new entrants in the process of seeking bank authorisation. The value of each case study lies in its ability to provide a detailed understanding of the way particular types of event unfold. They are therefore written as factual accounts of events.

We are publishing each case study as a separate working paper and each case study will inform our assessment of barriers to entry and expansion. We are also publishing separate working papers pulling together the evidence from the case studies and from other sources on potential barriers to entry and expansion. The first such working paper – Barriers to entry and expansion: regulation, IT systems and payments systems – will be published shortly and a further working paper on branches will be published in due course. Our updated issues statement published on 21 May 2015 sets out our current general thinking on barriers to entry and expansion.

## Executive summary

1. The purpose of this paper is to examine Tesco Bank's launch of a PCA in 2014, in order to help identify potential barriers to entry and expansion.
2. Tesco Bank has its origin in a joint venture (the JV) between Tesco and The Royal Bank of Scotland (RBS), which was formed in 1997. This JV offered various personal banking products such as credit cards and loans to its customers but not a PCA. After purchasing RBS's share of the JV in 2008, Tesco Bank established a stand-alone IT system and migrated its customers to this platform. In 2010, when most of this migration activity was complete, it began initial research on a PCA proposition with the objective of filling this gap in its banking portfolio.
3. After researching the market and enhancing its IT platform, Tesco Bank launched a PCA in June 2014. Tesco Bank's PCA is a direct, predominantly online product, and its main target market are existing Tesco Bank customers whom it plans to attract by emphasising the loyalty based rewards such as Tesco Clubcard points. Tesco Bank believes that its online proposition, coupled with providing basic transactions in some of Tesco's retail stores, is sufficient for it to succeed as a PCA provider, but it remains open-minded to assessing demand for different business models to meet customers' needs.
4. Tesco Bank did not face any significant regulatory hurdle to launch a PCA since it already had a bank licence which the JV had obtained in 1998. The main challenge it faced was the cost and complexity of developing an integrated IT platform to support its PCA offering. This took almost three years and [X] investment of about £[X] million. Tesco Bank also incurred £[X] million on user acceptance testing of the IT system, other programme costs, and developing and building business capability to run the product. Tesco Bank decided to spend heavily to promote its PCA at launch and may do so on an ongoing basis; it expects its marketing budget to normalise around £[X] million per year. It believes that it will take [X] before its PCA becomes profitable on a stand-alone basis, but expects to gain by selling other banking and non-banking products to its PCA customers.
5. According to Tesco Bank, factors that may inhibit its plans to expand include access to payment systems both in respect of quality of service and costs, the prevailing free-if-in-credit PCA model, and the larger banks' access to low-cost funding.
6. It is too early to judge if Tesco Bank will be able to grow its PCA business in line with its plans. That said, with its long-term plan of having [X], it is not

clear if Tesco Bank will pose a major challenge to the larger banks in the near to medium term.

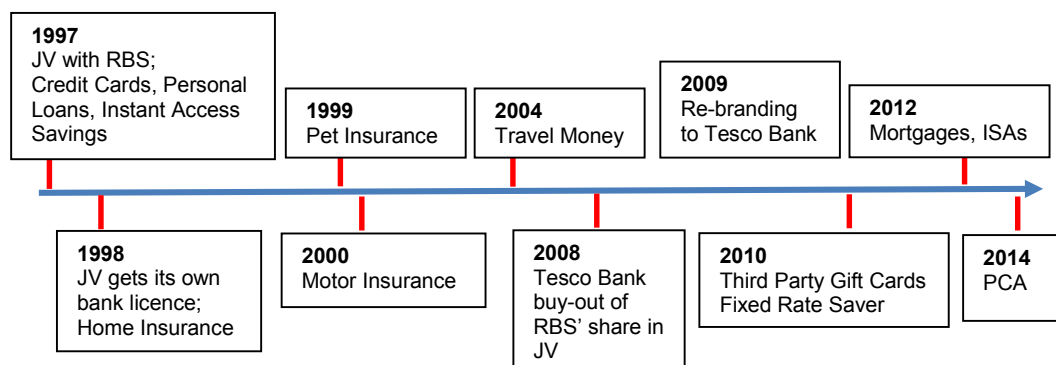
## Introduction and background

7. This case study focuses on Tesco Bank's launch of a PCA in 2014 in Great Britain.<sup>1</sup> The paper begins with a brief history of Tesco Bank and the background to the launch of its PCA. Next, it discusses Tesco Bank's business model and strategy in relation to its PCA business, including an analysis of its growth since launch. Finally, the paper considers the extent to which Tesco Bank's experience suggests the presence of barriers to entry or expansion into UK retail banking.
8. Tesco Bank is the trading name of Tesco Personal Finance PLC (TPF), a wholly owned subsidiary of Tesco Personal Finance Group Limited (a holding company) which, in turn, is wholly owned by Tesco PLC. TPF was formed in 1997 as a JV between RBS and Tesco PLC, and obtained its banking licence in June 1998, having operated under RBS's until then. The JV initially offered various financial products including a credit card, personal loans but not a PCA.
9. In December 2008, Tesco PLC acquired RBS's 50% shareholding in TPF. In order to continue servicing its customers without the support of RBS, it had to establish the necessary business functions (including finance, risk management, treasury, etc), and acquire the required physical infrastructure (eg buildings for its operational teams). In October 2009, TPF was rebranded and changed its trading name to Tesco Bank.
10. To remove its dependency on RBS, Tesco Bank needed to build a stand-alone IT infrastructure, before embarking on a major customer migration project. This process took three and a half years and cost £[~~8~~]. The migration project was staged in three parts: general insurance followed by savings and loans and concluded with credit cards (in May 2012).
11. Tesco Bank launched a PCA in June 2014 which added to its range of other banking and insurance products for personal customers in the UK. Figure 1 shows Tesco Bank's main products with launch dates, as well as key events since 1997.

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<sup>1</sup> Tesco Bank stated that the Northern Ireland PCA Banking Market Investigation Order 2008 ('NI Order') which was introduced by the then Competition Commission, provided specific rules governing the switching process of PCAs. This included, for example: suppressing interest and charges for three months following the opening of a new PCA and annual reminders to how customers can switch. Due to the additional time required to achieve compliance with the NI Order, a decision was taken by Tesco not to include Northern Ireland in the initial launch.

**Figure 1: Tesco Bank – product launches and key events**



Source: Tesco Bank.

12. Since 2009, Tesco Bank’s strategic direction was to be a bank which provided customers with a full range of personal banking services, and the development of a PCA was seen as the key element of this strategy. Given its focus on personal banking, it stated that offering banking services to SMEs was not part of its long-term plan.
13. At the end of the financial year 2013/14, Tesco Bank reported assets of £[£] and customer deposits of £[£] (Table 1).

**Table 1: Assets and deposits (2013/14)**

[£]

Source: Tesco Bank.

## Tesco Bank’s PCA launch

14. Tesco Bank viewed a PCA to be the key relationship product for customers, and its decision to launch a PCA was driven by the natural progression of its business to meet the full financial needs of Tesco Bank customers. It stated that:

A major step towards delivering banking credibility for Tesco Bank will be established when we successfully launch current accounts and are able to provide a fuller banking relationship to Tesco loyals ... Current account provides a deeper understanding of a customers['] financial situation – allowing the provider to produce better risk analysis, more informed decisions about a customers’ suitability for other products and ultimately wider product holding.

15. Tesco Bank had commenced initial research to understand the customer expectations of a PCA while its JV with RBS still existed. Tesco Bank said that once the initial products were launched by the JV, consideration was given to offering a PCA, but the long-term investment required at the time

when RBS already had more than 20% of the PCA market share did not make it a priority over other opportunities. In 2010, once the banking IT platforms and operations were fully controlled by Tesco Bank, and most of the data migration from RBS was complete, a new focus was established on what Tesco Bank could offer to customers in the PCA market.

16. Tesco Bank's objectives for offering a PCA were:
  - (a) to prove to loyal Tesco shoppers that Tesco Bank was a credible choice for a PCA and wider financial services products;
  - (b) to build momentum over time as it established a PCA reputation for excellent service and rewarding loyalty;
  - (c) to provide its customers with high-quality online, telephone and mobile banking services and to offer basic deposit and withdrawal services in Tesco stores; and
  - (d) to generate income to offset the cost of running its operation and rewarding loyalty.
  
17. Tesco Bank made the point that [X] there were tangible benefits of a PCA to the Tesco Bank and the Tesco Group, which included the following:
  - (a) Broadening the appeal of Tesco Bank by providing a more inclusive choice in terms of how Tesco customers wished to shop at Tesco and earn and benefit from Clubcard rewards.
  - (b) Issuance of Clubcard points for debit card spend anywhere which was likely to lead to increased spend in Tesco stores when customers used their vouchers.
  - (c) Incremental sales uplift in stores [X] from PCA customers.
  - (d) Net debit interchange benefit of PCA customers paying with a Tesco Bank debit card [X].
  - (e) Lower likelihood for customers to lapse in-store loyalty as their engagement increased through ownership of bank products and services.
  - (f) Greater affinity of transactional (PCA) customers with other retail services, [X].
  
18. Tesco Bank also stated that the incremental value to the Tesco group to be generated from cross-selling was in the range of £[X] cumulative [X] year contribution.



19. While considering whether to launch a PCA, Tesco Bank considered the product's contribution at three levels:
- (a) Stand-alone value where a PCA would enable it to participate in a large market, and be an anchor product for its customer relationships.
  - (b) Synergy value to Tesco Bank whereby a PCA could help to establish it as a 'real bank' in customers' minds. A PCA was also seen to help in increasing the potential for multiple product holdings, and improve the customer experience on other product journeys.
  - (c) Synergy value to the Tesco group by creating increased customer loyalty and increased spending in stores and reduced transaction costs as more transactions moved to contactless payments.
20. The Tesco Bank PCA was launched in June 2014 in Great Britain with the following main features:<sup>2</sup>
- (a) Clubcard points on debit card spend;
  - (b) 3% AER interest on credit balances up to £3,000;
  - (c) £5 monthly fee, but only if customers deposit less than £750 per month;
  - (d) online and mobile banking;
  - (e) UK-based customer service centres which were open 24 hours a day, seven days a week; and
  - (f) ability to make deposits and withdrawals at 305 Tesco stores.

21. Table 2 shows that [✂]

**Table 2: Tesco Bank PCA – forecast and long-term plan (LTP)**

[✂]

Source: Tesco Bank.

22. Figure 2 shows that [✂]

**Figure 2: Depreciation expense projections**

[✂]

Source: Tesco Bank.

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<sup>2</sup> More details of Tesco Bank's PCA are provided in Appendix B.

23. Tesco Bank estimates the net present value (NPV) of an individual PCA to be [£], but expects other benefits from the product in the form of lower cost of funds and cross-sell opportunities, and plans to review its forecast NPV per account as it acquires more customers. Tesco Bank stated that given the scale of (sunk) investment (mainly IT and promotion costs) required to launch and promote its PCA, it expects to break-even [£] after launch [£].

## Strategy and business model

24. Tesco Bank told us that its strategy was to be the bank for Tesco customers where it rewarded their loyalty and earned their trust. Tesco Clubcard is central to how Tesco recognises and rewards loyalty: it offers points on debit and credit card spend, mortgage repayments, and discounted pricing for Clubcard customers on Car and Home Insurance.
25. Tesco Bank told us that it had designed its PCA strategy and product offering to appeal to those customers:
- (a) who were happy not to have a face-to-face relationship with their bank since it determined that there was a sizeable customer appetite for a direct (branchless) proposition;
  - (b) who wanted a simple and transparent product, providing the payment and account servicing capability that were 'hygiene factors' for a current account, whilst allowing customers to take control and self-service where possible;<sup>3</sup>
  - (c) who wanted to be in control of their finances, avoid excessive charges and receive texts or emails to let them know when they needed to pay in or to confirm action taken on their account; and
  - (d) who wanted their bank to recognise them with ongoing rewards for doing their everyday banking.
26. Tesco Bank's research indicated that customers' overriding requirement of a current account was that it 'just worked'. This meant that customers did not want to spend time on their banking and wanted to be confident that their bank would take care of their money management needs.
27. Tesco Bank's research also found that there was a high level of 'emotional trust' (belief that a bank will do the right thing) in Tesco Bank but that customers had a 'higher transactional trust' (belief that a bank can do things

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<sup>3</sup> The term 'hygiene factors' is usually used to refer to factors which do not give positive satisfaction but if absent can cause dissatisfaction.

right) in the existing banks. This made it challenging to persuade customers to move their PCA to Tesco Bank even if they did not feel valued or rewarded by their existing bank.

28. Tesco Bank stated that the differentiation and appeal of its PCA was the provision of points for the loyalty of its customers. As it put it:

The target proposition is a fully functioning Tesco Bank current account that rewards ongoing loyalty, has a simpler approach to fees and charges and offers feature rich servicing options ... The proposition is differentiated in areas that hold significant appeal to Tesco loyal customers and are difficult for our competitors to replicate, in particular the areas of convenience and reward.

29. Tesco Bank told us that its PCA was designed to fit with its strategy 'to be the bank for Tesco Bank customers'. It also mentioned that 'The customer segments and target market for the Tesco Bank current account proposition are young adults, young families and older families, typically those who are poorly served by current competitor offerings and have demonstrated a strong affinity to our proposition.' Tesco Bank believed that those customers who already had other banking services (eg credit card) with them would be more receptive to its PCA than non-Tesco Bank customers.
30. Accordingly, Tesco Bank developed a targeting model to identify which Tesco Bank customers should be targeted based on the customer insights described above. [X] Tesco's defined target market is shown in Figure 3.

**Figure 3: Target market**

[X]

Source: Tesco Bank.

31. Based on the expected rate of PCA take-up from this target market, Tesco Bank's initial expectations were to gain about [X] PCA customers ([X]).
32. Tesco Bank's primary channels from a (PCA) customer acquisition perspective are as follows:
- (a) Above-the-line (television, outdoor and press) marketing: to reach out to customers in the switcher market that could be overlooked by direct channels.
  - (b) In-store: Tesco Bank leverages the large store network primarily to raise consumer awareness of its PCA among Tesco shoppers.

- (c) Direct: Tesco Bank uses targeted mailing to Tesco Clubcard holders and Tesco customers using its insight and segmentation models.
  - (d) Online: Tesco Bank has invested in search engine optimisation and implemented high-quality, easily accessible information on its website.
  - (e) Mobile Banking App: which can be used to send messages, and be a customer servicing platform.
  - (f) Public Relations: From January 2014 onwards, Tesco Bank engaged in a dialogue with journalists in the lead up to the PCA launch.
33. Tesco Bank stated that although its existing customers were always going to be its primary target market segment, with more than 20 million Tesco customers to reach, above the line – particularly television advertising – was the most effective and wide-reaching channel for building awareness of a new product with this customer group. Tesco Bank also made the point that whilst its PCA was designed with the needs of Tesco shoppers in mind, it expected the product to have a broader appeal, especially as it further developed its PCA product range.

## Performance so far

34. Figure 4 shows growth in the number of Tesco PCAs since launch. [✂]

### Figure 4: Number of PCAs

[✂]

Source: Tesco Bank.

35. Tesco's forecast and actual performance for PCA applications, new accounts and costs per account opened in the first year is shown in Table 3.

### Table 3: Key performance indicators – Year 1

[✂]

Source: Tesco Bank.

36. [✂]

37. Tesco Bank stated that based on the experience gained since the launch of its PCA, it was planning to make improvements to the application and account opening process in order to enhance the customer experience. It was also planning to review its product range to serve more customers. Tesco Bank mentioned that:

As such, our future product map will consist of a broader suite of products which will more than likely be segmented to meet the needs and desires of a wider range of customer, from lower affluence through to a more value adding higher affluences segment type.

38. As per Tesco Bank’s latest PCA forecast shown in Figure 5, it expects to have about [X] PCAs by year [X].

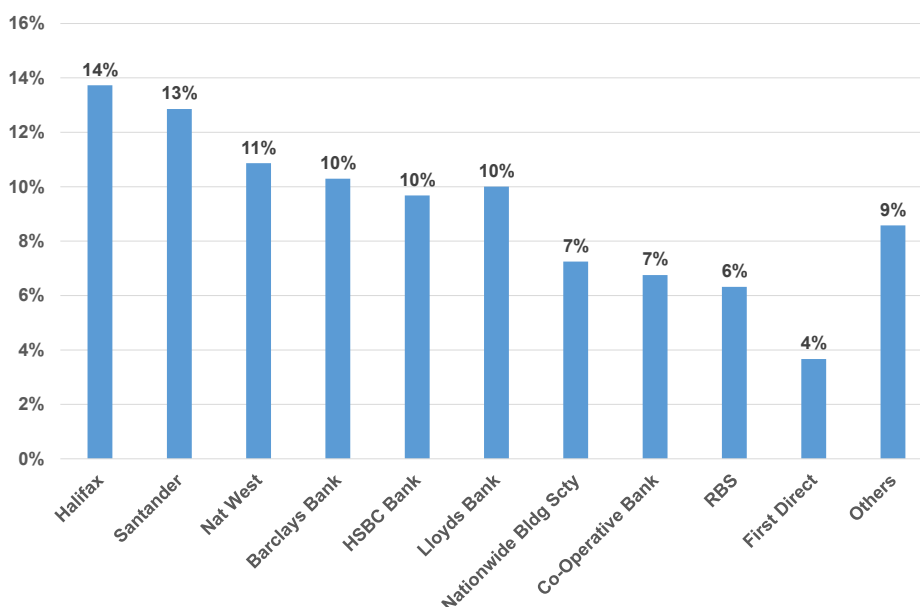
**Figure 5: Forecast – PCA stock**

[X]

Source: Tesco Bank.

39. Tesco Bank told us that it was too soon to determine reliably particular customer characteristics, demographics and the source of its new accounts. Some of the new accounts (around [X]%) included a full or partial switch via the current account switch service (CASS), which provided it with some information on the source of new customers. It stated however that it could not yet draw any firm conclusions from this data and its ongoing analysis would help to determine any notable trends. Tesco Bank’s analysis of customers switching via CASS for the period July 2014 to January 2015 is given in Figure 6 which shows that it is gaining customers from many established PCA providers.

**Figure 6: Tesco Bank PCA – sources of switchers**



Source: Tesco Bank.

## Barriers to entry and expansion

### *Regulatory requirements*

40. Tesco Bank obtained its banking licence in June 1998 under the JV with RBS, and does not consider that the hurdles to get this licence were overly burdensome. It was not required to become authorised to launch a PCA since it already had the required permissions in place. Tesco Bank said that as part of launching the PCA, it held a number of discussions and engagements with the regulators, but did not face any significant regulatory obstacles.
41. Tesco Bank had to hold £[redacted] million in additional capital against the risks associated with the launch of its PCA. [redacted]<sup>4</sup>
42. Tesco Bank stated that during the development of its PCA offering, there were a number of regulatory changes which impacted the complexity and cost of the product development, and also led to a modest delay in Tesco Bank's launch of a PCA. As examples, it cited the introduction of CASS and the transfer of consumer credit regulation from the OFT to the Financial Conduct Authority (FCA), but did not consider these as significant competitive disadvantages.

### *Access to payment systems*

43. Tesco Bank is an indirect (agency) member of the interbank payments schemes (such as Bacs, CHAPS, Faster Payments Service (FPS)), and the Cheque and Credit Clearing Company (C&CC) through [redacted]. It made the point that its ability to offer the same level of service as banks directly accessing the payment systems could be limited. As Tesco Bank put it: 'In practice, connecting to the UK interbank payment systems through a competitor means that the payments services we offer customers can be no better than our sponsor bank and, as we have experienced, a lesser offering in a number of instances'.
44. Tesco Bank told us that while the introduction of faster payments had been beneficial for its customers, agency banks were unable to process payments in real-time 24x7, making them less responsive to the customers' needs than banks with direct access to the payment networks. It also stated that this situation was exacerbated by the development of additional 'overlay' services utilising the faster payments infrastructure – such as Paym<sup>5</sup> – which further

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<sup>4</sup> [redacted]

<sup>5</sup> Paym allows customers to make payments to account holders of other participating banks or building societies using their mobile number.

exploited the asymmetry in real-time payments processing capability between agency banks and those accessing the UK interbank payment systems directly.<sup>6</sup>

45. Tesco Bank stated that the direct members of the interbank payment schemes were notified in the event of either scheme-wide issues or in the case that a particular scheme member experienced difficulty. For FPS, this notification was supported by real-time Unsolicited Messages (USMs). Tesco Bank told us that being an indirect member, it did not receive notification directly from the scheme and could not receive USMs, and was therefore reliant upon its sponsor bank for such notifications.
46. Regarding the costs of accessing payment systems, Tesco Bank told us that it paid a cost premium for accessing payment systems through the agency relationship. [✂]
47. Tesco Bank also made the point that direct members paid for the direct costs of running the interbank payment systems. These included the scheme operators' infrastructure, staff and administration costs, which were apportioned according to the direct member's share of transactions. It stated that Agency banking, on the other hand, was a commercial service, and the providers of these services recovered direct costs and generated a commercial return from providing such services.
48. Tesco Bank believed that the prices being charged of the agency banks reflected the concentrated nature of the service provision within the market and the high costs of switching provider.

### ***IT systems***

49. Tesco Bank told us that the development of IT infrastructure necessary to support its PCA offering was both complex and costly. At the point of taking full control of the business from RBS in 2008, Tesco Bank had none of its own IT infrastructure or applications to support its banking products. In order to remove its dependency on RBS, it acquired and built a number of IT components before migrating the existing customer base to its own system.
50. To develop a PCA platform on top of its existing IT infrastructure, Tesco Bank needed to enhance and extend the capability of many internal and external

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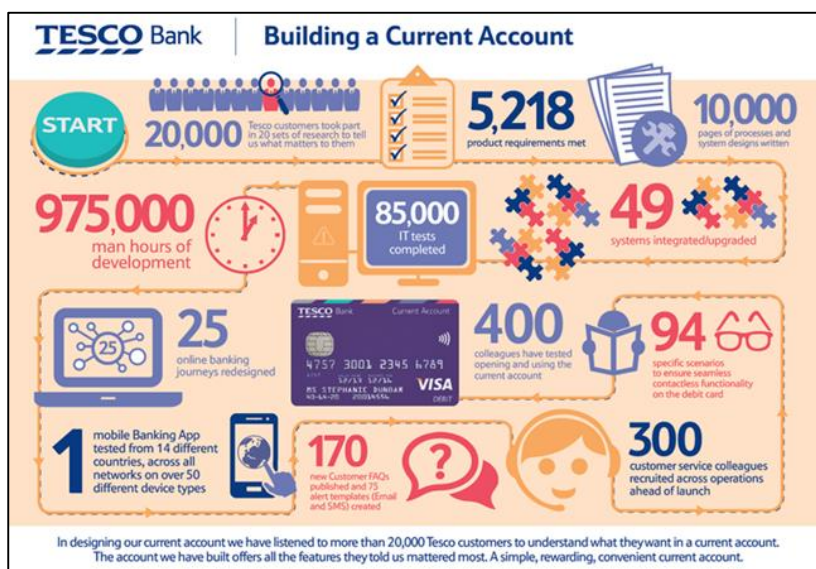
<sup>6</sup> Tesco Bank provided an example where its sponsor bank used Swift NET to transmit payments and since Swift gateways were closed for maintenance between 16:00 Saturday and 06:00 Sunday, no faster payments to/from Tesco Bank could be transmitted during this time. This, according to Tesco is an example of situations where it is unable to provide services, which other sponsor banks may be able to offer to their customers.

applications, and build and acquire a number of new infrastructure components.

51. Tesco Bank said that the transactional nature of a PCA (compared with, say, savings and loans book) meant that it had to substantially increase the processing speeds for a number of different payment types.<sup>7</sup> In order to minimise the disruption to existing customers of Tesco Bank, an extensive process was required to implement the new processes as part of its IT systems. In summary, the development of Tesco Bank's PCA IT infrastructure involved:
- (a) approximately 15,000 man-days on design and build;
  - (b) 5,218 requirements being met;
  - (c) 89 detailed design packs written and delivered;
  - (d) 49 systems integrated/upgraded;
  - (e) 67,388 system integration tests completed; and
  - (f) 3,300 user acceptance tests completed.

52. Figure 7 illustrates the scale of the effort involved in building Tesco Bank's PCA.

**Figure 7: Development of Tesco Bank's PCA**



Source: Tesco Bank.

<sup>7</sup> For example, card transactions processing were uplifted to process 30 times more transactions than Tesco Bank was processing pre-PCAs, and BACS payments 70 times faster.



53. The development of Tesco Bank's PCA programme required investment of £[redacted] million over [redacted] years. [redacted]<sup>8</sup> Tables 4 and 5 show the details of the investment to support Tesco Bank's PCA development, by spend category and by functional work streams.

**Table 4: PCA programme costs by year and major category**

[redacted]

Source: Tesco Bank.

**Table 5: PCA programme costs by business and IT work streams**

[redacted]

Source: Tesco Bank.

54. Tesco Bank stated that in addition to the above programme costs, an additional £[redacted] million per year had been added to its existing IT support costs as a result of launching the PCA. Tesco Bank told us that the complexity (and the cost) of developing the IT infrastructure to support its PCA was compounded due to the need for the IT platform to be placed on top of an existing set of systems, and the need for it to also support Tesco Bank's other products and customers rather than being built in isolation.
55. Tesco Bank made the point that it would be an easier task and would require less investment for a new bank with no existing products, customers and systems to put in place the necessary capabilities and IT system to launch a PCA with robust online, mobile and telephone banking propositions and services.

### ***Need for branch network***

56. Tesco Bank's PCA is mainly an online offering but it told us that it had also experimented (pre-PCA launch) with different in-store branch formats and locations with little consumer usage, and remained open minded to assessing customer demand for different models.<sup>9</sup>
57. Tesco Bank told the OFT in 2013 that 'Given our stores' footprint and their customer footfall, we have no interest in branch networks for sale or emulating those buying them. The overwhelming feedback from our customers is that they want a banking service which is convenient, easy to use and is available

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<sup>8</sup> Tesco Bank told us that during the design, build and testing of the PCA proposition, resources and spending were not limited to the PCA in isolation. Much of the testing was to ensure enterprise wide reliability for existing customers while a range of deliverables included in the PCA launch had a benefit beyond purely the PCA.

<sup>9</sup> Tesco Bank told the CMA that its PCA was developed while taking consideration of the shift in customer behaviour towards digital channels, and it had not conducted research into alternative business models.

when it most suits them.’ In a similar message, Tesco Bank said, in its response to the CMA’s consultation on a potential market investigation reference for retail banking, that ‘We believe [however], that the historically strong correlation between the number of branches a provider has and their PCA market share is breaking down’.<sup>10</sup>

58. Tesco Bank believed that whilst a branch network might still be important for a certain market segment, there continued to be a migration away from branches and towards digital channels. Tesco Bank stated that it had achieved considerable scale in certain products – such as credit cards and personal loans – by pursuing an online and telephone-based strategy, and while developing its PCA proposition, it determined that there was a sizeable customer appetite for a direct (branchless) proposition that was only likely to grow.
59. Tesco Bank stated that as it developed its PCA offering, it recognised that some customers valued the convenience of being able to deposit and withdraw funds face-to-face. It has provided the facility to PCA customers to take advantage of the deposit and withdrawal functionality at some of its stores across the UK.<sup>11</sup> However, Tesco Bank stores do not in general, operate like a bank branch, and it mainly makes use of the Tesco store network to raise consumer awareness about its banking products. In-store deposit and withdrawal capability for bank products is limited to its PCA and Instant Access Savings Accounts, and to only 305 of Tesco’s 3,378 UK stores (see the map in [Appendix A](#)).
60. Tesco Bank also operates three bank branches at its stores in Edinburgh, Coventry and West Durrington.<sup>12</sup> However, the technological capability in these branches is limited, and there is no connectivity to back office systems. The service in these branches mirrors the online customer experience but with staff available to support customers. Tesco Bank told us that most customers visited these branches to purchase foreign currency.
61. Tesco Bank made the point that its PCA was very much a direct, predominantly online account. Therefore, its limited in-store facilities were not intended to be a like-for-like offering with a branch network. Tesco Bank believed that its strong digital capabilities, coupled with some basic deposit and withdrawal facilities in store, would allow it to provide a strong service offering to its

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<sup>10</sup> [Tesco’s Bank’s response to the CMA’s consultation, 2014](#), Answer 1d.

<sup>11</sup> Tesco Bank told us that these stores were predominately larger format stores with the exception of small formats in outlying geographical locations.

<sup>12</sup> Tesco Bank stated that this was part of it testing approaches to in-store banking. These were selected based on their location, size, customer demographic as well as the availability of space in these stores. The services available at these branches are: account opening, deposit and withdrawal facilities for cheque and cash and account enquiries.

customers which would also be cost-effective. However, it planned to continue to assess whether its PCA proposition met its customers' needs, and review the offering and servicing channels accordingly.

62. Tesco Bank noted that the benefits of a branch network were heavily influenced by a bank's starting point: while for larger banks with an extensive physical estate, closing branches reduced cost significantly, for new entrants, opening branches added significant costs to their expense base. Similarly, Tesco Bank stated that any existing bank with a large customer user base that closed a traditional branch to open a smaller physical space in a retail environment would be reducing its operational costs. Tesco Bank believed that given the direction of travel in the market, its approach of offering primarily an online PCA was an appropriate starting point.

### ***Brand awareness and advertising***

63. Tesco Bank told us that its consumer research had referred to two types of trust in a brand: 'transactional trust' – the belief that the account would do what it said it would, and 'emotional trust' – the belief that a provider would act in the interests of its customers. It believed that the nature of a PCA was such that transactional trust was paramount and therefore customers favoured established brands with scale and experience in this market.
64. Tesco Bank made the point that it had been able to establish itself in financial services by leveraging the strength of its brand. It believed that for a new entrant without any existing customers or brand recognition, it would be more difficult to enter the PCA market and gain consumer acceptance.
65. Tesco Bank also stated that new entrants into the PCA market needed to make significant investment in marketing and promotion in order to grow brand awareness and consideration.
66. To grow its share of brand awareness and consideration, Tesco Bank decided to support the launch of its PCA by giving more weight to above the line (mainly through TV) promotional strategy for the short to medium term.<sup>13</sup> Table 6 shows the distribution of Tesco Bank's Year 1 PCA marketing budget across different marketing channels.

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<sup>13</sup> Above-the-line promotion involves the use of advertising to reach a mass audience. It uses media such as television, cinema, radio, print to promote brands or convey a specific offer.

**Table 6: Year 1 PCA marketing budget by channel**



Source: Tesco Bank.

67. Tesco Bank told us that its approach towards marketing and promotional spend and the primacy of above the line advertising was largely in line with the approach taken by other PCA providers in the market, as is shown in Figure 8.

**Figure 8: Spend on PCA marketing**



Source: Tesco Bank.

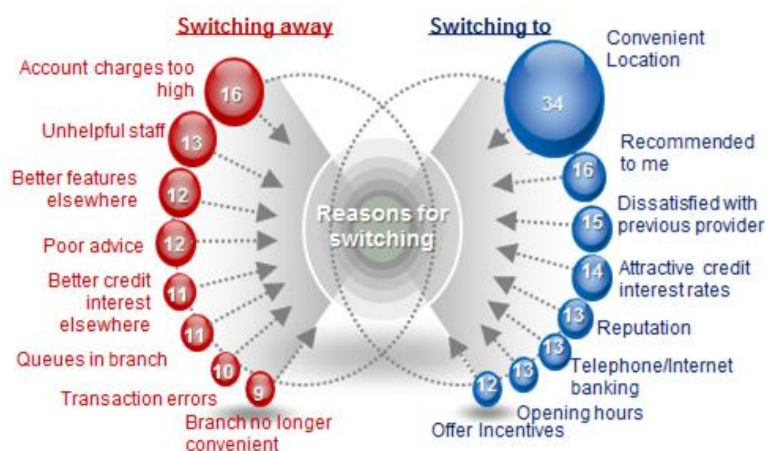
68. Despite having a well-known brand name, Tesco Bank believed that it needed to invest in building awareness of its PCA proposition and capabilities. The need to promote the PCA appeared to reflect the challenges it anticipates to overcome the 'transactional trust' barrier which means that established brands dominate. Tesco Bank expected its PCA marketing budget to normalise around £[redacted] million per year.

### **Customer acquisition and retention**

69. Tesco Bank pointed out that that its market insights drew out a linkage between customer satisfaction, service quality, and retention (see Figure 9):

- (a) For those who do switch, 'push' rather than 'pull' factors dominate.
- (b) Not feeling valued, high charges and poor customer service are the most frequent triggers for leaving a provider.

**Figure 9: Factors facilitating switching**



Source: Tesco Bank.

70. Tesco Bank mentioned the following challenges faced by it as a new entrant, in trying to acquire customers:
- (a) Lack of transparency and comparability in the market – Tesco Bank believed that there were issues with transparency, complexity and comparability of PCA product offerings making it harder for customers to shop around.
  - (b) Use of loss-leading pricing and incentives, which could be used by larger banks to grow market share, usually in combination with aggressive marketing investment.
  - (c) ‘Free if-in-credit’ model – Tesco Bank believed that this model created a barrier to entry which was very difficult for new entrants not to conform to, in order to compete. It had made a similar point in its response to the CMA’s consultation on a potential market investigation reference for PCA and SME banking services stating that, ‘...the perception that your PCA is “free” is a key contributing factor to the lack of customer engagement in assessing the value they derive from their account.’<sup>14</sup> Tesco Bank stated that this barrier was heightened by larger banks which were able to support competitive new business offerings at the expense of their existing customers. Tesco Bank [redacted] decided to enter the market with a £5 monthly fee which is waived if a customer deposited £750 a month.<sup>15</sup>
  - (d) Lower cost of funds for larger banks: Tesco Bank mentioned that larger banks paying high rates of credit interest on new business had significant current account and savings deposits in place that they were paying little or no interest on. This, according to Tesco Bank, meant that the larger banks’ cost of funds mix would be lower than for new entrants, which did not have such back books.<sup>16</sup>
71. Tesco Bank noted that whilst initiatives such as CASS were starting to make an impact, the scale was still modest. It believed that more needed to be done to promote the service, and without additional promotional investment, it was unlikely that CASS would achieve its full potential as an enabler of competition in the PCA market.
72. Tesco Bank did not anticipate any customer retention issues since it believed that its PCA had been designed to meet customer needs, and offered an all-

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<sup>14</sup> [Tesco Bank’s response to the CMA’s consultation, 2014](#). Answer 1c.

<sup>15</sup> [redacted]

<sup>16</sup> Tesco Bank pointed out that over time, as base rates climbed, this dynamic would alter as easy access savings rates became more competitive against current accounts.

round proposition including credit interest, Clubcard rewards and a convenient account.

## Conclusions

73. It appears that the development of an IT infrastructure was the main obstacle to Tesco Bank's launch of a PCA. It took about three years and a significant investment for Tesco Bank to build a PCA IT platform on top of an existing IT system.
74. Although Tesco Bank has launched a PCA, [✂] it is uncertain if it will be able to challenge the larger banks in the near future. The main factors identified for this limited scale are customer acquisition costs and inertia. As Benny Higgins, Tesco Bank's Chief Executive, recently remarked: 'I think that we can aspire to be a significant player but I think the nature of the market means it will take time ... I think the current account is going to be a long burner.'<sup>17</sup>

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<sup>17</sup> Reuters (11 February 2015), [Tesco Bank to grow current accounts market share – CEO](#).

## Appendix A – Map of Tesco stores with (limited) PCA services



Source: Tesco Bank.

## **Appendix B – Features of Tesco personal current account**

Tesco's PCA was launched with following key features:

- (a) Clubcard points on Visa debit card spend both in and out of Tesco stores.
- (b) 3% AER interest on credit balances up to £3,000.
- (c) £5 monthly fee if customers deposit less than £750 per month. No monthly fee for customers who deposit more than £750 per month.
- (d) Free 'overdraft control' feature to make managing the account easier.
- (e) Automatic text and email alerts and extended grace period to help customers avoid unarranged transactions fees.
- (f) Variable EAR of 18.9% for customers who use an arranged overdraft facility (no fixed monthly fee).
- (g) A set £5 fee for payments made using an unarranged overdraft or if Tesco rejected a payment.
- (h) Capped charges for paid and unpaid transaction fees at £50 per month.
- (i) Online and mobile banking.
- (j) UK-based customer service centres which were open 24 hours a day, seven days a week.
- (k) Ability to make deposits at over 300 Tesco stores.
- (l) Contactless Visa debit card which doubled as a Clubcard.