



The Future of Credit

A European perspective

Spring 2019



Monitor
Deloitte.



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1 | A note from the authors



1 | A note from the authors

Welcome to our report on the Future of Consumer Credit in Europe.

The market for consumer credit is changing. As individuals transact online and banking moves towards a digitised model, new competitors, bank and non-bank, are transforming the market. To remain relevant, all participants must form a view on the future of the market and consider what it means for their business. They must take the steps needed to succeed in a hotly contested, rapidly transforming sector. Our objective in writing this paper is to help in that process.

The heterogeneous nature of the consumer credit market across Europe means that multiple models are likely to prosper in the medium term and possibly beyond. The optimal strategy for participants will be determined by their specific market context and capabilities. Rather than trying to suggest what model and who will eventually prevail, we aim to stimulate a strategic discussion about the future of credit, what it means for the different stakeholders, and where the potential opportunities and threats lie.

Over the past three months we have engaged with industry experts and market participants from nine markets across Europe via more than thirty interviews supported by desk-based research to refine our hypotheses about the future of credit. Although each market at a national level has its own distinct features, we have found consistent views from those on the front line on how they expect the market to change and what issues concern them most.

Mastercard and Deloitte are excited about the opportunities for the market as a whole. But the profound challenge will be to explore in detail what its evolution means for individual participants. We look forward to continuing this discussion with many of you.

Regards

The Authors





2 | Executive summary



2 | Executive summary

How people spend money and finance their consumption has changed radically since the turn of the millennium. E-commerce now accounts for a significant and growing share of retail spending in all major European economies. Banking has become similarly digitised with ever more customers looking to online channels to interact with their financial services providers. Customer expectations have become more uniform, seeking greater immediacy, personalisation and ease of access. But historical preferences for different financial products and different approaches to financial innovation are likely to persist, even if regulatory and political trends suggest greater convergence.

Sustained regional differences in the product mix notwithstanding, we expect the market for consumer finance as a whole to continue to grow across Europe as consumption expands. Continued technological advances in consumer banking will also lead to a broadening and deepening of the market, so that consumer lending is likely to grow faster than consumption. Credit providers will benefit from the cost efficiencies that digitisation will deliver, especially in the areas of bank operations and customer acquisition. Meanwhile, the evolution of credit scoring will expand the addressable market, reducing the amount of unmet and underserved demand.

This growing market will be contested by a larger number of players. Although it will be difficult for any single new entrant to compete with incumbent banks in every aspect of the value chain, we think specialists will increasingly break up incumbents' end-to-end verticals. Customer inertia and superior data assets have long protected banks against competition. But regulation and technology-enabled data sharing will allow attackers to challenge them more effectively and build a relationship with customers based on product transparency and ease of use. Big technology companies and large merchants in particular will enter more deeply into financial services, mirroring current developments in non-European markets. This presents a serious threat to incumbents that cannot leverage their core strengths – customer stickiness and low-cost funding – to develop at-scale digital offerings to remain relevant to the consumer.

The products through which credit is provided will also evolve. The credit card will remain an important product due to its distinctive ability to combine the supply of credit with a payment device. But issuers will need to innovate in order to remain profitable, as interchange caps and the shift away from revolving balances squeeze revenue streams. As a consequence, credit cards will be unbundled and modularised for different customer segments.

It is unlikely these steps will suffice to reverse fully the market share gains for point-of-sale (PoS) finance in recent years. The digital checkout has given this alternative financing option greater applicability and visibility. However, there will eventually be limits to its growth, as consumers realise the trade-off between flexibility and control, lenders struggle to extend their low-touch credit scoring for online PoS finance to higher ticket items, and some existing products adapt to mimic features of PoS finance.

Ultimately, market participants uniformly agree that consumers look for outcomes, not for particular payment products or loan structures. Tech-enabled bespoke personal financial management tools will increasingly support borrowers, permitting them to optimise their credit lines on a product-agnostic basis, and thereby become the linchpin of the consumer financing decision.

Success in the future European consumer credit market will be determined by providing credit that is both efficient (in terms of cost, speed, and precision) and consumer-centric. In the long run, it will be challenging for participants to maintain the capability to be both efficient providers of credit and consumer experience specialists (although some may try). In response, some large-scale incumbents are likely to become low-cost mass-market credit lenders, while the most agile and innovative will maintain some control over both products and distribution, leading them down a path towards credit networks. Challenger banks that cannot grow to scale will become consumer segment specialists, and non-bank platforms will extract greater value from the provisioning process by managing the acquisition channels, leveraging their proprietary data and occupying a position of trust, making decisions on behalf of the consumer.





3 | Areas of change in the consumer credit market



We discuss the structure of the **European consumer credit market**, including the role credit plays for consumers, how credit requirements are fulfilled today and how consumer needs are changing. We look at how technology is disrupting the supply of consumer credit and at its potential to **broaden and deepen the credit market**. This has **implications for incumbents and their main challengers** and how they might reposition themselves to remain relevant. Finally, we posit a vision for the **future of credit cards and PoS finance**, the two key consumer credit products under observation. We conclude with a look at **who will win** in the future of consumer credit.

3 | Areas of change in the consumer credit market

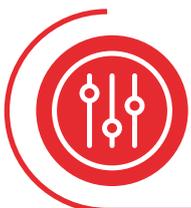
The consumer credit market in Europe is being shaped by four fundamental drivers:



Technological advancements in computing power and storage have transformed data analysis capabilities and the speed and precision with which digital services can be delivered



A fundamental shift in consumer expectations in terms of personalisation, flexibility and the level of friction they are willing to accept in any B2C relationship



Changing consumer behaviour as they seek out service providers that can meet their expectations. Customer loyalty is declining; consumers are up for grabs



Intervention by regulators to spur greater efficiency and innovation, not least by opening up data siloes to new entrants, while protecting consumers from unfair practices.

This paper examines the impact of these trends on the consumer lending market.

A | The European credit market

Summary

European consumers are united in their use of credit to finance their consumption, divided in the lending products they use. The demand for credit has long grown broadly in line with overall retail spending and has averaged 4 per cent annually in the last five years. Interest-earning credit card balances are declining, raising important questions about their future as a consumer lending product.

National markets tend to be dominated by consolidated incumbent banks, but this is beginning to change as technology and regulation transform the competitive landscape in favour of alternative providers with tailored offerings. We believe growing digitisation could ultimately encourage greater convergence in banking markets.

The function of consumer credit

Wages do not align perfectly with consumers' need to spend, particularly where big-ticket and emergency items are concerned. Unsecured credit supports purchases without the need to call on savings and allows consumers to structure the cost into manageable repayments. Available credit products (primarily credit cards, overdrafts, unsecured personal loans and PoS finance) address various circumstances and customer needs. Each of these products is typically financed by a bank or credit institution but varies in its point of provision, whether it is general or specific to the product or merchant, and how the debt is repaid.

Sources of revenue

The main source of revenue from consumer credit, around 70-80 per cent in the case of the UK, is the interest paid by consumers. Retail banks and other credit institutions are attracted to supplying unsecured consumer credit by the comparatively high risk-adjusted net interest margin available². There may also be a range of fees and charges associated with products which provide additional revenue. Finally, credit providers may also generate revenue from merchants by offering point-of-sale finance that supports sales conversion, return consumers and increased basket sizes.

The European landscape

Consumer credit markets are not uniform across Europe. The use and forms of unsecured lending have been shaped by distinct socio-economic factors over a long period of time. Germany, for example, is known for its debt-averse consumers while in the UK or Turkey it is more acceptable to hold large revolving balances on credit cards. Overall growth in the demand for credit is a more homogenous trend across Europe.

A Diverse Market

The low-cost, high limit overdrafts in Germany allow for easy access to credit via current accounts. This has made it difficult for revolving credit cards to penetrate the market.

Usury laws are common in Southern European states. In Spain, interest rates on overdrafts are prohibited from exceeding 2.5 times the legal interest rate (set at 3% in 2018) which may have impacted the use of other forms of revolving credit.

Unique country-specific products exist such as Cessione Del Quinto (a salary or pension secured loan) in Italy or Rahmenkredit (framework credit) in Germany that acts in a similar way to an overdraft but without a checking account attached.

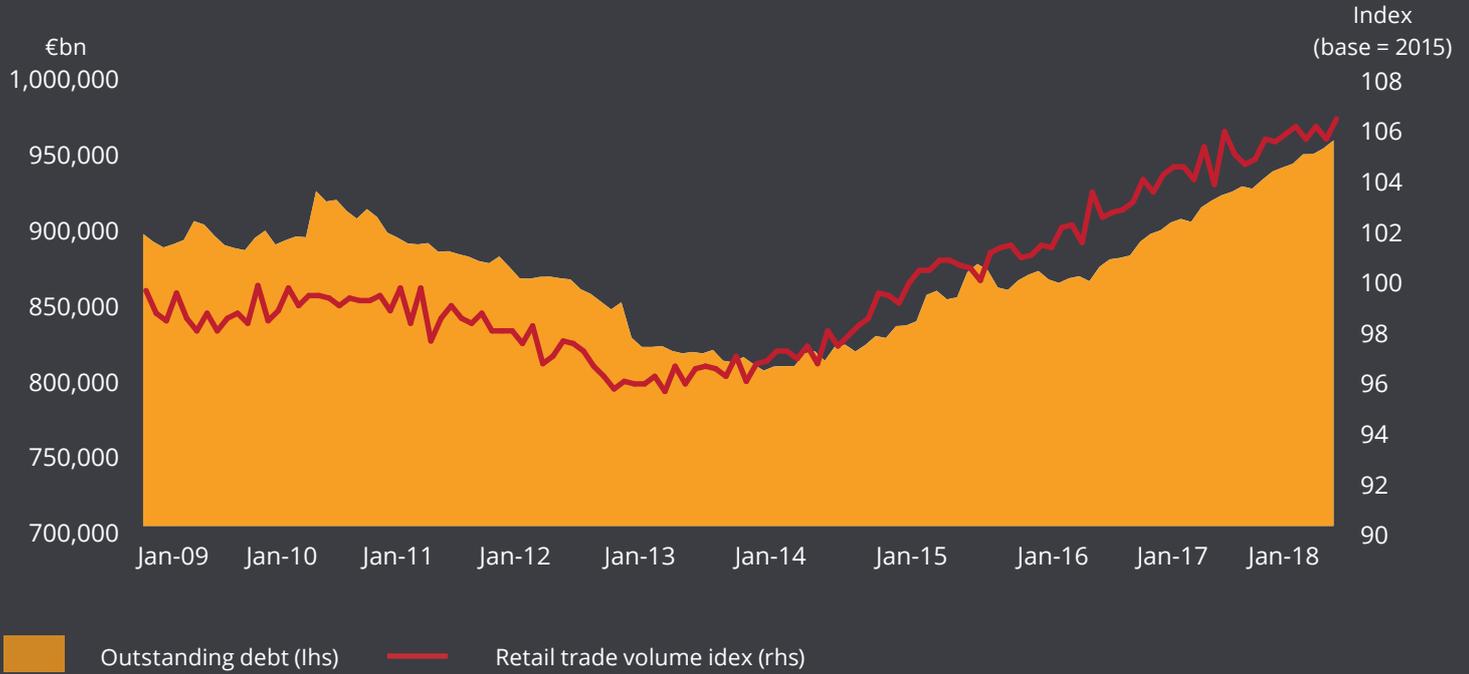
The European consumer credit market has experienced consistent year-on-year growth since 2013, following the Global Financial Crisis (GFC) and the European recession, and has been an important source of revenue for the retail banking sector. In the UK, for instance, income from consumer credit accounts for just above 20 per cent of retail banking income. The market is highly concentrated with the five largest credit institutions accounting for 46 per cent of assets across the EU³.

Disruptive forces such as regulatory change in the form of Open Banking initiatives and technological advancements in the digital space are beginning to make it easier for challengers to access the market across Europe. However, the adoption and impact of digitisation will not be uniform and will occur at varying rates across the continent. At a national level, markets will retain distinct characteristics but we see points of convergence in the way consumers access credit and how it is supplied.

Degrees of convergence

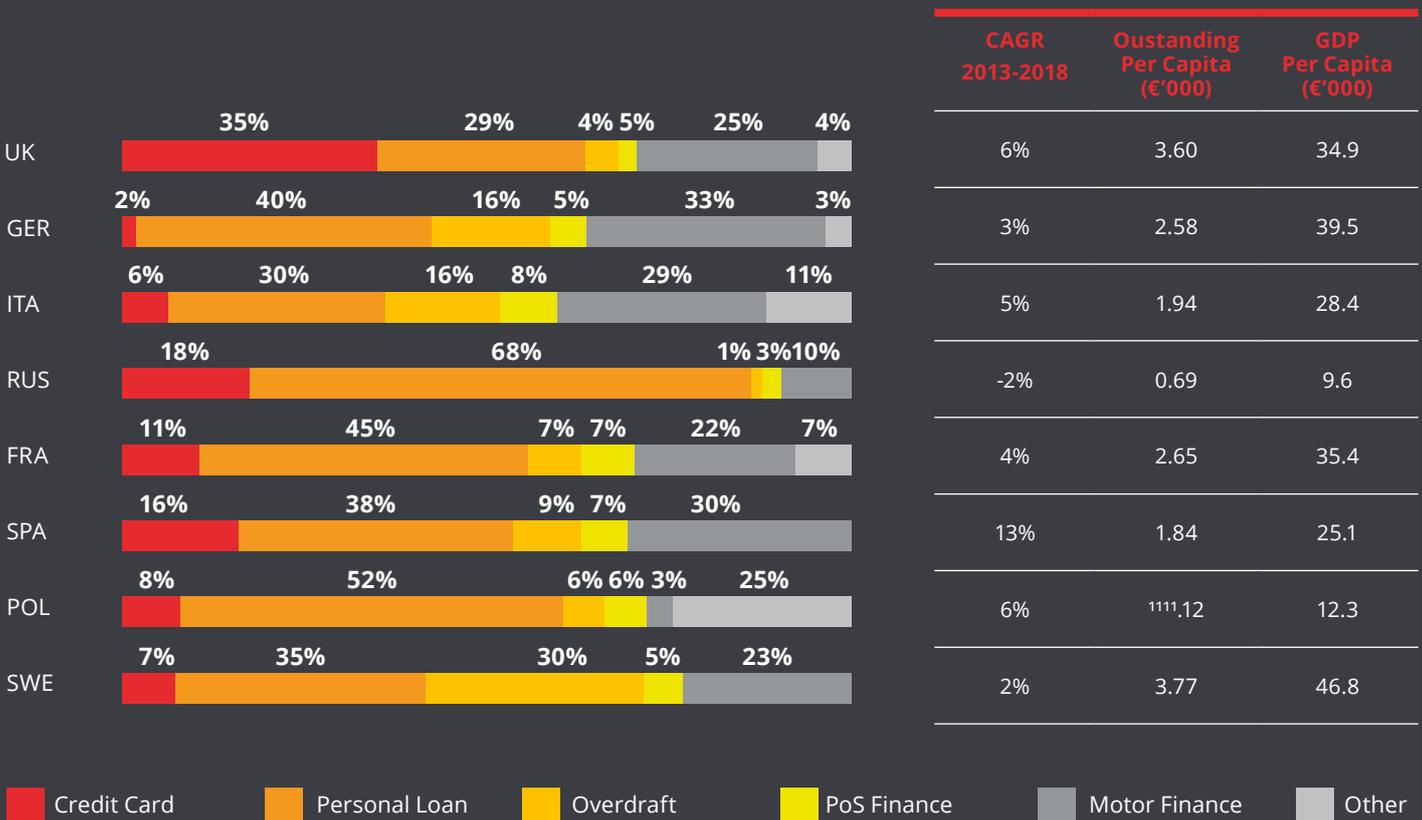
As consumers move online, suppliers of credit are following. Lower-cost models of digital provisioning will be far easier to replicate across borders and supported by regulators who want European consumers to enjoy greater choice. However, these technological advancements will not be enough on their own to drive convergence. Consumers' attitudes to debt and product preferences will not shift easily. Rather, emerging propositions must adapt to local market preferences. Flexibility will be key for any new propositions seeking relevance across the whole of Europe.

EU consumer credit outstanding and retail volume growth



Source: ECB, Eurostat ¹

Product mix by geographic and balance growth (2018; GDP: 2017)



Source: Central bank statistics, company reports

B | Technology will broaden and deepen the market

Summary

Technology is revolutionising consumption, from media streaming services to app-based delivery and mobility services. Lending is no exception. Technological innovation will fundamentally alter how credit providers find consumers and serve them. The increasingly digital shopping experience opens up marketing channels to consumers who were previously unaware of the available credit financing options. Greater operational efficiency and tech-driven advances in risk scoring reduce the marginal cost to serve and will ultimately lead to a net expansion of the addressable market.

Technology-driven credit distribution

Historically, consumers wanting to make a debt-financed purchase had to run parallel shopping and loan application processes. This led to inefficient outcomes; for example, consumers unaware they would be eligible for a larger loan and hence able to afford a more expensive purchase. As more purchases are made online, there will be new opportunities to link the two experiences.

The B2C e-commerce market has expanded rapidly. The UK is leading the way with 16 per cent of retail sales over the Internet, and while other Western economies, such as Germany (9 per cent), France (8 per cent) and Italy (6 per cent) are still some way behind, the direction of travel is clear. Growth, at 14 per cent CAGR 2013-2018⁴, is likely to continue, as consumers abandon the high street in favour of the convenience of remote e-commerce via mobile and other digital sales channels.

This trend will provide novel and lower-cost avenues to market credit products to consumers. Access to data and advanced real-time analytics are shifting the point of approval from a stand-alone credit application to one embedded in the search and checkout process. Lenders can now tap new consumer segments at minimal marginal cost. However, this will require close co-operation – and most likely revenue-sharing – with marketplaces and merchants. In addition, simplified click-of-a-button PoS borrower acquisition will level the playing field between intermediated debt providers. A slick digital interface will replace physical assets or a pre-existing business relationship as the key competitive advantage. Greater competition for consumers implies lower margins. Those who win will necessarily be the providers with greatest operational efficiency.

Lower costs and more efficient pricing

The price at which credit is provided is in part driven by the costs incurred by the lender. These costs can be broadly defined as related to the following categories: acquisition, funds, operations and risk. We believe that advances in technology will reduce many of these costs and therefore lead to more efficient pricing.

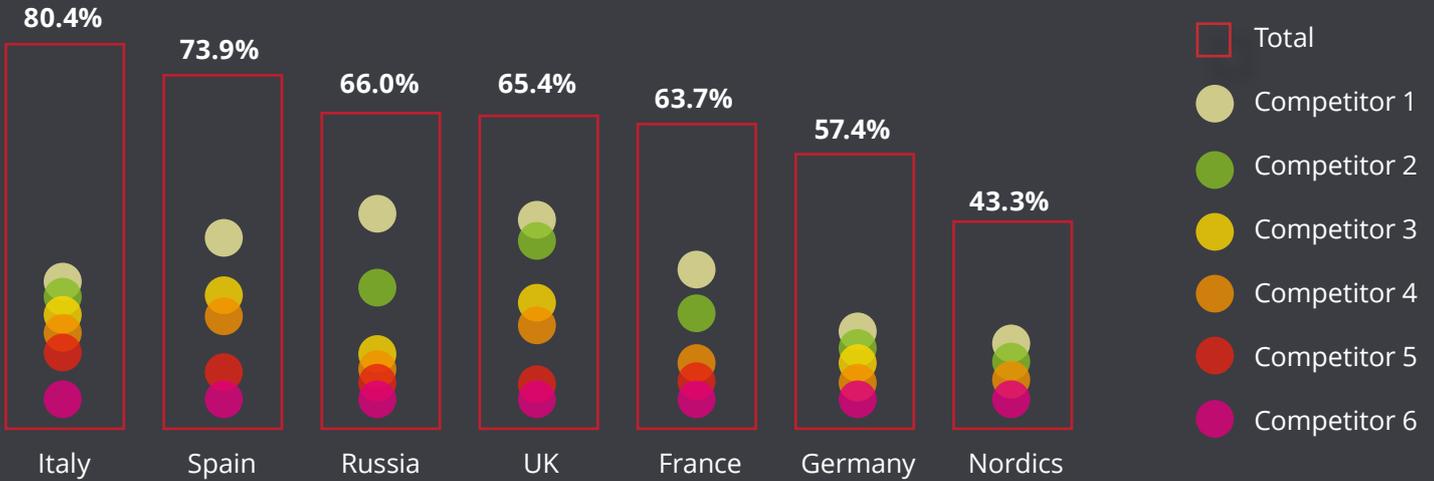
Next generation credit scoring

Among other factors, the price of consumer credit is a reflection of the perceived credit risk that a borrower poses. The correct pricing of a loan is therefore to a large extent dependent on a correct assessment of credit risk. Existing models employed by credit bureaux and banks are, by design, retrospective, static and limited in the number and nature of data points used. Therefore significant segments of the population either overpay for credit (and therefore do not borrowing as much as they might) or are unable to obtain a loan at all.

We expect credit scoring to become a more bespoke process, in which new market entrants focus on specific consumer segments and provide more precise and reliable scores. Across Europe, there will be growing awareness of the factors that determine credit decisions and the actions that affect credit scores. Greater understanding will eventually lead to consumers providing information that supports their request for credit, such as permitting access to social media profiles or past shopping behaviour. All this will reduce information asymmetries. New entrants are likely to begin with riskier customers, gain scale and start to compete for prime consumers, forcing incumbents to adapt their own credit-scoring methodologies or defend their market share by expanding into hitherto underserved segments of the population. Given the lower price sensitivity generally exhibited by these consumers, there may be an opportunity to improve margins without taking on unrewarded additional risk.

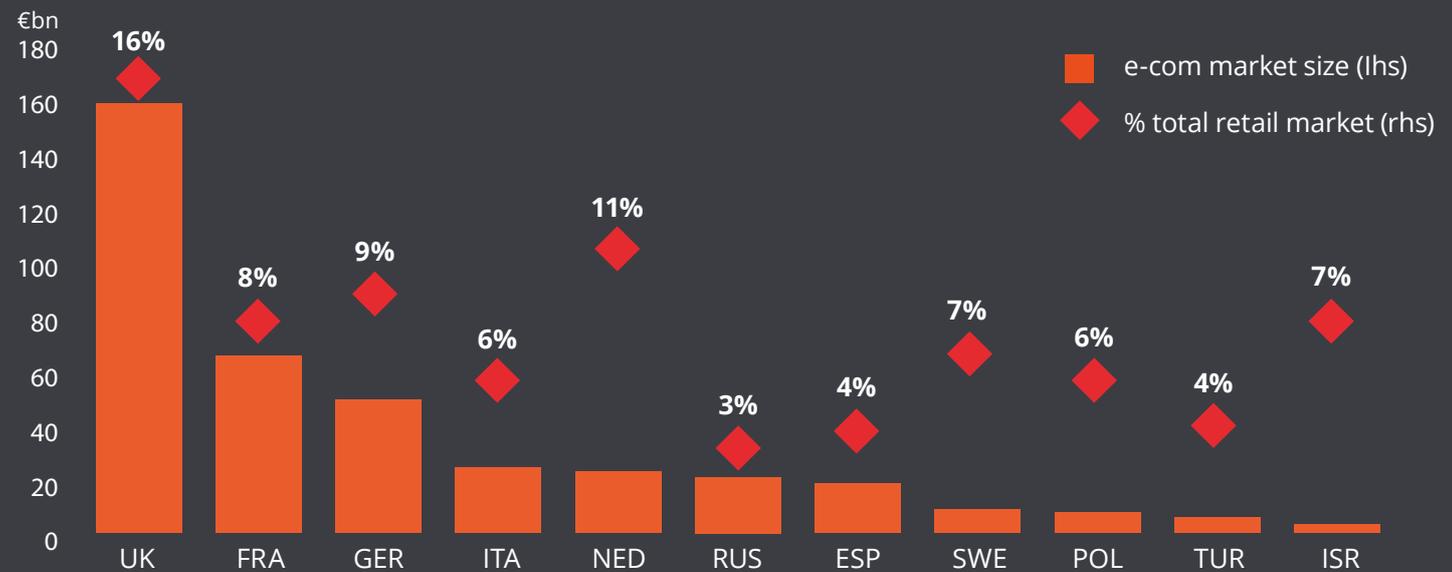
More dynamic risk scoring will also foster product innovation. Aspirational loan offers will become common. Potential borrowers will be guided towards lower interest rates. Credit limits too will become more dynamic and oriented to credit scores and other borrower information. More innovative markets are already experimenting with credit limits based on trailing averages and seasonal adjustments. We expect this concept to be much more widely applied in the future as it is both customer-centric and beneficial for issuers, for whom more dynamic management of credit lines may translate directly into lower capital requirements.

Consumer credit market share of top 6 market providers (2018)



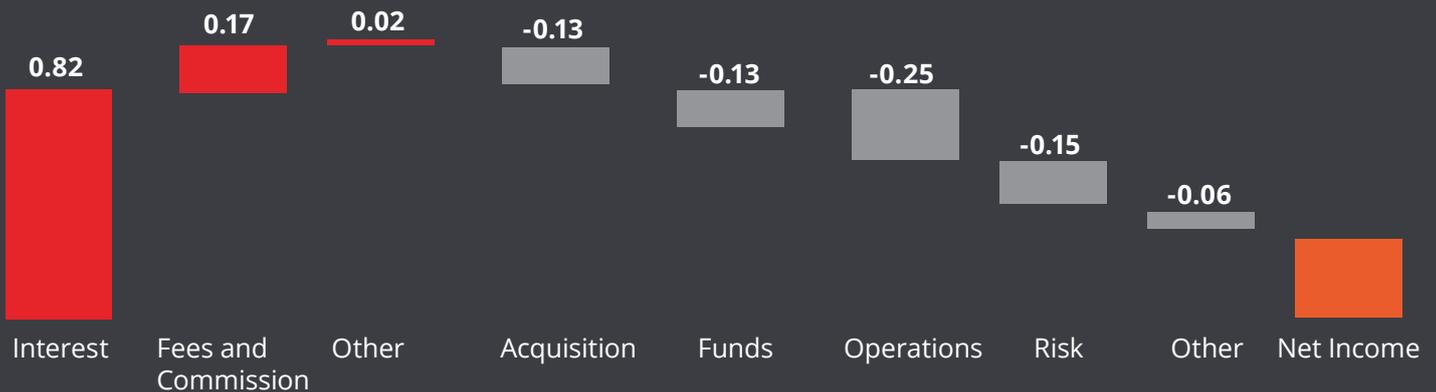
Source: Company accounts, central banks, industry associations

E-commerce market sizes (2017 or latest available)



Source: Deloitte/Tubisad, Einzelhandel, ONS, Morgan Stanley, E-Marketer, Confcommercio

Consumer credit provider cost by driver (2017, %)



Source: Company accounts ⁵

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“Ultimately, people will know their credit scores as well as their weight.”

Since these new credit models will rely on the sharing of personal data beyond income and credit history, independent trusted actors will play a more important role in the scoring process. Only those agents and credit bureaux that can convince consumers they are working for them will be able to collect the necessary data. The practical scope of consumer consent will be limited by strict provisions around data privacy (particularly under GDPR). However, we believe that, given the substantial value at stake and market share to be won, providers will put checks in place to overcome trust barriers, and that the law will reflect social change and eventually strike a balance between consumers' desires for frictionless shopping and privacy.

Operational and acquisition cost leadership

Interviewees across Europe highlighted on-boarding processes as inefficient and ripe for disruption. At present, loans from incumbents may still require branch visits and signatures while statements continue to be sent by mail, and customer service and card management are in many cases still handled on the phone. In the face of much nimbler, digital competition, this model is unsustainable. Expensive-to-run branch networks, which have shrunk by 21 per cent over the past decade, will continue to decline in size and importance as a sales channel for credit. Instead, consumers will rely on digital channels to choose their providers. Paper-based on-boarding processes will be streamlined, shortened and digitised. Improved and more predictive data analysis capabilities and consumer understanding will mean that borrowers that might fall into distress can be spotted before they default or incur costly collection charges. Lenders will profit from lower costs and a larger addressable market. However, the benefits will not be spread evenly. More agile and innovative new entrants are likely to capture a larger share of the expanded market, as they are more focused on understanding and serving specific consumer segments and can attract digitally aware customers with lower prices commensurate with their lower cost to serve. Incumbents have to transform to stay relevant to modern consumers and drive down their costs, but are constrained by the need to continue to serve their current consumers and, due to regulatory requirements, provide for vulnerable ones. Incumbents will therefore face the sensitive choice between differential pricing vs. cross-subsidising expensive-to-serve consumers.

Funding costs

The funding element of the cost stack will not be immune from technology-driven change. The most widely publicised challenge to traditional deposit-funded bank lending has come from marketplace and peer-to-peer (P2P) lending platforms. While their growth has attracted a lot of attention in recent years, many of their business models have not been stress-tested through the entire economic cycle and their volumes remain small in comparison to the overall consumer finance market. For instance, even in the UK, Europe's most developed alternative finance market, P2P consumer lending, accounted for only about 0.7 per cent of total unsecured consumer lending in 2016⁷, although the market is growing much faster than consumer lending as a whole⁸. As Deloitte has previously predicted⁹, we do not foresee that marketplace lending will be a viable alternative to deposit-taking in the near or even medium term, especially outside the UK. Potentially more disruptive are deposits collected easily through digital channels, which will challenge traditional branch-heavy banks. Corporate and investment banks that have historically relied on wholesale market funding have begun to target retail depositors with lean digital propositions. If this model were to gain scale, it could drive up funding costs for incumbents who would not only have to compete harder for deposits but also risk additional competition from investments banks diversifying into consumer lending. AI-driven personal financial management (PFM) tools that find the best offers for customer deposits could help these challenger banks gain traction.

Improvements in risk scoring (schematic)



Traditional Risk Scoring

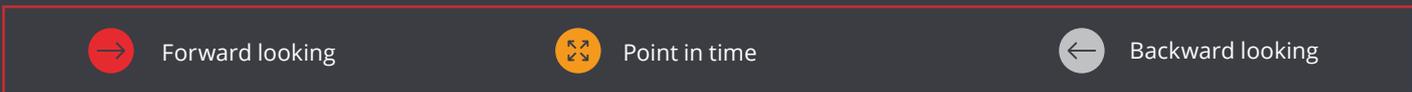
Enhanced Risk Scoring

Holistic Risk Scoring

- Static, backward looking, point-in-time
- Overweight on financial information
- Disadvantaging those with limited credit history

- Better reflection of customers' lifetime journey
- Introduction of forward looking information but no truly innovative predictive modelling

- Based on real-time 360° view of customer
- Premium on customer trust and collaboration
- Data analysis capabilities and access to wide-ranging data assets key
- Suited to "gig economy" lifestyles



Source: Deloitte analysis

C | Incumbents required to refocus and reposition

Summary

Banks still largely control the lending value chain from infrastructure to distribution. Customer inertia and superior data assets have long served as a moat against new entrants and even between incumbent providers, as shown by low switching rates (outside of credit card balance transfers) across Europe¹⁰. As regulators and technological advancements have enabled more data sharing, attackers have begun to break up the value chain and to build a rapport with end customers based on product transparency and ease of use. “Big Tech” and large merchant platforms in particular pose a clear and present danger to any incumbents that cannot leverage their core strengths – customer stickiness and low-cost funding – to develop an at-scale digital offering to remain relevant to the consumer going forward.

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“Can challengers acquire enough customers to compete against legacy banks by the time incumbents have updated?”

Lenders are under pressure to open up to competition

The relatively small number of competitors that maintain the majority of lending balances are typically deposit-taking institutions that have a franchise relationship with many of their consumers and operate an integrated vertical model, which gives them full front-to-back ownership of the credit provisioning process.

This model, built on low-cost funding in the form of retail deposits and face-to-face customer relationships has long enabled incumbents to maintain high margins in consumer lending. More recently, however, former strengths have become weaknesses. Maintaining legacy assets, including an extensive physical presence and what were once relatively sophisticated IT operations, is burdening incumbents with large transformation costs. They struggle to undertake the infrastructure re-platforming necessary to match challengers’ product innovation cycles. Even when the technical obstacles can be overcome, culture often stands in the way. Over decades banks have fostered a culture of compliance and risk aversion that clashes with the agility of the new entrants.

A particular threat for incumbents comes from regulators keen to promote innovation and competition through data sharing initiatives. Combined with enhanced analytics capabilities, open application programming interfaces (APIs) have begun to tilt the playing

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“Banks think first about what their IT can do, not customer needs”

field against incumbent banks, whose end-to-end data on customers used to be a core competitive strength. The sharing of transaction-level data will enable challengers to attract specific consumer segments with more precisely tailored lending propositions. Crucially, this reduces the advantage of holding and owning the infrastructure originally required to collect and structure that data. Rather, competitive advantage is becoming a matter of how effectively the organisation can analyse the data to identify and meet demand for credit. The extent to which this disrupts the market, however, will depend in part on society’s comfort with sharing potentially sensitive financial information and the speed with which the legal framework adapts.

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“Customers get products from different providers but will eventually consolidate in one place – and who will occupy that place?”

Digital aggregators transform customer acquisition and disintermediate the banks

The digitisation of customer journeys has forced banks to cede control over the channels through which customers are acquired, both before and at point-of-sale. The disruption from PoS finance at the check-out is covered in greater detail below, but even discretionary consumer financing (i.e. personal loans that are not tied to a particular merchant or purchase) is increasingly disintermediated. New digital players are inserting themselves at key points in the decision-making process, before, during or after the purchase, helping customers find suitable refinancing or restructuring options for loans. New aggregator services (often in the form of price comparison websites) deliver consumer value through wide-ranging consideration of product options and providers based on factors such as price and likelihood of acceptance, and have successfully established a reputation for neutrality and transparency that has attracted millions of users. The more consumers consider aggregators as their primary port of call the journey to obtaining credit, the more essential it will be on for credit providers to participate and accept these platforms as gatekeepers. These non-traditional channels will continue to evolve as non-bank challengers capitalise on behavioural change and become marketplaces for specific consumer segments in their own right.

Historically, banks have been able to maintain a dominant position in acquisition and retention by having an expansive physical footprint that gave them proximity to the consumer. Now that the main customer interaction is in the digital space, it is becoming easier for challengers to outmanoeuvre incumbents by providing a better consumer experience. In addition, recently introduced Account Information Service Providers (AISPs) will reduce the interaction between banks and consumers further by bundling information about various banking relationships and services in one place, giving consumers a comprehensive view of their personal finances. Ultimately, the biggest threat to incumbents is the combination of account aggregation and consumer credit marketplaces in one service provider that can recommend the optimal mix of lending products. At that point it will become less compelling for consumers to hold their credit balances in the same place as their current accounts and linked savings accounts. Scale incumbents run the risk of being relegated to manufacturers of credit, providing the balance sheets and operating capabilities to credit broker platforms, price comparison websites and AISPs with greater control over the consumer relationship. Regulatory requirements protect their funding benefit but the provision of credit could become increasingly commoditised between providers, leaving them to compete on price and risk management.

Bank Sponsored Digital Wallets

Banks and a number of merchants across Europe have collaborated to develop digital wallets, with those in Scandinavia having the greatest penetration to date.



1. **Swish:** 6.5 million users in Sweden. Built by a consortium of Nordic financial institutions. User penetration: 64%



2. **Vipps:** developed by DNB in Norway with over 3.2 million users. User penetration: 60%



3. **Blik:** 6.1 million users in Poland. Created by Polish Payment Standard. Collaborating with Mastercard to enable global ecommerce payments. User penetration: 16%

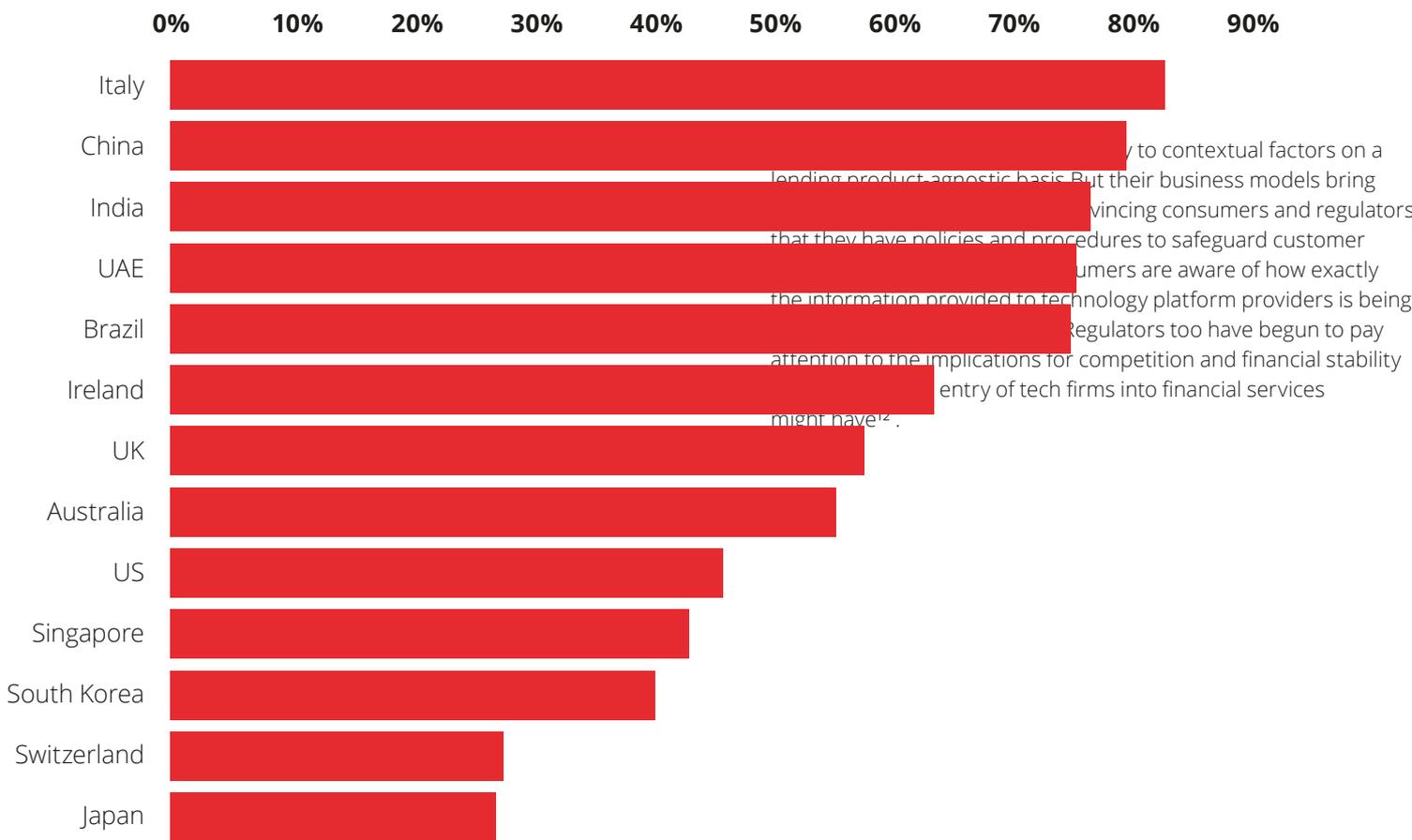


4. **Twint:** set up by Switzerland's six largest banks, allowing for A2A, online payments and physical payments. User penetration: 10%

Big Tech is a key competitive threat

'Big Tech' companies in particular have a number of key advantages that position them well to play a greater role in consumer credit. Their wealth of data and analytics capabilities and comparatively high levels of trust among the key millennial demographic position them exceptionally well to encroach on incumbent lenders. Credit scoring and risk management, especially for thin-file consumers, could benefit significantly from an expansion of the data points taken into account, as well as superior algorithms. Big Tech's 360° view of consumers' online interactions can enable them to tailor

Share of people who trust at least one tech company more than banks, 2018



Source: Bain & Co ¹¹



99 “Banks’ challenge is getting their representation into the check-out screen.”

Digital merchant platforms will play a greater role in provision

Merchants have long been an important channel for credit distribution in the shape of store cards and structured (typically paper-based) PoS finance. Merchants' motivation to drive incremental sales and/or share in the income generated from lending is not changing. However, application for credit can be far slicker in the digital environment. Hence, the role of digital merchant platforms with their critical control over the check-out experience and regular consumer interaction deserves particular attention. Merchants' detailed insights into shopping behaviour through item-level purchase information gives them a potentially transformative advantage in assessing borrower risk and providing rewards and benefits to meet consumer needs. Equally, lenders with access to this additional information can make more accurate risk decisions and potentially extend more credit. In business models where sales conversion takes precedence over interest income, merchants should be able to price credit at least as competitively as banks.

Several factors, however, are likely to constrain merchants' foray into credit provisioning. Lack of scale in customer base and product range will mean that most online merchants will not have the breadth or depth of information required to be more efficient than other credit providers. Many will have limited appetite to diversify into the heavily regulated financial services sector and a strong motivation to protect their brand from being tainted by association with consumer indebtedness.

While it remains to be seen how the relationship between merchants and credit providers will evolve, we believe it is unlikely that merchants will compete outright. Rather we expect them to continue to focus on improving the provision of credit that aligns with their existing capabilities, drawing specifically on the wealth of transactional data they hold on consumers. Digital merchant platforms will monetise their control over the checkout journey by extracting a greater share of revenue from credit providers, who will increasingly rely on others to gain proximity to the consumer at the point of payment.

Incumbents must consider repositioning options

The challenge from new entrants means that incumbents will need to think carefully about their future positioning. The diminishing advantages of historical relationships, proprietary data, and direct channels force them to focus on what is harder for non-banks to replicate.

Their regulatory expertise will become an increasingly important competitive advantage, as challengers grow and become subject to more intense regulatory scrutiny. Although the GFC has severely damaged banks' reputations, they still command strong brand loyalty and are fixtures in any country's corporate landscape. Their systemic importance, deposit insurance coverage and strict prudential regulation mark them out as the natural home for savings and deposits in the eyes of most retail customers. Their sizeable back books and relatively disengaged customer base give them unrivalled access to low-cost funding and scale-driven operating cost advantages.

All in all, we believe that incumbents are in a strong position to manage successfully the transition to a more diverse consumer lending landscape. It is clear that they are far from complacent. Banks realise they are seen as an important source of information about the security and suitability of different payment mechanisms. This gives them an opportunity to educate consumers more effectively about the benefits they enjoy from using credit cards responsibly. Moreover, all incumbents interviewed for this report were actively pursuing digitisation strategies and acutely aware of the customer needs better served by User Experience (UX) specialists from the start-up space. In Russia and CEE, incumbents are already setting the industry standard with regard to digitisation, reducing the room for digital competition to emerge.

D | Future of consumer credit products

Summary

Credit cards have adapted well to the growth of e-commerce, as their use as a widely accepted, secure payment method transitioned seamlessly from offline to online channels. To a large extent, however, their success was due more to familiarity and first mover advantage than to true customer satisfaction. Alternative propositions specifically developed for the online consumer journey, such as digital wallets, are encroaching on card territory.

The credit card will not disappear but will be supplemented by more targeted lending products that address the demands of the digital-first generation of shoppers. In order to maintain a significant role for cards, issuers need to tailor the product better to customer needs, while making the economics of their card portfolios work in the face of tighter regulation and falling balances.

The PoS loan is poised to gain market share as its visibility in digital customer journeys continues to attract new consumers. Ultimately, however, there will be limits to its growth. Market participants uniformly agree that consumers look for outcomes, not for particular payment products or loan structures. Tech-enabled bespoke personal financial management will increasingly support borrowers, optimising their use of credit across a basket of products tailored to the multiple needs of each consumer.

A wholly digital credit market

The B2C e-commerce market has expanded rapidly in the last decade and looks set to continue to do so as payment models extend to mobile payment wallets and apps. Since consumer credit is primarily driven by consumption, this trend means that prime positioning in the e-commerce space is essential for future success.

While cards maintain their dominant position for e-commerce payments, this is primarily due to customer inertia and their ubiquity as a secure payments device rather than convenience as an e-commerce-specific payment mechanism or the associated credit they offer. Online PoS finance solutions, on the other hand, have been designed with the online consumer in mind and often provide superior user experiences.

Growth in PoS finance, especially among younger generations, is unlikely to be reversed. Instead credit card issuers are facing an additional threat from the loss of interchange income as consumers move away from revolving balances within many credit card portfolios. Issuers must therefore deal with the challenge to their business models and seek to maintain their relevance to the modern-day digital consumer.

Preferred online payment methods (2016 or latest available)

	Payment methods (primary)	UK	DE	IT	NL	PL	SWE	FR	RU	ES
Cards	Debit	43%	1%	23%	11%	33%	25%	28%	37%	31%
	Credit	11%	14%	13%	2%	7%	9%	17%	5%	24%
Transfer	Invoice		21%		4%		25%			
	SEPA		20%		14%					
	A2A	7%	16%	12%	60%	45%	14%	14%		9%
E-wallets	Paypal	19%	20%	17%	5%	2%	7%	18%	5%	20%
	Other	2%	3%	5%				4%	53%	5%
Other	Cash	4%	5%	14%				6%		11%
	Other	14%		16%	4%	13%	20%	13%		

Source: Adyen, JP Morgan, central banks, Deloitte estimate ¹³

The credit card is under pressure

Credit and charge cards are the main form of credit in the digital space. This is primarily due to their convenience as a payments device, international acceptance, payment protection in case of merchant fraud or default and consumer familiarity built over decades. Consumers are also incentivised by well-established loyalty programmes that deliver tangible benefits to card users. The ability to roll over credit card debt flexibly is also valuable for customers, particularly those with unpredictable incomes, such as the self-employed, who may be unable to commit to fixed instalment repayments.

Other forms of consumer credit conspicuously lack most or even all of these features. Cards stand out as the most versatile lending product.

However, regulators and market participants themselves have expressed concern that a corollary of this versatility is increased complexity, lack of transparency on what it will take to pay down the debt and a risk of persistent debt. It is reported that almost a third of consumers in the UK do not know what interest rate they are paying on their revolving balance, let alone how it is calculated. Similarly, very few customers are aware of the various ancillary benefits that their cards provide, such as concierge or insurance services.

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“Cards are hugely valuable if used correctly.”

Partly as a result of this complexity, there is growing public aversion to credit cards, first and foremost in continental Europe but increasingly also in the UK, the largest credit card market in Europe, with over £70bn in balances. Interviewees agreed that this “toxic reputation” contributes to the challenges facing credit cards.

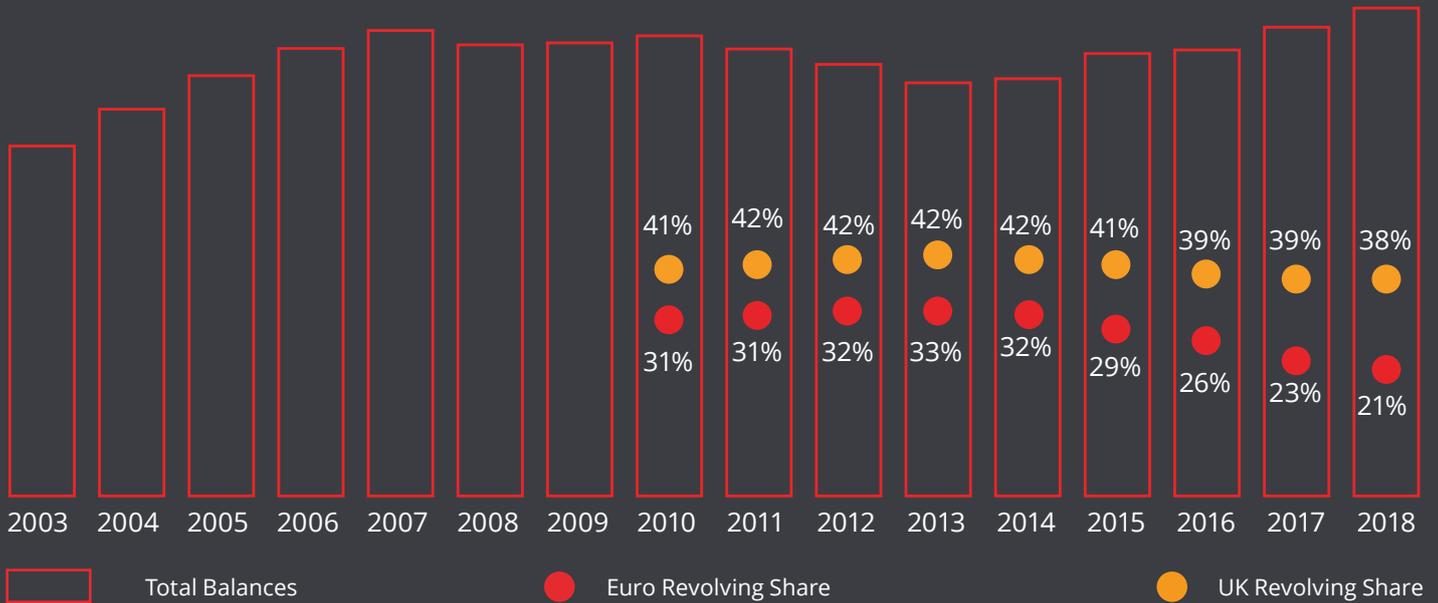
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“Returns are down for the credit card industry from super normal profits in recent years.”

The market, however, is highly profitable overall, thanks mainly to strong interest income, which accounts for 70-80 per cent of revenue. However, consumers are carrying fewer interest-bearing balances and the share of 0 per cent interest balance transfers has steadily risen, while competition has intensified. When funding costs normalise, net interest margins will come under additional pressure, since regulators have signalled their opposition to any significant increases in credit card APRs. For a long time, transactors could be profitably served without cross-subsidisation from revolvers thanks to interchange paid by merchants to issuers. Caps on interchange at 30bps for domestic and intra-EU credit transactions and the prospect of further changes as part of the upcoming review of the EU Interchange Fee Regulation create a serious challenge to the viability of the transactor customer segment. Conduct regulators have recently taken a tougher line on cross-subsidisation in the interests of fair customer treatment but, even if no formal action is taken, issuers will on current trends reach a tipping point at which the proportion of revolvers is no longer sufficient to support transactors.

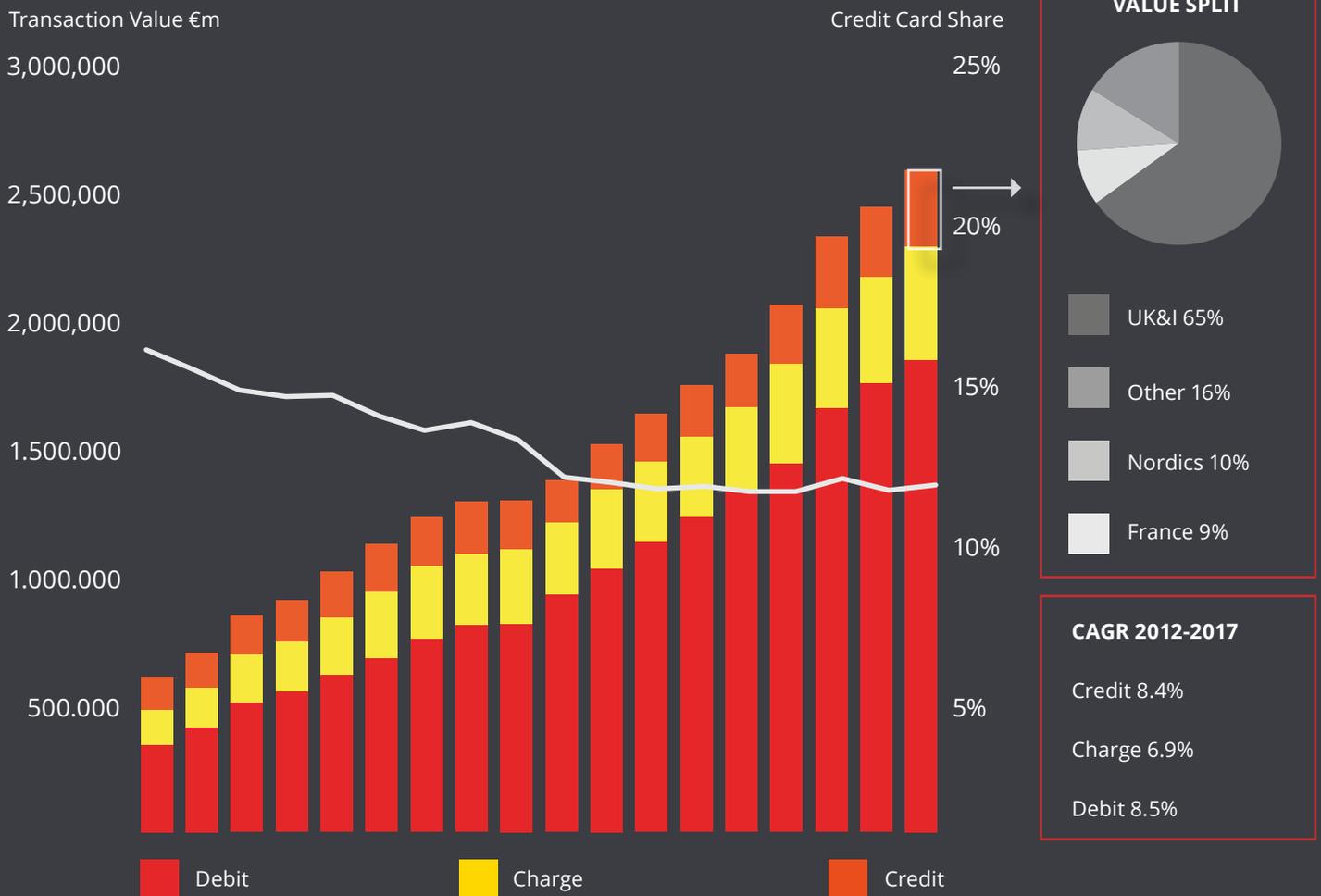
One crucial driver of the shift away from revolvers is the re-emergence of PoS finance as a competitive threat to credit card usage at the checkout. Incumbents should consider which

Consumer credit amounts outstanding



Source: ECB, Bank of England, Deloitte Analysis

Total value of transactions by card type in EU28



Source: ECB, Deloitte analysis

The competitive challenge of PoS finance

The digitisation of the checkout has given greater prominence to new “Buy Now, Pay Later” (BNPL) financing options that were less visible in an offline environment. This has drawn in new customer segments, notably millennial shoppers who are said to consider the greater perceived level of control a deciding factor. Today’s offerings typically give consumers clarity on exactly how much they need to pay at each instalment; an automated repayment schedule, reducing the risk of persistent debt; and choice on the desired duration and number of instalments.

Moreover, greater transparency is coupled with a convenient user experience. PoS lenders do not rely purely on conventional credit checks but tend to thin-file customers. Although the overlay of card payments with online and mobile wallets is an improvement, 16-digit PAN entry into unfamiliar merchant sites creates more friction than some consumers are willing to tolerate. In some markets, such as Germany, domestic schemes do not allow cards to be used online at all, forcing adoption of alternative ways to pay.

A further reason for the success of PoS finance has been its application to specific segments of the retail market. While outside the scope of this report, original equipment manufacturer (OEM)-provided auto finance has boomed in recent years, as traditional lenders have held back from supplying credit into the market and OEMs sacrificed margins for control of the end-to-end product lifecycle. We see parallel opportunities for PoS finance solutions in other segments.

However, the latest BNPL offerings are yet to be tested in a less benign credit environment, which could materially increase the volume of payments in arrears and non-payments. It is questionable to what extent providers fully understand the risk quality of their receivables, given that some forgo credit checks in order to facilitate the checkout process.

As PoS finance grows, providers will face greater regulatory scrutiny in terms of transparency and customer treatment, which may force them to add friction to the process. And while BNPL has gained traction in the fashion retail market, this success has not yet spread to other retail categories with higher average ticket values and less frequent purchases. We see a ceiling to the addressable market for BNPL relative to credit or charge cards, which are agnostic to the type of spend on their pre-approved credit lines, especially as issuers are likely to take concerted action to raise the profile of the benefits offered by their credit card propositions.

PoS Emerging Players

PoS specialists have grown rapidly, particularly in the US and Australia. With some generating revenue from interest income (e.g. Affirm, Klarna) others opt for a model that merchant funded. Examples include:



Affirm, allows for purchases up to \$15,000 (USD) on instalment plans up to twelve months at an interest rate similar to credit cards. Transaction volume doubled to \$2bn in 2018.



Klarna, offers a range of short term repayment options and involves a soft credit check.



Laybuy, is a buy now pay later platform that offers consumers a limit up to £600 based on a hard credit check.



Afterpay, generates income from merchant fees, no credit checks involved, volume up 147% YoY to \$2.3bn (AUD).

Credit cards: Fit for the future

In response to the threats to credit card profitability, issuers need to develop a comprehensive credit card strategy.

Firstly, they should consider their options to turn transactors into a self-sustaining enterprise. This is most pressing in the UK where falling interest income is going to impact profitability significantly. But even in continental Europe, where charge cards are more popular, the capping of interchange means costs must be cut and new revenue streams tapped. Pre-approved credit lines for transactors are a capital-intensive service that is becoming difficult to justify. In the context of next generation risk-scoring (see above), we believe credit limits will become more dynamic based on better customer understanding. If an outright reduction of credit limits is not viable, we are convinced issuers will begin to incentivise customers to accept lower limits in return for alternative benefits. The same advances in data analysis that underlie better capital management will also enable issuers to create differentiated propositions tailored to customers' requirements and price sensitivity, and to strip away rarely used credit cards features. Instead of the issuer funding ancillary benefits, they will make their propositions more modular and begin offering optional components as chargeable add-ons. Unbundling is generally viewed favourably by regulators, although opt in/opt out models do not eliminate conduct risk but rather shift it from cross-subsidisation to potential mis-selling. Any benefits a customer receives from opting in should be tested periodically and customer agreement sought again. More broadly, many issuers acknowledge they are not as effective as they would like at harvesting transaction data and capitalising on the relationship with the cardholder to sell other financial products, not least because of data privacy constraints. Russia stands out as one market where privacy concerns feature less prominently and banks are even diversifying into non-financial services in order to gather additional customer data. Another supplementary revenue source are card fees, e.g. for foreign exchange or cash withdrawals, although low-fee challengers will make it difficult for incumbents to replace interest income with fees.

Secondly, to sustain the long-term profitability of their credit card business, issuers must also consider how to win borrowers back from PoS finance. Promisingly many issuers have begun to incorporate instalment optionality into their card offerings.

In markets such as Czech Republic, Italy and Israel, customers can spend on a credit card and use account-based controls via an app to split the outstanding balance or an individual transaction into instalments, setting the desired terms for repayment of the debt. Issuers need to understand and manage their portfolios differently, as instalment finance consumes available credit lines, and revolving interest revenues may be cannibalised, but a number of issuers have made a clear and compelling business case for this service. Evidence suggests¹⁵ that such a feature could not only entice PoS customers back to credit cards but also convince some transactors to take out credit.

Thirdly, issuers need to address credit cards' reputational problems. The issuers we spoke to recognise that it is in their strategic interest to educate consumers better about the mechanics and benefits of credit cards and help them to make financially sensible credit decisions in order to improve trust.

In the long run, both PoS finance and credit cards will co-exist, benefiting consumers, since they meet different needs and are suitable for different circumstances. Given persistently low financial literacy, however, it is unlikely consumers will be able to pick the optimal mix of lending products. Instead, AI-enabled financial advice will step into the breach.

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“Customers want outcomes, not debt.”

The future: AI-driven product agnosticism

Open Banking and the rise of AISP are allowing new market entrants, and the more digitally agile incumbents, to consolidate all the financial information about an individual in one place. Predictive analytics, optimised via machine learning, will provide powerful insights into how to manage finances better. The actions required to exploit these insights will be automated within customer-defined parameters. While this type of service is nascent, it has the potential to become the future platform through which individuals manage all their finances. We expect PFM platforms, as they become more sophisticated, to act on behalf of the individual to find the most suitable form and amount of credit. This will be enabled by analysis of transactional data and behavioural preferences, accurately identifying the lowest-cost means of meeting consumption and consolidation needs.

Banks are building their own AISP capabilities, recognising their future importance to the personal banking market in general. They have the resources to build a compelling platform and to make it a natural adjunct to their online and mobile banking services but we believe non-bank participants have an important structural advantage: independence. PFM platforms rely on building a level of trust to act on behalf of the individual to connect them with the best-suited credit proposition. It will be much more difficult for issuers of credit than for non-banks to be seen as truly unbiased, since directing customers away from their own products would be counter-intuitive.

In their most sophisticated form, PFM platforms will fully intermediate the provision of credit to the point where the concept of a specific product proposition, bundled with a payment solution, becomes anachronistic. The future will see a product-agnostic line of credit that can be infinitely tailored to balance the length of repayment, flexibility, cost and other individual customer preferences. In this future credit market, the position of the credit issuer becomes much more price-competitive, as customer experience and marketing are provided by an AI tool that opts for what is genuinely best for the customer. The issuer is increasingly relegated to the position of a holder of balances and risk. Of course, price is not the only consideration. Issuers can differentiate themselves by inserting as much flexibility as possible into their products so that they meet more types of cash-flow smoothing requirements. At a minimum, issuers that offer simpler integration will gain a significant advantage through the transition period as the preferred partner to the PFMs. The best positioned issuer will perfectly balance price with flexibility and could establish a significant and hard to displace position across a substantial, pan-European, market.

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“Credit will become an afterthought to payment.”





A black and white photograph of three men in a modern office setting. The man in the center is wearing a dark suit and a striped tie, looking down at a document on a table. To his left, another man is partially visible, smiling. To his right, a third man is also partially visible, looking towards the center. The background shows a large window with blinds. A red semi-transparent banner is overlaid at the bottom of the image, containing white text.

4 | So, who wins the future of credit?



4 | So, who wins the future of credit?

Consumers will win...

Given that we expect consumer spending to rise, it is very likely that there will be corresponding growth in credit demand. Consumers will find themselves in the fortunate position that greater demand is unlikely to lead to higher prices, as tech-enabled improvements in efficiency will allow lenders not to raise prices significantly. Consumers in more precarious financial circumstances should profit from improvements in risk scoring and reduced information asymmetries – although this may come at the expense of data privacy – a concern especially in a number of continental European countries. Consumers at the other end of the financial spectrum may notice a reduction in credit card benefits as the trend towards micro-segmentation, as well as regulation, reduce cross-subsidisation.

Overall, however, the argument that consumers will enjoy a net gain looks strong. They will profit from greater choice and the information and tools to manage the increased complexity effectively. This will be thanks largely to open data sharing and the possibilities it opens for information providers, such as account aggregators and price comparison services. The channels through which consumers communicate with their providers will adapt to most people's daily lives, in which mobile and digital have replaced many face-to-face interactions. These developments will be part of a broader wave of innovation that makes consumers' relationship with personal finances simpler, reducing their anxiety about financial planning. In a world where a smooth user experience and frictionless customer journeys are key differentiators, consumers capture an even larger share of the value.

This will provoke significant change on the credit provider side.

...providers can win

Those actors who consumers trust to help them prosper in the digital age of consumer credit are likely to accrue significant returns. To gain that trust, customer centricity will be key. Banks have long had the privilege of disengaged customers that accepted a dismal user experience as the norm. The relentless focus on personalisation and responsiveness to consumer needs that new entrants have brought is forcing banks to re-invent their business models.

Incumbents that successfully build a digital offering (either of their own or through acquisition) and leverage their low-cost funding should be able to maintain their current vertical business models in the medium term.

Certain elements may be taken on by specialists, but the combination of credit manufacturing and distribution in the same hands seems likely to be a viable model for some time. Ultimately, we believe that incumbents will turn to an ecosystem model where they co-opt segment specialists and focus on network orchestration. Incumbents that fail to transform into digital champions will drift away from the customer. The larger ones will become utilities and provide commoditised lending products, competing primarily on price; the smaller ones will inevitably exit the consumer lending business.

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“Fintechs have professionalised to become true suppliers or competitors to incumbents.”

Given the diverse challengers looking to attack at various points of the lending value chain, the range of possible outcomes is broad. The key question is scale. We expect challenger banks that achieve customer scale to follow (or lead) the digitally savvy incumbents towards a network model. Those that remain subscale have the option to consolidate to achieve a more sustainable size or focus on a niche sub-segment that ultimately feeds into a larger competitor's ecosystem. Current platforms, notably price comparison websites but also challenger banks that leverage their customer base rather than invest in core banking products, could pursue the pure platform model and take on a brokerage role for consumer credit, based on transparency and neutrality. The final question on everyone's mind is how Big Tech will expand into consumer lending. If – and that if is considerable – they decide to wade deep into regulated territory and take on credit manufacturing, their existing businesses immediately provide them with formidable advantages. If the compliance burden proves too great, however, they will pursue a pure platform model and try to extract value from their customer network and proprietary data through targeted co-operation with consumer lenders.

It is clear to us that everything is to play for. In the end, only the complacent will lose.





5 | Conclusion



5 | Conclusion

The future of the consumer credit market in Europe is exciting. It will be attractive for many participants for years to come.

We think that European consumers will benefit from better propositions, offering more choice, lower prices and an increased ability to tailor credit to meet personal needs and preferences.

Credit markets are going to change

- Stable, predictable growth rate in outstandings with faster growth in countries that are well protected from economic and credit cycles
- Enhanced growth in particular consumer segments such as credit builders
- New participants in the market, thanks to improved access, comfort with credit, or participation enabled by improved risk processes and scoring
- Improved efficiency in provision due to competitive pressure and technological enablement
- Continued success for the established players within the existing ecosystem
- Consumer preference-led decision-making
- Fragmented value stack consolidating around participant types, driven by comparative efficiency.

We see a bright future for many participants in the industry provided they follow through with their transitions.

Strategies that enable consumers to access world-class products in a frictionless way are going to win, and these solutions will be digital.

Providers of credit will need to change more

- Growth: the market for credit will grow but the opportunity to extract revenue will decline; value will be more closely linked to competitive advantage and proximity to consumers
- Efficiency: the market is becoming more efficient due to a range of trends; a sustained commitment to efficiency will be needed to win and remain relevant
- Digital: everything is going digital, quicker than you want it to; being prepared will enable you to win the future
- Personalisation: technology, analytics, data and changing consumer preferences are going to enable personal credit from providers that put consumers first
- Partnership: market participants that operate with trusted peers and leverage the strength of other organisations will gain advantage.

Overall, banks and incumbents are best placed to direct the future and win. After all, they already have the customers, making incumbency the best preparation for the future.

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“Today we are at the beginning of a new phase of consumer credit; consumer expectations, coupled with changes in technology will start a new era.”





6 | Glossary



6 | Glossary

CAGR 2013-2018

£
 €
 AISP
 API
 B2C
 bn
 BNPL
 CAGR
 CC
 FRA
 FX
 GDPR
 GER
 GFC
 ITA
 MF
 OD
 OEM
 P2P
 PFM
 POL
 PoS
 PSD2
 RUS
 SPA
 SWE
 UK
 UPL
 UX

GDP per Capita (€'000)

British pound sterling
 Euro
 Account Information Service Provider
 Application Programming Interface
 Business-to-Consumer
 Billion
 Buy Now, Pay Later
 Compound Annual Growth Rate
 Credit Card
 France
 Foreign Exchange
 General Data Protection Regulation
 Germany
 Global Financial Crisis
 Italy
 Motor Finance
 Overdraft
 Original Equipment Manufacturer
 Peer-to-peer
 Personal Finance Management
 Poland
 Point of Sale
 Payment Services Directive 2
 Russia
 Spain
 Sweden
 United Kingdom
 Unsecured Personal Loan
 User Experience





7 | Authors



7 | Authors

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8 | Thanks



8 | Thanks

We interviewed more than fifteen senior market participants, most of whom requested anonymity, with a focus on credit-providing banks. These included Head of Consumer Payments, Head of Group Retail Strategy and Head of Unsecured Lending at some of the largest banks in the major European markets. In addition to the banks, we spoke to investors and participants in Fintech and Big Tech, and senior business leaders across Mastercard's and Deloitte's European networks. We thank all our interviewees for their generous and candid contributions.

¹ ECB; Eurostat

² FCA (2018)

³ ECB (2017), p. 82

⁴ Ecommerce News

⁵ Tesco, Capital One, New Day, Virgin Money 2017 company reports

⁶ EBF (2018)

⁷ CCAF (2018)

⁸ AltFi (2018)

⁹ Deloitte: "Marketplace lending | A temporary phenomenon?" (2016)

¹⁰ Bristol University (2016)

¹¹ Bain & Co. (2018)

¹² FSB (2019)

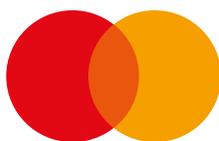
¹³ Adyen; JP Morgan; central banks; Deloitte estimate

¹⁴ Arrow Global (2018)

¹⁵ Amex (2018), p. 50

¹⁶ OECD (2017)

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