EQUITY

PODCAST: Engaging a New Generation of Investors

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We recognize the financial services sector is in the midst of a digital journey as participants feel the footsteps of big technology platforms encroaching on their space. In many cases, these new entrants see a fundamentally more efficient way of serving customers and extracting value and insights about their customers using digital technologies. Franklin Equity Group's James Cross, along with a panel of CEOs at three other companies, explores appealing to a new generation of customers, with new solutions.

As analysts as well as investors, we take a long-term view. That means we don't obsess about every headline, nor do we tend to default to knee-jerk reactions. Taking a long-term perspective means looking at current developments and thinking about how they might play out in the future, both directly and indirectly.

We're not alone in that. We expect the companies we invest in to have a robust and realistic long-term vision that demonstrates they understand the degree to which the world is changing so they can position themselves to attract the customers of tomorrow (and the next decade).

Understanding the expectations of the customer of tomorrow plays a crucial role, which is why companies across the spectrum of sectors pay such close attention to Millennials.

Research suggests that in general, Millennials are worse off financially—on a like-for-like age comparison—than any generation since the so-called "Greatest Generation" that suffered through the Great Depression.

In large part, that's the result of the Great Recession, and it's prompted a substantial change in mindset among that younger generation. But while Millennials may not be as wealthy on an inflation-adjusted basis as their grandparents were at the same age, there's a looming intergenerational wealth transfer that means they could come into money later.

We realize the importance of engaging customers and potential customers at an early stage. That's the long-term play for many financial services companies. If they can attract Millennials as customers now, they stand a better chance of retaining the customers when today's younger generations have more assets in the future.

What Do Millennials Really Want?

- Trust in legacy brands is low
- Millennials have clear expectations
- Branding is crucial

There's a perception that Millennials are very different from previous generations. We don't necessarily subscribe to that view. The main difference, in our view, is that previous generations didn't have smartphones or access to the mobile internet.

The ubiquity and speed of mobile communications are changing the way Millennials and other generations interact with brands.

With past generations, there was a fair amount of consistency in the way financial institutions went about appealing to potential customers. Their approach tended to be built around inter-personal relationships, centered on branches and human interaction.

That's why initial steps towards the digitalization of banking were greeted with suspicion and skepticism about usability and security.

With Millennials, we're seeing the first generation that cannot be appealed to in the traditional ways that were used to target their predecessors. We think that while Millennials are not so different from previous generations per se, they may offer some insight into the way future generations could behave.

We think subsequent generations are going to be more like Millennials than like previous generations.

At our recent Global Investor Forum, we hosted a panel of prominent fintech entrepreneurs who shared their thoughts on the rationale for—and challenges of—appealing to Millennial customers. We offer an excerpt from the discussion in our latest "Talking Markets" podcast featuring Walter Cruttenden, CEO of Blast and Co-founder/chairman of Acorns, Lindsay Holden, founder and CEO of Long Game, and Henry Yoshida, founder & CEO of Rocket Dollar. Listen below.

Lindsay Holden: *There is a lot of mistrust among younger people right now. Big-brand financial services companies have almost no brand equity among Millennials and their Generation Z successors, who are really looking for something new.*

Millennials are the most diverse compared to any generation that's come before them. They have their own points of view and they really respect others that have strong points of view. This is not only reflected in our acquisition strategy—we use influencers to acquire users today on Long Game—but also in our brand strategy.

It's fun to be able to take a real shot at creating a new consumer brand in financial services because it's something that I think hasn't been done well in the past. And especially since we're very targeted towards a specific demographic, we're able to have a lot of fun with the Long Game brand. Millennials feel: "I know who I am. You should know who you are." And so we have a very strong point of view with our branding.

The Challenging of Building Engagement

- Mobile internet has simplified and democratized access to information and services
- People tend not to change their behavior
- Simple choices drive better engagement

Millennials are the first generation born with a smartphone in their hand. The mobile internet gives much easier access to information and services around the world.

And in that regard, we see the different Millennial attitudes more as evidence of evolution than revolution.

New disruptive technology has been put in front of them and it's changed the way they want to interact with the world in everything from hard assets to their financial life to their personal life.

Previous generations might have considered riding a horse to be an essential life skill. Then driving a car became a fundamental life skill. Someday, self-driving cars will be ubiquitous and people will ask, "Why would I bother learning to drive a car?"

So, life skills are changing and so are the fixed life decisions, such as buying a house or a car, that previous generations had to make.

The “American Dream” used to be owning a house and having a family. For various reasons—including financial insecurity—homeownership among Millennials has been lower than prior generations. Many actually see greater benefits in renting. As such, engaging with them requires a new approach.

Walter Cruttenden: *Behavioral psychologists such as Shlomo Benartzi and Richard Thaler have taught us that we’re not going to change people’s behavior. People are going to do what they want to do. So if you want to reach them, you need to attach a good outcome to something that they’re already doing.*

For example, there are hundreds of millions of gamers out there and if we can incorporate investing into gaming, that could have an impact and lead to a positive outcome.

Lindsay Holden: *Our customers are between the ages of 18 and 30. They engage quite differently with their mobile devices. Millennials and Gen Zers are always on their phones. And what they expect from their interactions on their phones is quite different than I think a lot of other generations. They expect things to be beautiful; they expect them to be rewarding; they expect things to be immediate, and also personalized.*

Understanding that informs our brand strategies. It used to be that you could reach everyone through just 50 channels on television. Everyone was consuming very similar media. Now that’s not the case.

We focus on essentially putting the user at the center of the experience. We believe that if we’re creating value in their lives, we are creating a valuable company. The high production values of our platform itself I think have really created a lot of trust with our customers. That’s something that has evolved over time and we’ve seen better retention, better engagement over time with our evolution.

How Gamification Is Driving Engagement

- Gamification is entering nearly every industry
- Employing game theory may drive more engagement and a stickier customer base
- Smartphone ubiquity marries micro investing with gaming

Incorporating gaming dynamics into financial services has the potential to change how, what and when consumers spend, save, invest, repay and insure.

We believe that gamified finance will become an important new category that helps motivate people to change financial behaviors and should result in a more engaged, sticky customer base. This could be disruptive to existing banks as users link their existing bank account with gamified finance apps and are incentivized to switch their direct deposit from their existing provider.

These apps are adding social games that are helping them go viral. For example, once a company owns the primary checking account relationship, it can cross-sell other products such as investments, insurance and debt refinancing.

Walter Cruttenden: *With hundreds of millions of people playing games, it’s not surprising that gamification is entering all sorts of industries, including health care and education. We believe savings and investing are ripe for gamification.*

In the past, there’s been a kind of wall up around financial services because it’s such a traditional industry and you’re not supposed to play around with any money. What we’re seeing with the development of gamification in many instances is “not playing around with money.” Rather, it’s a way to get people started and encourage them to continue.

There’s something called Moore’s Law, which says the number of transistors on a microchip doubles every two years. So, as the cost of computers has fallen, it’s much cheaper to make little transfers online to carry accounts. We realized that the dawning of micro investing was here when the smartphone came out, which was the distribution platform for it.

With Acorns, we came up with a solution that makes people want to start investing. My son suggested that getting your first investment account is like getting your driver's license. It's a coming-of-age symbol. For young people, it's an aspiration and we're trying to fill that aspiration.

Customers connect their payment cards to the Acorns app and anytime they use those cards, the app rounds up to the nearest dollar and [invests the difference].

We've been able to bring in about 300 brand partners, including Nike, Airbnb, Walmart and Amazon.

When customers use their card to buy in those stores, the retailer will put little dividends in their account. That might double or triple the amount of dividends that the average account gets. And it's a good way to help these small accounts get started.

It might not make much difference to the average large account here, but for little guys, it really helps them feel good performance when they're getting going.

I thought we'd take it to the next step through gaming. And that's why we started Blast. We work with 20 of the top gaming companies in the world.

We think there's a terrific overlap among Millennials and Gen Zers of people who are trying to get investment accounts going and people who enjoy gaming. With around 200 million gamers in the United States, and 2.5 billion worldwide, that's a substantial opportunity set and a wonderful way to engage people.

***Lindsay Holden:** At Long Game, we use a lot of gaming characteristics, including the chance to win money, in the form of cryptocurrency or cash.*

This is not a new idea. Prize-linked savings is something that has been around since the 1600s. One of the most famous implementations is the United Kingdom's Premium Bonds, a government bond whose holders are entered into a monthly draw to win prizes up to £1 million. A lot of people have recommended a similar system should be introduced in the United States.

In 2015, the US government passed legislation called the American Savings and Promotion Act, which allowed banks to offer prize-linked savings accounts. That was very impactful for us.

But although our app includes gaming characteristics, it's not a game. In the traditional game world, developers are optimizing around having people spend time in-app or spend revenue in the app. They're shooting, for example, for two-hour session times.

At Long Game, we are optimizing around financial outcomes for our customers. We use gaming and we want engagement, but we're not looking for long engagement as the outcome.

Our customers are engaging daily, but they're engaging for three minutes and we're then optimizing around that. Our belief is: if you're going to be succeeding in your financial life, you love the game. That's a different thing from what you see in the gaming world.

Why Are Legacy Banks Investing in Fintech Start-Ups?

- Big Finance has not traditionally been an innovator
- Traditional financial services are often encumbered by legacy systems
- Big institutions need visibility of upcoming developments

There's a perception—rightly in many cases—that traditional financial services firms, including banks and insurance companies and the businesses that support them, are encumbered by legacy systems and processes.

US banks, for example, haven't traditionally been innovators. Many have technology that is still in the mainframe era, not in the cloud era.

Fintech start-ups are generally free of those restrictions and so are often able to move faster and develop solutions that compete directly with traditional methods of delivering financial services.

So, many fintech companies have an advantage in that they can be in real-time—their systems can immediately talk to each other. Traditional banks are spending an enormous amount on technology as this area is both a challenge and tremendous opportunity.

Walter Cruttenden: *In our experience, many of the big institutions are investing in fintech for the experience. They want to know what's going on at this end of the market. We generally give our major investors board attendance rights and it's a good relationship.*

Henry Yoshida: *The CEO of one financial behemoth has said they're trying to increase wallet share. But he also admitted that the overall wallet might be shrinking. So, I think for some of the big financial services firms, an investment in companies like ours simply gives them the ability to invest in a project that they otherwise wouldn't be able to justify internally. Not to preserve relevance to young savers.*

The Use of Customer Data

- Many existing firms are failing to make the most of the data available
- Rich customer data can help firms make personalization improvements
- Fintech can learn from retail giants' use of data

Our research tells us that with deeper, data-driven insights, financial institutions should be able to better identify what customers need and want in their financial engagements, prioritize investments into customer experience enhancements, redesign outdated processes and create innovative, intuitive digital experiences.

The ability to deduce actionable insights from data is driving the financial industry to an inflection point in terms of its ability to create frictionless and personalized consumer experiences that are predictive, personally relevant and useful. Taking a page from the playbooks of Amazon and Netflix, incumbent financial firms are seeking to move from a "search-and-browse" to "curate-and-deliver" model, where they anticipate client needs utilizing data and machine learning.

Lindsay Holden: *It's absolutely incredible to me how little banks have used financial data to drive the customer experience. You might get an offer from your bank for a credit card that's worse than the one you have with them. We really do think that there's a huge opportunity on the data side in this industry and it's something that we're really excited about as a company.*

We don't monetize customer data directly. Obviously using customer data in the app experience is very valuable monetarily speaking. We learn about what is driving customer behavior and then do more of that.

We also have savings goals in our app today and we can use that data to better understand our customers and offer them affiliate discounts on things they already plan to purchase.

Walter Cruttenden: *We never ever sell customer data to outside parties, but we do use the data to deliver better products. We learn what type of game and the customer likes, then serve them those type of games. At Acorns, we have 300 brand partners. We're just backing a new company called ATM.com, which helps people self-monetize their data, which might answer some of these concerns and then people can toggle their data on and off too.*

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All investments involve risks, including possible loss of principal. The technology industry can be significantly affected by obsolescence of existing technology, short product cycles, falling prices and profits, competition from new market entrants as well as general economic conditions.