MOONROC ARTICLE

GERMAN CONSUMER LENDING MARKET

Battleground, paradise or the place to be

MOONROC
ADVISORY PARTNERS

GERMAN CONSUMER LENDING MARKET

Battleground, paradise or the place to be

MOONROC Article

AUTHORS
Marcel Quasigroch
Sven Sommer
Dr. Torsten Stuska

Table of Content

1. THE BEST IS YET TO COME

Banks across Europe have fought significant battles to cope with new economic and regulatory conditions as well as changing customer requirements and demands in recent years. The Covid-19 crisis, zero interest rate world, platform economy, new competitors and declining profit margins in almost all relevant business segments are just some examples of the major challenges.

One of the new niche stars and among the business segments least affected by all these challenges is the consumer lending market. **Growth figures point straight north and consumer lending appetite in Germany seems to be very high.** Nonetheless, competition in this market is rising, and a lot of players – not only traditional banks – have recently recognized the high relevance and profit potential of this market segment.

In this study, we analyze the core opportunities and challenges ahead in the German consumer lending business. Where are the unique business opportunities? What are possible winning strategies? How to coexist with new tech/banking players such as Klarna and PayPal?

2. GERMAN CONSUMER LENDING IN A NUTSHELL

Consumer lending enables individuals to buy products they otherwise might not be able to afford ("bridging the gap") and/or to improve the timing of purchases and cashflows in accordance with individual financial planning. Fuelled by lower interest rates and higher public acceptance of consumer debt, the overall German consumer lending market is gaining traction.

> ***According to our definition, the consumer lending universe consists of traditional components such as instalment loans and (revolving) credit cards as well as "new solutions" such as instalment payments, buy-now-pay-later (BNPL), and subscription models for consumer products.***

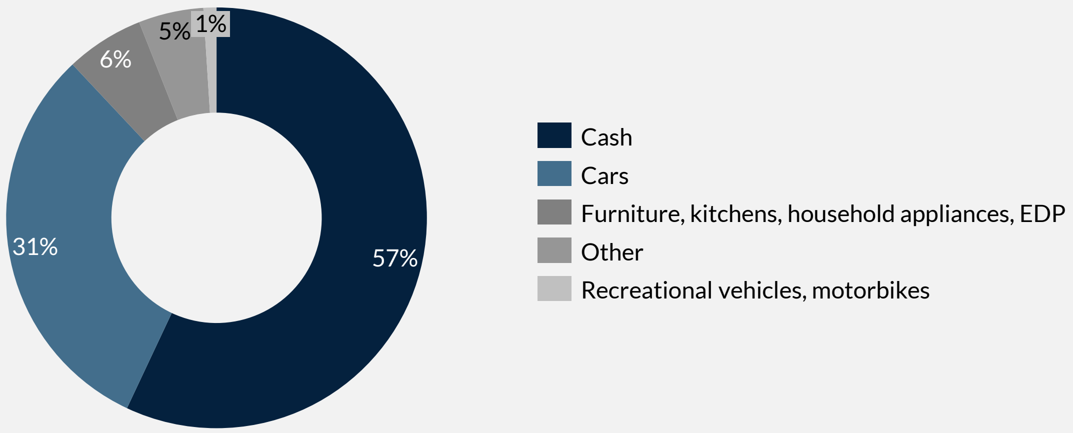
With a new business volume of EUR 103bn in 2020, the German consumer credit market is one of the largest credit markets in Europe, accounting for 30% of total European consumer credit outstanding. Further growth potential becomes apparent when comparing the German market with the US market.

While the average German consumer has EUR 2,336 of outstanding consumer credit, in the USA this number is more than four times as high at EUR 10,817 p.c. (including revolving / non-revolving credit and student loans). Even though both markets are not directly comparable, it shows that there lies great potential in the German consumer lending market.

In recent years, new business volume of the German consumer lending market has been rising steadily. While Covid-19 has had a comparatively moderate impact on the overall instalment loan market, new solutions such as BNPL and instalment purchases have also reached new highs in 2020.

The largest share of the consumer lending market in Germany consists of cash instalment loans (57%), while car financing is the largest product-related category with 31% of new business volume.

MARKET SHARE OF FINANCED PRODUCT CATEGORY BY FINANCIAL INSTITUTION



Source: Bankenfachverband

> ***„If you don't drive your business, you will be driven out of business."***
>
> **BERTIE CHARLES FORBES**
> **JOURNALIST AND AUTHOR**

While 75% of the instalment loan new business volume is facilitated through branches and retailers, 25% are (already) handled through online sales channels. Online channels have picked up speed recently and are becoming increasingly important to financial institutions and lending providers.

Due to the pandemic the overall volume of new consumer loans in Germany has decreased by 7% in 2020, whereas loans facilitated through online channels have increased. Furthermore, online consumer lending solutions are gaining ground through direct sales channels and partners such as online retailers and comparison platforms (e.g., Smava, Check24, Verivox).

With new automated digital solutions small- to mid-sized consumer lending tickets can now be handled more efficiently. The technological development generates new opportunities and a completely new market for new and traditional lending players.

In this study, we analyze some of the most promising trends and developments shaping this industry. We illustrate the challenges and opportunities financial institutions are facing and outline potential solutions, how market participants can benefit from the expected growth.

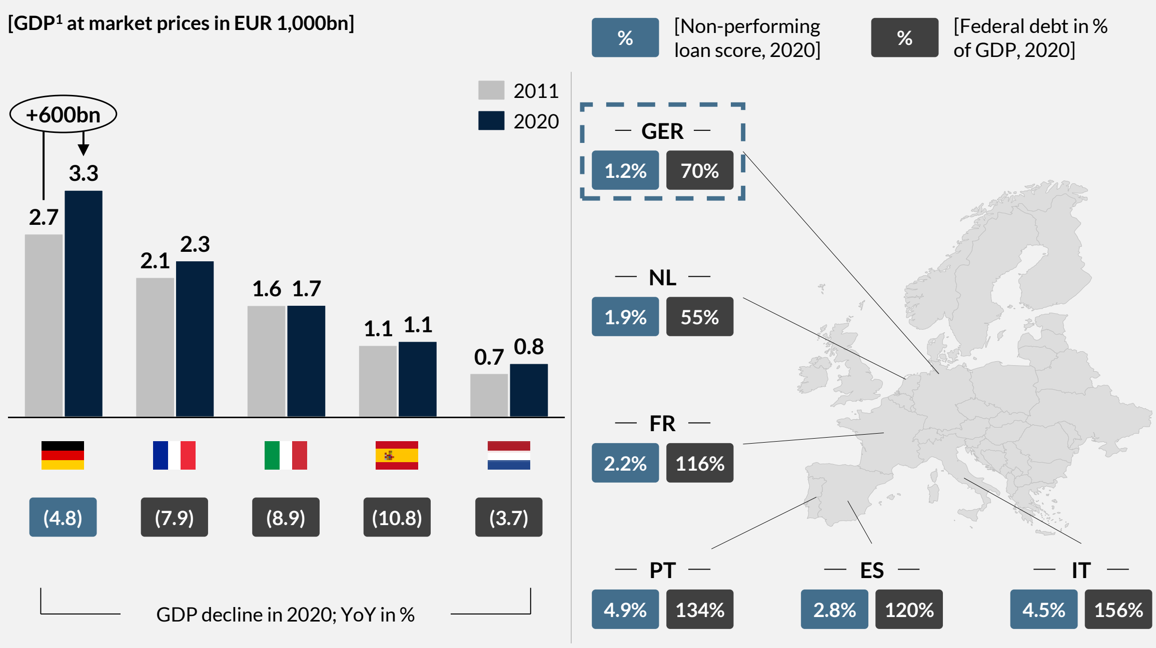
3. THE GAME IS ON

Germany is Europe's largest economy with a GDP of EUR 3.3tn. Total GDP has grown by 24% since 2011 (+ 600bn EUR). Hence, Germany is one of the fastest growing economies within the EU and one of largest consumer lending markets.

The low federal debt level of 70% in 2020 gives Germany enough financial latitude to react in case economic conditions deteriorate. Most European countries had to increase their federal debt levels significantly during the Covid-19 pandemic. In contrast, Germany has the financial firepower to stabilize demand and secure lending markets, if considered necessary in the future.

This is confirmed by the extremely reliable repayment behaviour of German consumers. The non-performing loan (NPL) score in Germany is at 1.2% compared to an EU average of 4.1%. Even during the pandemic, the NPL ratio in Germany only slightly increased from its long term level of 1,0% to the 1.2% (in 2020) mentioned previously.

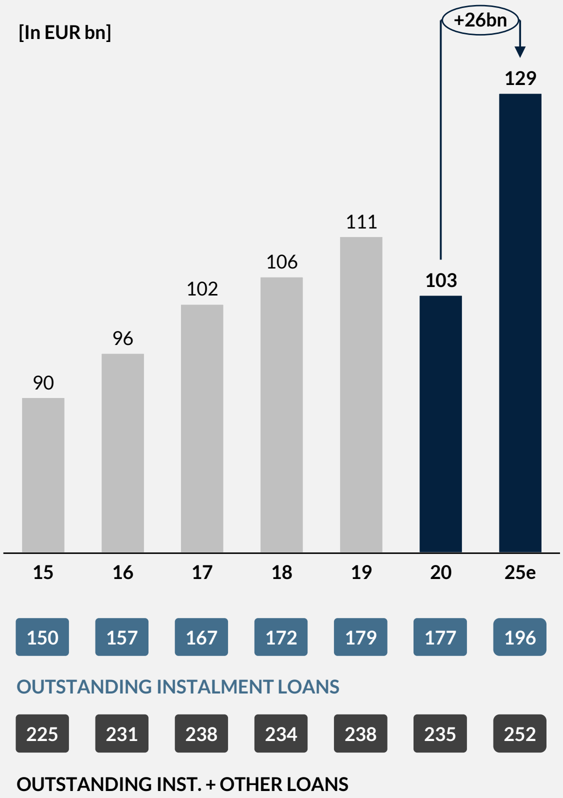
GERMAN ECONOMY — A EUROPEAN COMPARISON



[1] GDP = Gross Domestic Product

Source: Eurostat, MOONROC

NEW BUSINESS CONSUMER CREDIT – PRIVATE CUSTOMERS IN GERMANY



[1] Rounding differences possible

Source: Bundesbank, MOONROC

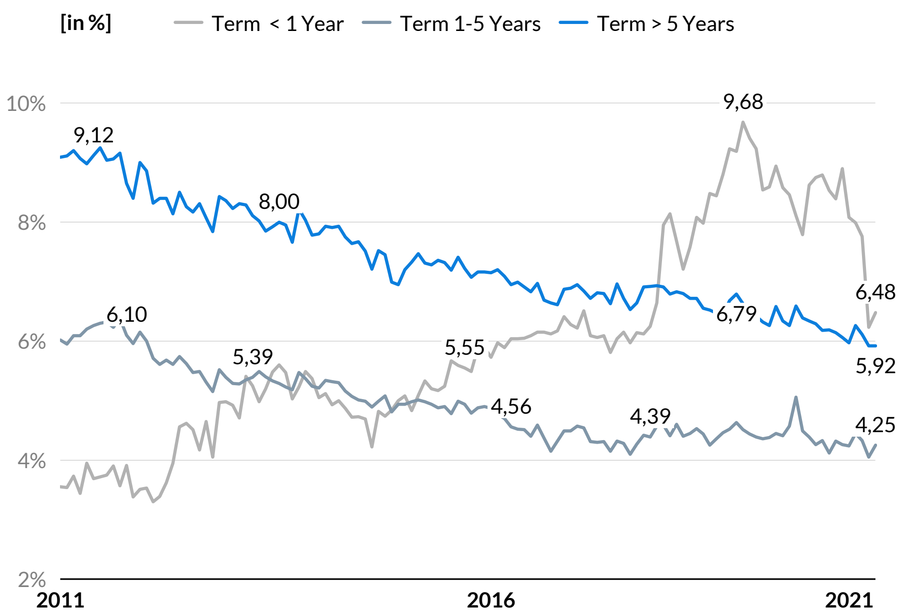
However, in relation to the size of the overall German economy, the German consumer lending market is still relatively small with a volume of outstanding instalment loans of EUR 177bn in 2020. New business volume is around 103bn EUR.

Given current market circumstances and growth rates, we expect new business volume of consumer credit to grow by 26bn EUR and reach EUR 129bn by 2025.

In summary, the German consumer lending market represents one of the largest lending markets in Europe, growing at stable rates and not even close to being at its full potential. The high resilience of the German economy coupled with a reliable credit repayment behaviour of German clients could be seen as a 'safety belt' for the overall credit market in Germany. Nonetheless, the high attractiveness of the German lending market has its flip side. Many international banks, near banks, new players and BigTechs are evaluating the options available to increase their footprint in the German market. Although market conditions seem to be quite favourable, paradise is yet to come as competition is becomeing more and more active.

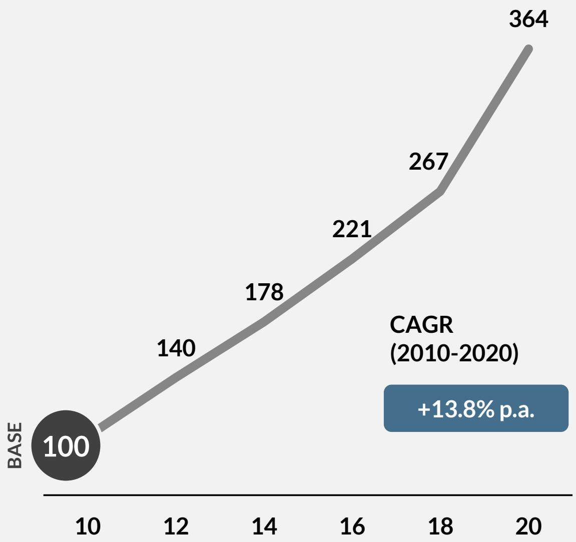
The market landscape is getting increasingly competitive. Consequently, local market circumstances must be analyzed and understood in detail to benefit from the growing German consumer lending market. The cards are being reshuffled due to diverse changes in client behaviour, technological advancement and platform banking making former winning strategies obsolete. A new group of winners in the market is leading and shaping the future of the German lending market.

INTEREST RATES NEW BUSINESS CONSUMER LOANS



Source: Bundesbank, MOONROC

INDEXED E-COMMERCE REVENUE IN GERMANY



Source: HDE, MOONROC

Nowadays, customers expect a variety of payment methods at the checkout and will even abandon their virtual shopping cart if their payment method of choice is not available. Consumers are not only becoming more open towards new solutions but also towards new players offering these solutions. Coupled with constantly decreasing loyalty of customers to their house bank, traditional financial institutions face significant challenges in providing the right solutions to their customers even in new buying processes online and offline.

Further fuelled by the pandemic, the e-commerce market in Germany is steadily growing. Many of the segments driving the e-commerce market consist of product categories that are most likely financed. In addition to increasing online sales, consumers are becoming more open towards new and innovative payment solutions when shopping online.

4. 5 KEY TRENDS IN THE GERMAN CONSUMER LENDING MARKET

Enabled and driven by technological developments (e.g., mobile banking solutions, faster and digital processes, Open Banking and sophisticated partnerships between tech-savvy players), the lending market is changing dramatically.

New players, innovative integrated solutions (facilitating a smooth customer experience) as well as new customer access channels (through online platforms) have put serious pressure on established banks in the German consumer lending market.

Nonetheless, if banks and other financial institutions pay attention to certain key trends and use them to shape their winning strategies, they can strengthen their market position or even further increase their market share. Here are five of the most notable consumer lending trends:

5 KEY TRENDS IN THE GERMAN CONSUMER LENDING MARKET

#1 NEW LENDING PRODUCTS

Due to their unique customer experience and convenience as well as value-added features, new lending products significantly gain market share formerly served by traditional banks with instalment loans.

#2 EMBEDDED FINANCING

Partner offerings and customer journeys featuring embedded and integrated lending solutions will represent a key building block in the e-commerce and stationary landscape.

#3 PLATFORMS

The growth of platforms will continue across all banking solutions. In consumer lending this is driven by 'the best-deal-behaviour' of German consumers looking for the best offer at the lowest price.

#4 BIGTECHS AND NEW DIGITAL PLAYERS

Equipped with vast financial resources, customer access and innovative products, BigTechs and new digital players challenge the existing business models of traditional banks in consumer lending.

#5 NEW MEANS OF PAYMENT AND CURRENCIES

Not only the payment landscape regarding consumer lending is developing, money itself is also changing. With the rise of cryptocurrencies and other digital currencies, we can see current business models of banks shifting significantly.

1 NEW LENDING PRODUCTS

New lending products are experiencing a meteoric rise in popularity. Due to their improved customer experience, increased convenience, and new added features, they significantly gain market share formerly served by traditional banks. As an example, BNPL or new subscription models can serve as a perfect substitute for traditional instalment loans.

While some car subscription providers have been in business for more than 20 years, the concept has only recently gained public attention and serious traction. Not to be confused with car rental or car sharing, car subscription works similarly to traditional leasing but with shorter rental terms and more services included. Usually, the consumer pays a slightly higher monthly rate compared to a similar leasing contract but in exchange gains more flexibility due to a shorter contract duration (usually 6-12 months) while just paying for fuel.

Convenience and flexibility for clients is key. These new car subscription solutions have already inspired off-the-wall partnerships. Recently, MediaMarkt for example offered a Fiat 500 in cooperation with Vehiculum at EUR 99 per month in a 48-months contract.

As consumer electronics, especially smartphones, tablets, laptops and similar devices become more expensive and are therefore financed more often, subscription solutions for consumer electronics have picked up speed over the last few months. Probably the most prominent of these players is Grover with an annual recurring revenue of EUR 60m in 2020.

These new solutions enable consumers to have access to the most recent model of the respective devices while paying only a small monthly fee. At the end of the pre-defined contract term, the device is usually returned to the lender, or its contractor (3rd-party provider) and the consumer receives a new device. The contractor refurbishes the used devices and brings them back into circulation, thereby contributing to sustainability efforts (circular economy).

Established financial players are still reluctant to fully embrace these new products and solutions as they might fear cannibalization effects on their more traditional lending products.

2 EMBEDDED FINANCING

Embedded and integrated lending solutions will represent a key building block in the future e-commerce and POS landscape. Customers increasingly expect integrated and effortless financing solutions. Banks are challenged by specialized players who have developed and shaped the market. Technological capabilities, user experience and understanding the needs and interests of partners (above all retailers) play a crucial role when entering these markets.

Those players capable of offering the right solutions will be rewarded with long-term client relationships as it is difficult to switch providers on a technological level. This leads to a high lock-in effect of banking and credit solutions in the value chain of the partners.

Established players have a solid starting position by using their existing business partner network and their long-lasting relationships to their advantage. If banks manage to develop their own innovative solutions (through developing, buying or merging) and integrate these solutions into potential partner offerings, the first step is taken.

Also, a broad product portfolio is of advantage, as business partners tend to only buy from one or two banking solution providers instead of contracting a vast number of suppliers. Being a 'one-stop shop' and able to adapt quickly to business partners' demands is key when offering integrated and embedded finance solutions.

3 PLATFORMS

Platforms are already a major contributor to many credit banks' new business volume. In the future, we see this trend continuing as clients in Germany are used to compare prices. This 'best-deal-behaviour' will further fuel demand on comparison platforms, especially since clients are increasingly questioning whether banks are offering them the best product, best service or best price.

However, comparison platforms are not merely a threat. Banks can profit from them and increase new business volume by joining the ride, accepting the new speed and flexibility in pricing and building part of their business model around these new touch points and channels. As they cannot afford to lose customer access, established financial institutions should not fight platforms, since they would risk losing significant shares of their revenues by excluding themselves from a major part of the market.

Another learning of the platform economy can be the fact that banks need to focus more on the stickiness of their own solutions and products. Clients won through channels like Google or comparison platforms are comparatively expensive. These intermediates charge significant tolls without carrying the risk of the service or product sold.

In contrast, clients won by good service and a positive experience with the banks' respective products are won and kept at no extra cost. Therefore, financial institutions should put more emphasis on customer retention. Recent studies show that even though German consumers regularly use comparison platforms, they are not always sure if they receive the best offer. Consequently, banks can increase their customer retention rate by becoming a trusted and reliable partner for their core offerings in the eyes of the customers.

4 BIGTECHS AND NEW DIGITAL PLAYERS

BigTechs and new digital players have changed the way how we do business. They have changed the way we shop and they have also changed the way we finance purchases. They even found ways to create a user experience, where consumers do not have the feeling that they just lent money when completing their financed purchase.

New digital players such as Klarna and PayPal indirectly and directly attack banks' market share by either offering classic banking products (e.g., instalment loans) or by introducing new innovative products and services (e.g., BNPL, Klarna wallet) during the checkout process. BigTechs, such as Apple and Google, leverage their market power and their user access through their devices and platforms to build up whole new financial environments for their customers ('ecosystems').

Google Pay with Google Plex is a good example in this regard. The internet giants offer new solutions which are very close to a traditional checking account, making it easy for clients to transfer money and to better organize their finances. The direct financial client interface ('financial home') seems to be perfectly interpreted by BigTechs' solutions.

Banks in this scenario will become a pure product and banking license provider. Eventually having lost most of the direct client access to BigTechs, the new role of banks would need to be defined entirely different. To successfully co-exist with both groups (new players and BigTechs), banks must understand the "new and future normal" in the market. They then need to define their purpose, where they aim at playing a major role, what their unique value add in this field would be and what the requirements are to establish oneself as one of the key players in the market.

Banks will not be able to change the new credit solution world, but they bring a lot to the table to play a significant role in these markets. One example can be that they provide their balance sheet and potentially the volume and risk appetite to absorb new client demand more easily. They also have the processes in place to manage credit scorings just-in-time and provide all the regulatory frameworks necessary for running these new solutions. This does not imply that banks should give up conquering the client interface. Indeed, they should try to provide good frontend solutions so that their dependency on BigTechs and new digital players will be kept as low as possible.

5 NEW MEANS OF PAYMENT AND CURRENCIES

Another influential factor in the German consumer lending market is the rise of new payment methods (online/offline). Payment is one central impulse generator for the financial system. People buy and pay for things every day. Banks and financial players that offer modern solutions in the payment world would profit from full client access day by day. Payment solutions can also be bundled perfectly with credit or near credit products, as it can already be observed with the above mentioned BNPL model.

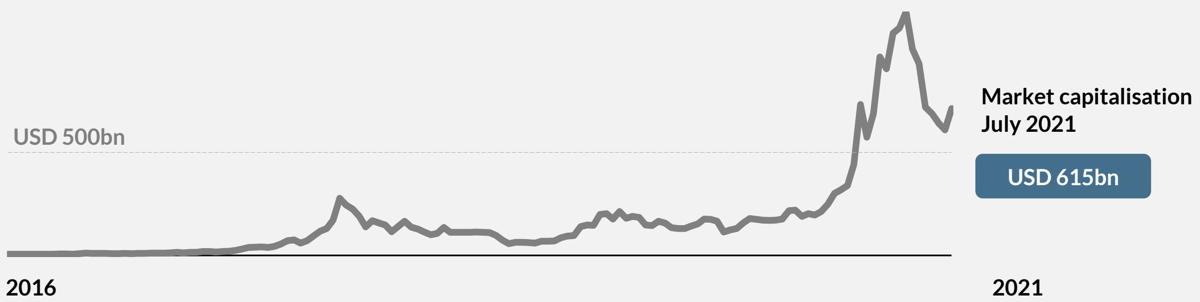
Banking in former times was founded to increase local or international trading and commerce and many of the new payment solutions start exactly at this point. It is about helping businesses and clients doing business, mostly through online and digital solutions. One could say, “Banking is coming home” and finally fulfilling the founding ideas and concepts of many traditional banks again.

When we think of money, paper bills, coins and the numbers on our bank accounts usually come to mind. These are examples for fiat money, i.e., a currency that has been issued by a government and is not backed by gold or any other commodity. The US Dollar, the British Pound and the Euro are all examples of fiat currencies.

In recent years, there has been a development that challenges the influence of these currencies. So-called crypto currencies have gained public attention, led by the astronomical rise of Bitcoin which remains the most influential crypto currency – regardless of its volatility over time. These digital currencies are decentralized, mostly anonymous and vastly unregulated.

Now central banks, governments and private companies are also trying to figure out how to handle and tackle the topic of digital currencies. The Digital Renminbi (e-RMB) introduced by the Chinese central bank, the People's Bank of China, is currently undergoing a pilot phase, while the European Central Bank (ECB) is preparing for the potential introduction of a digital Euro as a complement to cash.

MARKET CAPITALISATION BITCOIN



Source: Coinmarketcap, MOONROC

These centralized currencies are more likely to be used as currency in the future compared to Bitcoin and other cryptocurrencies which, due to their volatile nature, might never be able to fulfil that function.

Not only the payment landscape is developing, money itself is also changing. Banks need to be ready and prepare their systems to be flexible enough to integrate new solutions for new ways of payment and currencies, in whatever form they might arrive.

It is crucial for financial institutions to define their role in these new systems as centralized digital currencies might be stored and handled at the respective central banks. Local financial institutions face becoming mere intermediaries in this case.

The German consumer lending market is constantly changing and offers great potential for those who are willing to act fast and decisive as it is one of the last profitable business fields in the German financial system.

Financial institutions face great risks but also great opportunities in the times ahead.

Those who will focus on customer experience, understand the technological implications of societal change and maintain a large share of customer touchpoints will come out on top.

Those who refuse to adapt will experience the disruptive power of new market entrants and digital innovation and see their business model under attack.

ABOUT MOONROC

MOONROC is the leading Management Consultancy Boutique for the European and German banking market. Headquartered in Munich, our consultants combine highest banking industry expertise with positive and open personalities. We develop new strategies, implement new solutions or products and transform traditional banking players into agile powerhouses ready to conquer the new banking world. Our values are an integral part of our daily business life. MOONROC stands for the highest quality, independent/honest advice and always acting in the very best interest of our clients.

ADDITIONAL STUDIES

Additional studies published by MOOONROC and currently available:

DIGITALES MINDSET

RETAIL BANKING KOMPASS 2021

EUROPEAN BANKS

or a complete overview of all studies available please visit:
https://www.moonroc.de/insights/artikel

DISCLAIMER

The information contained in this report is meant for the purposes of information only and is not intended to be investment, legal, tax or other advice, nor is it intended to be relied upon in making an investment or other decision. MOONROC is not an investment adviser, and thus MOONROC cannot and does not provide investment advice. Nothing in this report is intended to serve as investment advice, or a recommendation of any particular transaction or investment, any type of transaction or investment, the merits of purchasing or selling securities, or an invitation or inducement to engage in investment activity.

This report is provided with the understanding that the authors and publishers are not providing advice on legal, economic, investment or other professional issues and services. MOONROC is not responsible for the content of websites and information resources that may be referenced in the report. The access provided to these sites or the provision of such information resources does not constitute an endorsement by MOONROC of the information contained therein. The inclusion of company examples does not in any way constitute an endorsement of these organizations by MOONROC. While we have endeavored to ensure that the information contained in this report has been obtained from reliable and up-to-date sources, the changing nature of statistics, laws, rules and regulations may result in delays, omissions or inaccuracies in information contained in this report. MOONROC is not responsible for any errors or omissions, or for any decision made or action taken based on information contained in this report, or for any loss or damage arising from or caused by such decision or action. All information in this report is provided "as-is", with no guarantee of completeness, accuracy, timeliness or of the results obtained from the use of this information, and without warranty of any kind, expressed or implied.

IMPRINT

GERMAN CONSUMER LENDING MARKET
Battleground, paradise or the place to be

This article is published by MOONROC Advisory Partners

Edition 09/2021

Editor
MOONROC Advisory Partners Gmbh and
MOONROC Institute of Economic Research (MIER)

Steinsdorfstrasse 14
80538 Munich
Phone: +49 (0) 89 41 11 96 0
E-mail: company@moonroc.de
Website: www.moonroc.de

Register Court
District Court Munich
HRB 191134 / tax number: 143.164.01148
Registered office: Munich
UST-ID - DE276206799
VAT Reg Number according to §27 a UStG
Person responsible accoring to §6 MDStv: Patrick Natus

LinkedIN
Xing
Twitter