

Digital Economy

The Millennials Paradox

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- Millennials constitute the latest wave of banking customers
- Banks face a paradox of balancing one-click solutions with empathy
- Millennials are increasingly turning to non-bank disruptors to meet their financial needs
- Corporate cultures and processes need to adapt to changing preferences

"As we have no immediate experience of what other men feel, we can form no idea of the manner in which they are affected, but by conceiving what we ourselves should feel in the like situation." Adam Smith. The Theory of Moral Sentiments.

Introduction

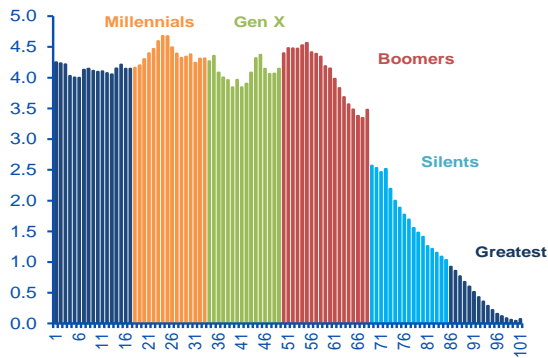
The Millennial generation is taking the world by storm, leaving their mark on today's society just like previous generations have done before them. Defined as those reaching young adulthood around the year 2000, Millennials are known as the hyper-connected and technology-savvy crowds that interact on social media or the Boomerang generation that go back to live with their parents. For others, Millennials represent the middle-class protesters of the Occupy movements, the new generations of highly-indebted professionals, or the narcissists that made "selfie" the most famous word of 2013. Despite these labels, Millennials' attitudes and preferences are touching upon many aspects of social and economic life with significant implications for the banking industry.

What Makes Them Unique?

For banks, the Millennial generation represents a natural opportunity as they begin their financial life-cycle. However, their unique characteristics impose many challenges to the banking industry.

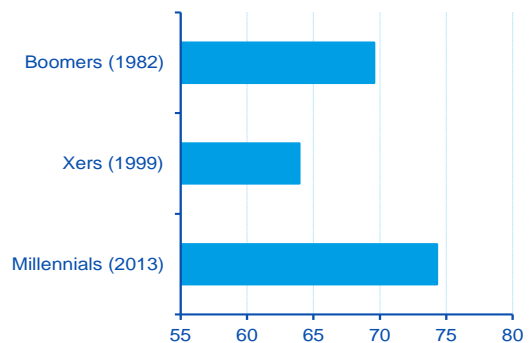
Market Size: In the United States, around 75 million residents are currently between 18 and 34 years old. This represents roughly 24% of total population and 25% of individuals with a transactional account. By 2050, the size of this age group will increase to 85 million, accounting for 21.4% of the total population.

Chart 1
U.S. Resident Population by Age



Source: U.S. Census Bureau

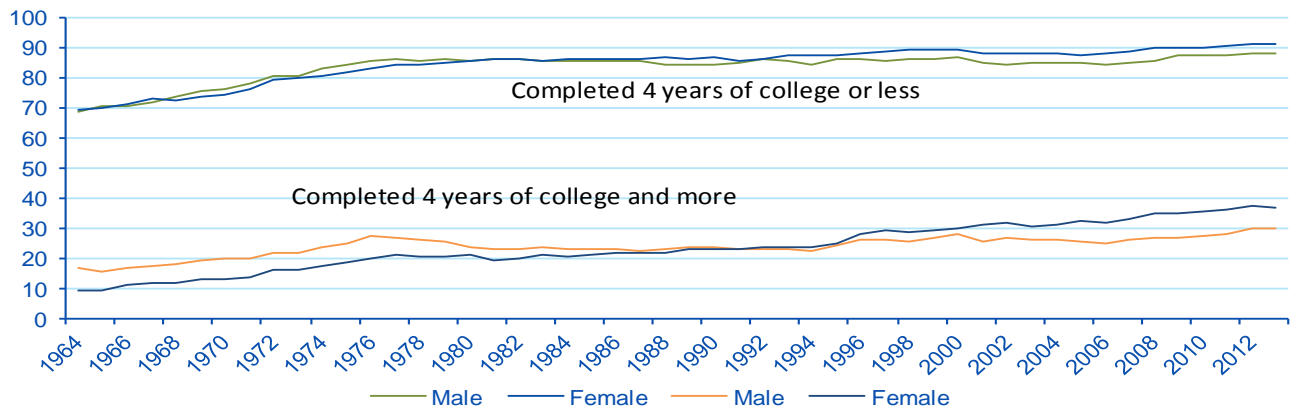
Chart 2
U.S. Resident Population 18 to 34 Years Old, millions



Source: U.S. Census Bureau

Educational Attainment: Millennials are the most educated generation in America with a larger share of these individuals holding higher degrees. In 2013, the proportion of individuals 25-29 years old with four years of college or more reached 33.6%, the highest on record. The figure is greater for females (37%) than males (30%). In 1950, the share of individuals with four years of college or more was 7.7%; by 1980, when the last baby boomers were starting college, the percentage was 22.5%.

Chart 3
Percentage of Population 25 to 29 Years Old by Educational Attainment and Gender



Source: Current Population Survey

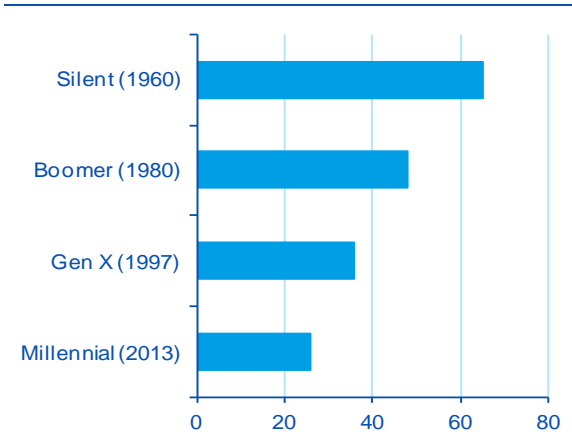
Technology: Millennials intensively use the internet, mobile technologies and social media to conduct transactions and share their opinions about products and services in a global marketplace with endless options. Almost 80% of Millennials have a smartphone. This is critical for brands as positive feedback on blogs, Twitter, YouTube or Facebook can turn viral in seconds, influencing the behavior of existing and potential customers with long-lasting effects. In regards to banking, more than 70% of Millennials have used mobile services within the last 12 months compared to only 40% for the remaining adult population.¹ Around 94% of Millennials are active users of online banking.²

Diversity: Millennials are also the most racially diverse generation in history as nearly 43% of them are non-white. The reshaping of America’s demographics will continue. By 2050, non-whites will account for 59% of young adults, which means that subsequent generations will be even more diverse than Millennials.

¹ Source Federal Reserve

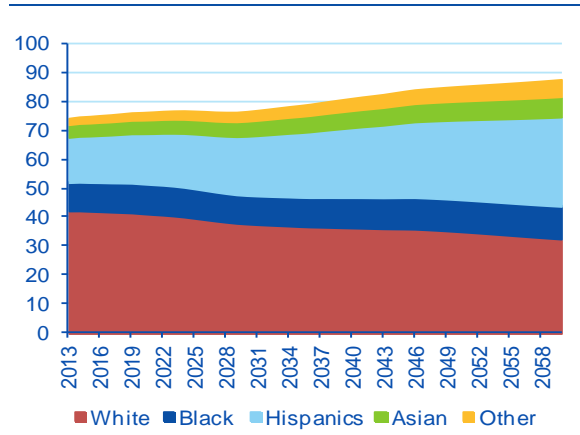
² Source Accenture

Chart 4
Married at Age 18 to 32, %



Source: Pew Research Center

Chart 5
U.S. Population Age 18 to 34 by Race, %



Source: U.S. Census Bureau

Singlehood: Compared to their predecessors, Millennials wait more time to get married. Approximately 22% of Millennials between 18 and 29 years old are married, compared to 36% of Gen Xers (34-49 years old) when they were the same age. This proportion was even higher for Baby Boomers at 40% (50-68 years old) and Silents at 50% (69-86 years old).³ Millennials are also delaying household formation. As of March 2013, only 34% of them have formed a household. This share is even lower than the 35% observed in 2009⁴, when the economy lost six million jobs. This phenomenon partly explains the slow recovery of the housing market, the drop in homeownership rates and the spike in the demand for rental and multifamily units.

Disbelievers: Almost half of Millennials declare themselves as politically independent while a third report no affiliation with religious institutions. These are the highest rates of political and religious dissatisfaction in twenty five years. Nevertheless, despite Millennials' apparent disinterest in political parties, they tend to identify themselves with political liberalism. In fact, during the 2008 presidential election, young voters gave 66% of their vote to Obama and 32% to McCain. In addition, Millennials tend to be less trustful about people than their predecessors, although they are more optimistic about the future.⁵

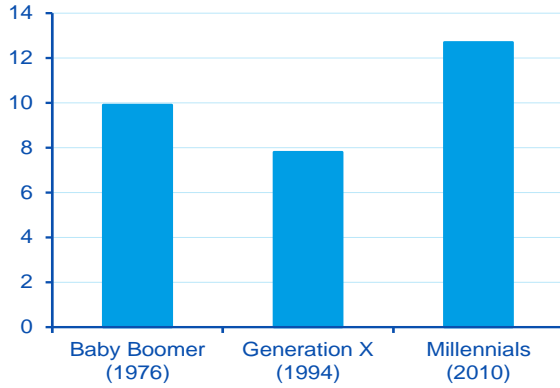
Economic Disappointment: When the first Millennials reached 30 years old back in 2010, their unemployment rate was 12.7%, higher than the unemployment rate experienced by Baby Boomers and Gen. Xers when they reached the same age. By 2013, four years after the start of the recovery, the unemployment rate for Millennials had only declined to 10%, more than 3 percentage points higher than the 2004-2007 average.

³ Source: Pew Research Center

⁴ *Ibidem*

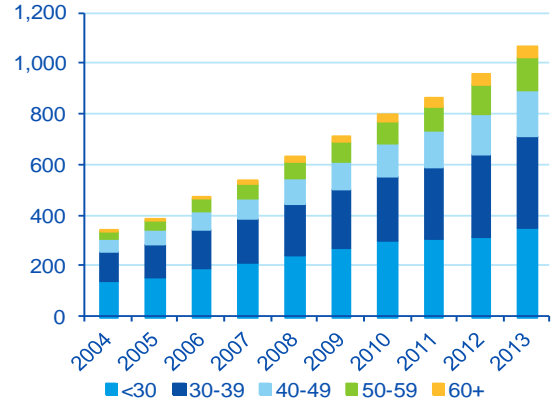
⁵ Source: Pew Research Center and Huffington Post.

Chart 6
Unemployment Rate for Individuals 30-Years Old



Source: BBVA Research calculations with data from the Bureau of Labor Statistics

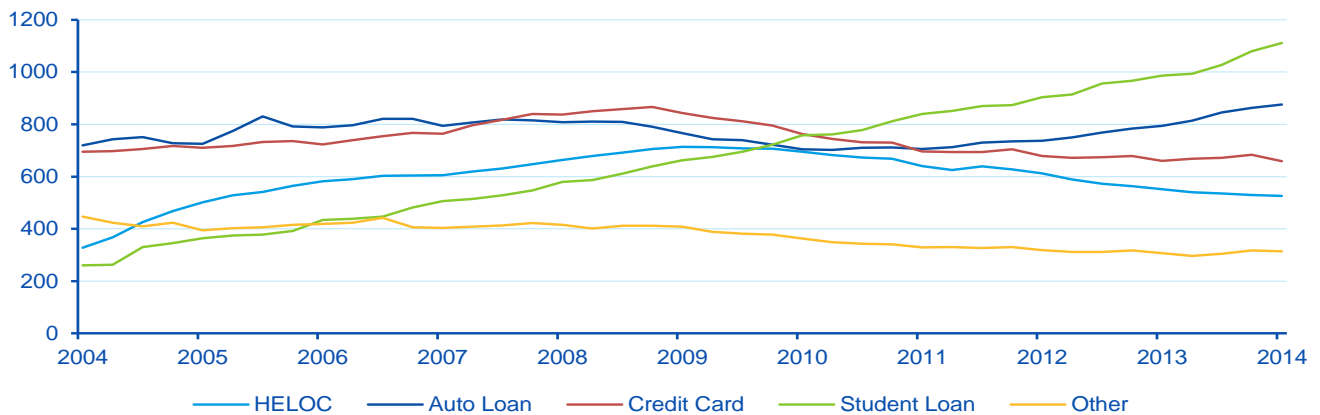
Chart 7
Total Student Loan Balances By Age Group, \$ billion



Source: Federal Reserve Bank of New York Consumer Credit Panel / Equifax

Indebtedness: Student debt is crippling Millennials. In 2013, total outstanding student debt reached \$1 trillion dollars or 6.4% of Gross Domestic Product. Total student loan balances have tripled since 2004; one third of these balances are held by individuals under 30 years old and another third is held by those between 30 and 39 years old. Also in 2013, there were 42.2 million student loan borrowers in the country with an average balance of \$25,366. This was 66% higher than in 2004. Meanwhile, 38.6% of the 25 year old population had student debt in 2013, up from 26.8% in 2004.

Chart 8
Non-Mortgage Balances, \$ billion



Source: Federal Reserve Bank of New York Consumer Credit Panel / Equifax

Banking Millennials Will Not Be Easy

In addition to their population size, Millennials have other positives for banks. First, as mentioned above, they are more educated than their predecessors. In general, higher levels of educational attainment are associated

with lower unemployment, job stability and higher incomes - key variables in assessing credit worthiness and demand for financial services. Therefore, as the economic recovery strengthens, the unemployment rate for Millennials will decline. Second, mobile technologies and connectivity are ingrained in their daily lives, allowing banks to generate economies of scales in reaching millions of hyper-connected individuals for which the branch has become irrelevant.

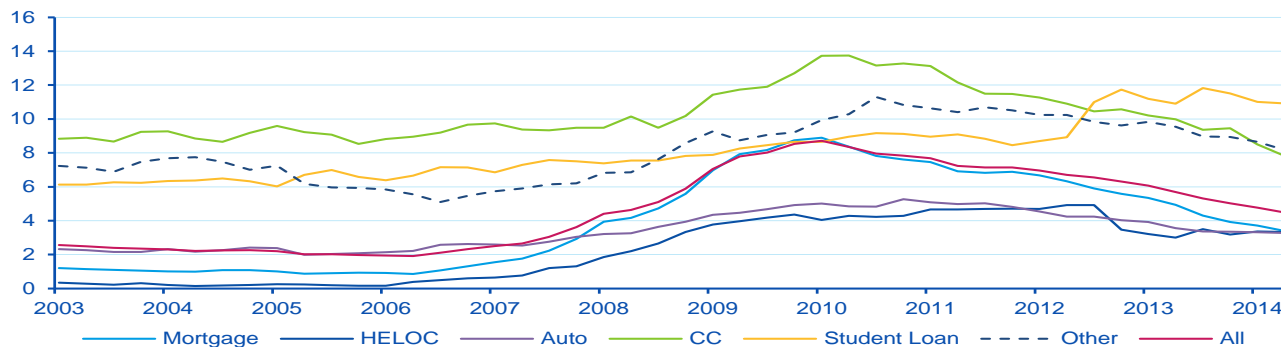
However, serving Millennial customers will not be easy. The common assumption that they will embrace traditional banking as they get older may prove to be wrong.

Contrary to previous generations, banks now have to navigate the complexity of a multiracial and multicultural customer base. From here on, marketing strategies aimed at young adults should account for cultural differences in saving and spending, as well as gaps in educational attainment and economic conditions among ethnic groups. Enduring education and income gaps tend to feed different –and sometimes conflicting- views on political and social issues. Banks need to be aware of these differences to avoid alienating young customers.

Postponing marriage has a direct impact on banking as it lowers the demand for new and existing homes, apartments, furniture and home-related services that are financed through credit (mortgages, CRE loans, HELOCS and credit cards). Other products like insurance, auto loans, and college savings accounts are also impacted.

High levels of student debt limit the access and demand for other forms of credit, particularly for individuals who struggle to repay their student loans. Student lending was the only type of debt that increased in the aftermath of the Great Recession, rapidly consolidating as the second largest source of consumer debt, only below mortgages. Higher levels of student debt have reduced the amount of non-student debt undertaken by Millennials. As Chart 8 shows, student loan balances have increased continuously since 2004. In comparison, home equity lines of credit and credit card balances have not recovered from their pre-recession levels. Student debt is increasingly becoming a drag to young people’s finances. The proportion of 90+ days delinquent borrowers went from 7.9% in 2004 to 16.1% in 2012, for individuals 30 years old or less.⁶ Trends in the cost of higher education and student debt are likely to persist as advancements in technology and economic complexity have increased the returns on additional years of education, incentivizing young adults to spend more time at school relative to their predecessors. For an in depth analysis see BBVA Research article on [student debt](#).

Chart 9
Percent of Balance 90+ Days Delinquent by Loan Type, %



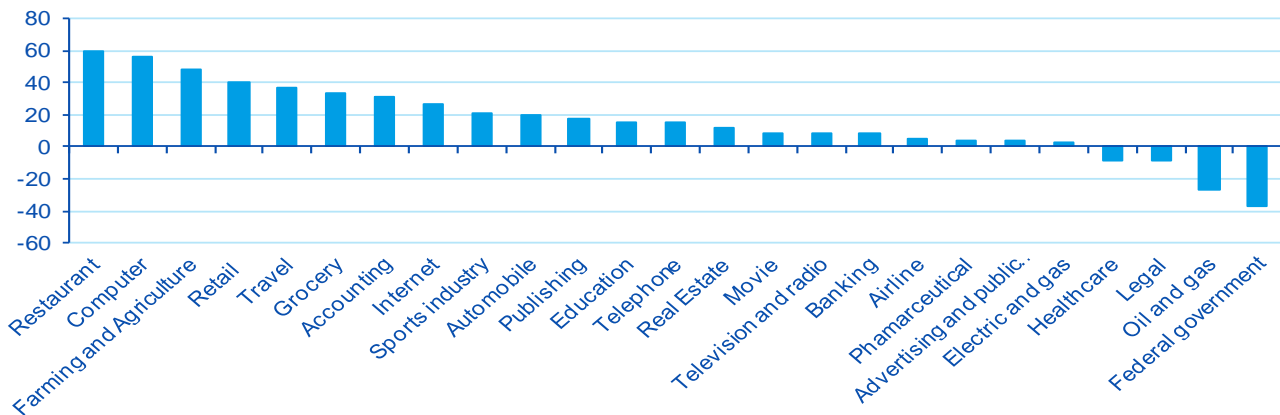
Source: Federal Reserve Bank of New York Consumer Credit Panel / Equifax

⁶ Source: Federal Reserve Bank of New York

Millennials skepticism about political and religious institutions also extends to banks. Recent surveys indicate that half of Millennials consider their bank no different than other banks. In addition, Millennials expect innovation in banking to come from outside the industry, either from high-tech startups or well-established names like Google, Amazon, or Apple. Around 68% of Millennials believe that in five years from now, both the way they access their money and pay for goods and services will be completely different. Moreover, 33% believe that they will not need a bank at all.⁷

In addition, there is a reputational problem inherited by the latest financial crisis and the following recession that inhibited investments and job creation like no other downturn since the Great Depression of the 1930's. The negative impact on banks' reputation continues as illustrated by the fact that the four biggest brands in the banking industry are among the "least loved" by Millennials.⁸ For the industry, this trend has been difficult to revert, although some progress has been made, according to recent polls. The reputational crisis was leveraged by new disruptors outside the scope of banking regulation. On-line-based peer-to-peer lending, crowdfunding, payment platforms and virtual currencies have proliferated in the aftermath of the recession in large part due to their value propositions based on technology, simplicity, transparency and anti-bank rhetoric.

Chart 10
Business and Industry Sector Ratings, August 2014, % net view



Source: Gallup

A Strategy for Banks

The following ideas could serve as the basis for a comprehensive strategy to build a long-lasting relationship between the banking industry and Millennials.

Avoid transactional relationships and commoditization. Millennials expect their banks to be pro-active; however, they increasingly perceive their relationship with banks as purely transactional despite banks' efforts to attract them -mainly through technology. This suggests that, in order to build strong relationships with Millennials, on-line and mobile banking will not yield the best results if they are not combined with customized services. In addition, banks need to understand the specific needs and preferences of their clients, and be sensitive and open to client concerns. This is how banks will build an empathic relationship.

⁷ Source: Viacom Media Networks

⁸ *Ibidem*

Millennials expect banks to provide them with options amongst standard products like a checking account or an auto loan. In addition, they want banks to guide them on how to maximize their financial wealth based on lifestyles and personal goals. Millennials not only want a mortgage but also to understand how it works. They want their banks' honest opinion about the best time to buy a house and when does renting makes more sense than buying.

A successful strategy should consider advising on what is the best way to build a good credit history under high levels of student debt, how to start saving for retirement in the absence of a stable job, and how to overcome the investment fears generated from the last financial crisis.

These are just some of the issues that banks can help Millennials to solve in order to gain their loyalty. The risk of neglecting Millennials' demand for empathy and customized services is that other companies will take the lead at the expense of bank revenues, which is already happening in the payment systems and the peer-to-peer space. In fact, roughly 70% of Millennials below 30 years old embrace new entrants in the financial industry and want help with managing their finances.⁹

Turn Millennials into your champions. Millennials' strong dependency on connectivity and mobile devices can turn a positive opinion into a referral with the potential to reach hundreds or thousands of other Millennials. However, the opposite can also be true with disastrous consequences for an industry that is painfully rebuilding its reputation. Therefore, seeking Millennials' feedback, listening carefully and responding promptly on a personalized basis, could attract them to banks at a relatively low cost. This could be challenging for large institutions relative to their smaller peers. Therefore, success requires the ability to reach scale while providing a meaningful customer experience.

Speak their language. For banks, to speak the language of Millennials there is nothing like having them as part of their staff. Banks could not only increase the number of Millennials in their payroll, but also create a Millennial Committee of young employees with the goal of assisting initiatives to better serve this segment.

Embrace their values. Millennials –the most diverse and most educated generation in America's history– demand companies to embrace transparency, simplicity, integrity and commitment to social and environmental causes. These values should be taken seriously in order to appeal to this segment of the population. A recent survey showed that wealthy young investors are increasingly paying attention to concepts such as “values-based investing” and “impact philanthropy”. Social responsibility was listed as an increasingly important factor to select investments among affluent young. Banks can use sound corporate social responsibility initiatives to attract Millennials and learn from industries that have successfully incorporated Millennial values into their bottom line such as grocery stores, fashion designers, restaurant chains, hotel companies or multifamily housing complexes.

Pay special attention to the youngest. Millennials are a complex and diverse group with different needs and preferences. Consider as an example the contrast between the financial needs of a 34 year old individual with a family and a stable job versus those of a 20 year old individual still in college. The former may demand a mortgage while the latter may require a credit card to start building credit history. From a traditional banking perspective, the 30 year old Millennial may be a more profitable and stable customer. However, banks should also devote resources to attract the youngest Millennials if they want to maintain a stable customer base over time, and thus avoid the fate of companies that failed to recognize changing consumer preferences, as in the digital camera business or home video rental.

⁹ Source: Accenture

Contrary to their older peers, young Millennials are “technology natives”, meaning that they have never experienced a world without social media or smartphones and are not prone to do business inside a branch. Thus, their relationship with financial services has to be built upon these tools from the beginning. However, although banks are aware of the need to invest in on-line and mobile technologies, these are not their exclusive domain. The same technologies that allow a person to bank over the phone also facilitate the entrance of financial disruptors that compete directly against banks. Young Millennials are more prone to embrace these new entrants in substitution of traditional banks and develop financial preferences outside the industry. In today’s world, a 20-year-old can build a diversified investment portfolio using a specialized mobile application and the spare change from her daily purchases. With financial innovations following an exponential growth path, it won’t be long before large shares of young professionals get sophisticated financial products from on-line platforms, ignoring traditional retail banking or wealth management services. For banks, neglecting young Millennials’ preferences is risky because non-banks will continue competing across the value chain.

Consider targeting Millennials from outside. Paradoxically, financial disruption has not come from banks. Because of structure, regulation and size, the vast majority of banks are technology adopters rather than creators. This puts them in a natural disadvantage relative to the disruptors. Moreover, strategies that focus on young Millennials and subsequent generations may be difficult to incorporate into banks’ processes and culture.

Banks still have the option to establish independent teams and separate them from their core businesses. This will allow management to develop and implement a strategy for Millennials outside the organizations’ structure, culture and processes. Another way that banks can effectively target Millennials is by partnering or acquiring financial disruptors that have proved successful in attracting this segment of the population.

Bottom line:

Millennials demand a genuine and meaningful relationship with banks that transcends commoditization and transactions. This trend was exacerbated by the financial crisis and the slow recovery which has yielded a high level of distrust in traditional industries and institutions. This explains why Millennials welcome disruption from non-banks.

New generations of young and technology-savvy Americans are starting adulthood in a highly complex and uncertain economic environment with a degree of choice and consumer freedom never seen before. As a result, banks need to help Millennials not only to access credit but also to navigate the intricacy of their financial-life cycle. To maximize the impact of technology banks need to establish empathic relationships. If banks do not embrace these changes and confront these challenges non-banks will.

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