Master Thesis

# A Challenger Bank's Entry Strategy Into a New Market

*A Case Study of the Danish Challenger Bank Lunar and it's Potential Entry into the Icelandic Financial Market*



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# Abstract

The rise of digital-native challenger banks causes a global disruption as they traverse borders and disrupt the status quo in most mature and emerging markets. Challenger banks have different business models than traditional banks as they have adopted digital platform strategy models where they have become more of a financial marketplace for customers. Digital platforms face competitive dynamics different from established companies. These include high multi-homing costs and significant reductions in transaction costs. This global disruption has yet to reach Iceland, where there are no challenger banks in the Icelandic infrastructure, which offers an opportunity for a new entrant. This paper explores the entry strategy of a Danish challenger bank, Lunar, into the Icelandic financial market. The research is a case study and action research with an in-depth analysis of the Icelandic financial market and Lunar supported by interviews with nine specialists from the Icelandic financial market.

This thesis concludes that significant first-mover advantages can be built in the Icelandic market, emphasizing the value of Lunar aiming to be a first-mover and acquire a critical mass of users. The research recognizes the significance of Lunar integrating the IT infrastructure in Iceland, concluding that it is necessary to become competitive in the market. Lunar's focus should be on differentiating themselves and becoming a financial marketplace in Iceland, connecting customers to the best available financial services. They should launch with their most standard products and anchor financial literacy products with the personal finance tool and goal setting. Their point of difference should be their socially conscious products, investments, and subscription manager.

The authors recommend that researchers continue investigating the topic of platform entry strategies for challenger banks into a new market.



Keywords: Digital Platforms, Challenger Banks, Neobanks, FinTech, Entry Strategy

# Acknowledgement

Writing this Master's thesis has been both challenging and learnful at the same time. The process has helped us build on the foundation we have gotten throughout our studies and we have gained a valuable knowledge of digital platforms and especially in the field of financial services.

This thesis would not have been possible without the help of a few people. We would like to express our deep gratitude to everyone who has supported us in this process. Firstly, we would like to thank our supervisor Jan Damsgaard, Professor at the Department of Digitalization at CBS, who shares our deep interest in this topic and has with his experience, professional insights and guidance been of great help throughout the whole process. For his immense support and encouraging words, it was a great privilege and honor to work and study under his guidance. We are certain that this would not have been achieved without his help.

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Thirdly, to the Icelandic specialists that took part in our research. We thank them for taking time out of their busy schedules to do the interviews with us about our shared interest in the Icelandic financial market. We truly enjoyed talking to each and everyone of them, and would like to thank them for being so open and easy to talk to.

Lastly, a heartfelt appreciation is extended to our families and friends, who we are indebted to for their immeasurable support throughout our graduate studies at Copenhagen Business School.

We hope you will enjoy reading this thesis,
Thank you!

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# Introduction

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## 1. Introduction

*This introduction provides the context of the thesis. First, it presents the background of the financial technology sector and challenger banks. Next, the motivation of the research and the research question. Lastly, the research limitations.*

## 1.1 Digitalization of the Financial Sector - the Emergence of Digital Challenger Banks

*"Banking is necessary. Banks are not". - Bill Gates*

In a fast-moving world, technology is a crucial driver in all aspects of our lives. Information technology is widely accepted, where working and handling activities electronically is often our preferred way of doing things (Pikkarainen et al., 2004). New technology and regulations have revolutionized many industries, and the financial sector is no exception. New entrants focusing on financial technology or "Fintech" have been emerging at almost every level of the financial services industry and are fundamentally introducing new ideas, new channels, new processes, and new expectations around the speed, efficiency, cost, accessibility, and convenience of financial services (Accenture Fintech Report, 2015). Challenger banks are one of those fintech companies. They are digital banks that can bypass the costly brick and mortar branches with innovative apps that provide the user with the whole banking experience from the palm of their hands. This emergence of challenger banks comes at a crucial time where predictions assume mobile banking to overtake branch visits by 2021, and the COVID-19 pandemic has accelerated a shift towards digital banking among banking customers (Moden & Neufeld, 2020). Challenger banks can adapt and develop new offerings quicker and cheaper than their traditional banking rivals, who have large overarching business models. Key actors in the challenger banking sector in Europe are Starling Bank, Revolut and Monzo from the UK, and N26 from Germany (Starling Bank, 2021; Monzo, 2021; N26, 2021). The rise in popularity of digital challengers has also piqued the interest of tech industry giants like Apple and Google. Apple launched its banking service named "Apple Card" in 2019 (Apple, n.d.).

Challenger banks have different business models than traditional banks as they have adopted digital platform strategy models where they have become more of a financial marketplace for customers. Digital platforms are a technology that facilitates the exchange between different types of actors or actor groups, which could otherwise not interact with each other (Gawer, 2014). Challenger banks collaborate with other fintech companies to provide customers with the whole banking experience and facilitate the exchange between them, defining them as digital platforms.

The existing literature on entry strategies of challenger banks is almost nonexistent. There has been little research in general about entry strategies of digital platforms in the early stages when they are entering the market (Kim, 2018). Most have focused on more visible digital platform companies such as social media platforms, mobile payment platforms, sharing economy platforms, etc. Therefore, this research could contribute to an improved understanding of this still-evolving phenomenon of banks adopting digital platform business models and their entry strategies.

## 1.2 Motivation

Due to the financial crisis in 2008, the economic landscape in Iceland changed drastically. The banks became government-owned, and distrust towards the banks and the whole financial industry emerged (Rúnarsson et al., 2018). There are currently three banks in Iceland that dominate the market, with little to no outside competition. The general public's attitude towards the banks is quite negative, where high-interest rates and expensive services are one of the main complaints (Rúnarsson et al., 2018). The three banks all provide almost identical products and services, so there is little motivation for consumers to switch.

Furthermore, many Icelanders struggle with their finances and financial literacy. There has been a significant rise in applications for financial assistance for young adults (Umboðsmaður skuldara, 2020). That could indicate an opportunity for a new entrant to challenge the three incumbent banks and offer more diverse product offerings.

Lunar is a Danish challenger bank that focuses on helping its customers make the most out of their money with a modern innovative banking app. Lunar differentiates from other challenger banks because they have always had a regional focus on the Nordics. In 2018 and 2019, Lunar became a Scandinavian banking app with offices in Stockholm and Oslo, making it possible for Danes, Swedes, and Norwegians to manage their finances. Launching in Iceland would be a natural next development of their business ventures.

As a new bank built from scratch, they are not tied down by legacy. They use technology to react swiftly to their customer's needs and expectations. Therefore, Lunar could be

the first challenger bank in the Icelandic financial market. This research's objective is to develop an entry strategy for Lunar into the Icelandic financial market.

## 1.3 Research Question

After establishing the relevant introduction of the topic and motivation of the research, the research question is as follows:

***If the digital platform Lunar were to launch in Iceland, what entry strategy should they implement to succeed in the market as the first digital challenger bank?***

1. **Sub-Question:** *What are the most important macro environmental factors affecting the financial market in Iceland, and how does that impact Lunar's entry strategy?*

2. **Sub-Question:** *What should be Lunar's minimum viable product according to market opportunities?*

3. ***Sub-Question:*** *How is the competitive landscape in terms of native and non-native players in the Icelandic financial market, and what competitive actions should Lunar take for each player?*

## 1.4 Delimitation

This research aims to develop an entry strategy for Lunar in the Icelandic financial market with a case study and action research. The research question indicates that a qualitative research approach is suitable where it asks what and how(Cooper et al., 2006). Non-numerical data is needed to understand what entry strategy Lunar should implement. Additionally, the sub-questions ask how or what, which also will not be answered by numerical data. Therefore a qualitative research method is most suitable for this research.

When developing a successful entry strategy, it is useful to understand the consumer perception of the product and services. Launching a product or service that consumers do not want or need could result in the failure of the entire launch. Although acknowledging the significance of this component of the entry strategy, the consumer perspective is not included in this research, as that could be a thesis research on its own.

Further, as the analysis later reveals, large tech firms such as Amazon, Google, and Facebook, can potentially be a competitor for Lunar in Iceland and can become disruptors of the financial services industry in the future. Despite being aware of this possibility, the authors have chosen not to include that in-depth in the research, but it is touched upon in the findings. The authors argue that extensive research and analysis of such firms' business models and services are required, or else there would be a risk of providing flawed and wrong recommendations.

## 1.5 Thesis Structure

Figure 1 below illustrates the flow and structure of the thesis

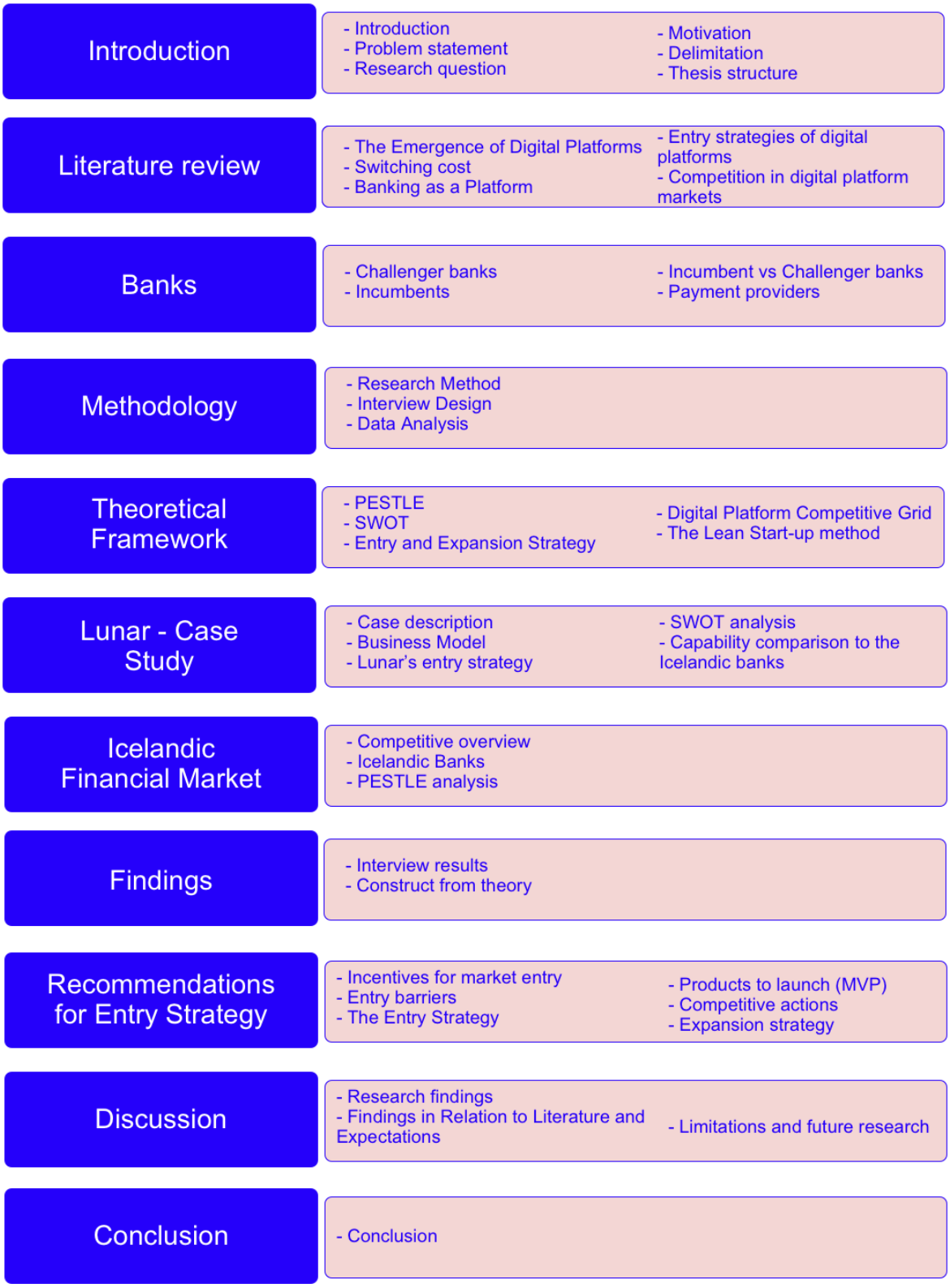


*Figure 1 - Thesis Structure (Figure is a production of thesis authors)*

# 2

# Literature Review

Contents



## 2. Literature review

*The study is primarily associated with three streams in the existing literature (1) digital platforms, (2) platform entry strategies, and (3) platform competition. This chapter provides an overview of previous research in the field of this paper.*

## 2.1 The Emergence of Digital Platforms

In the last few decades, we have seen the emergence of digital platform business models that move away from the conventional vertical integration of companies providing a flatter, more transparent, and innovation-centric approach to value creation (Gawer, 2009). Digital platform is a digital innovation that facilitates the exchange between different types of actors or actor groups, which could otherwise not interact with each other (Gawer, 2014). This kind of business model generates value-creating interactions between consumers and external producers. More importantly, they can produce multi-sided markets that enable direct interactions between two, or more, distinct types of affiliated customers (Hagiu et al., 2011). Digital platform leaders aim to deliver two key functions. First, bringing together disparate resources and know-how from different firms, and second, matching and connecting users with producers of products. Companies like Apple, Google, Airbnb, Facebook, and VISA use these two fundamental principles to build successful digital platforms and take advantage of an entire ecosystem of suppliers and users (Zachariadis & Ozcan, 2017).

Given the above, there are two economic theories in platform business models worth exploring in more detail as they are the main reason that platforms thrive over traditional business strategies. These are the transaction cost theory and network effects. Digital platforms contribute to significant reductions in transaction costs. Transaction costs include the distribution, search, contraction, and monitoring costs that organizations face while making choices about their production process (Eisenmann et al., 2006). For example, aggregation platforms such as TripAdvisor and Expedia gather and combine travel information from multiple sources into one platform, reducing the cost of searching for information and using intermediary agents (Tiwana et al., 2010). In that context, the key value proposition of the platform business model is not about selling products but "selling reductions in the transaction costs" (Munger, 2015). While this is a key benefit of a platform business model, there is one more element to the platform strategy value-proposition that makes it even more powerful: the network effects. Network externalities or network effects describe the impact the number of network adopters has on the utility of each user on a platform (Shapiro & Varian, 1999). In other words, the marginal benefit that platform users gain increases as the number of users on the platform increases. The classic example is the telephone

network: The more people have telephones, the more valuable telephone access becomes to any individual telephone user (Katz & Shapiro, 1985). Network effects can be found in almost any platform and can make a real difference in users' value. Because they rely on network effects, those markets are also called network markets or platform markets (Luchetta, 2014). The number of distinct user groups allowed on a platform defines the number of sides a platform accommodates (Ruutu et al., 2017). Network effects can be either direct or indirect. Direct network effects appear if an additional user creates value for a user on the same side of the platform. Otherwise, if a user joins one side, it creates value for users on another side, and indirect network effects occur. If the network effects are beneficial to the user group, positive network effects ensue; otherwise, negative network effects arise. Indirect network effects imply the need for an underlying connection or interdependency between two or more user groups (Gawer, 2014). Network effects are existential to the research into platform markets (Rysman, 2009). It is essential to understand the nature of network effects because these effects on a specific platform influence the competition between platforms.

### 2.1.1. Multihoming

One aspect that companies that adopt platform business models must be wary of is homing costs. Homing costs are related to the adoption, operation and other expenses incurred due to platform affiliation (Armstrong, 2006). A low homing cost suggests that the platform technology is easy to use and adopt and implies that users will multi-home. Multihoming occurs when users engage in similar interactions on more than one platform (Parker et al., 2016). An excellent example of this is the payment card. Most people hold several credit and debit cards, they are all used in the same way, but each one brings a different value to the user in terms of charges, loyalty points, and other benefits. The homing cost is high when users are likely to stick to only one or a limited number of platforms. That often occurs when the switching cost is high due to lock-in effects (Parker et al., 2016). Most platform businesses seek to discourage multihoming since it facilitates switching when a user abandons one platform in favor of another. Limiting multihoming is a cardinal competitive tactic for platforms. To gain a complete understanding of multihoming behavior, researchers have examined the factors that make them happen. According to Rochet and Tirole (2003), multihoming is common in conditions where users don't pay a fixed fee for using multiple services. Zhang and

Sarvary (2015) explored different situations of single- and multihoming behavior. They found that it is harder for the platform to differentiate its products from the competition if there are many multihoming users. More importantly, recent research suggests that the assumption of single homing behavior may cause substantial bias in research contexts where multihoming behavior is prevalent due to the distinct competitive dynamics under single- and multihoming assumptions. Goode (2013) argued that the factors affecting a customer's potential of switching to another cloud storage service differ substantially between single- and multihoming users. Ambrus et al. (2016) found that multihoming significantly alters the competitive structure of digital advertising markets. Empirical research has also emphasized the need to consider multihoming behavior. Due to the recent shift in the financial industry towards digital solutions and new regulations, the authors assume that multihoming behavior in financial services will become more widespread by consumers.

## 2.2. Switching cost

One of the most pressing obstacles of digitally-focused challenger banks is whether they will be able to attract customers away from their existing banks (KPMG, 2016). In the financial industry, customer inertia presents a big issue, especially in current accounts, which many digital challengers aim to capture (PWC, 2019). Scholars have implied that digitalization has increased customer loyalty through innovative offerings that have diminished switching costs (Pousttchi & Dehnert, 2018). Burnham et al. (2003) describe switching costs as the one-time costs which can arise when a consumer switches between service providers. These costs can hinder consumers from switching if they consider the cost to be too high. Bitner (1995) argues that consumers who engage with service providers over a long time, such as banking, form trust with the provider and feel comfortable being served efficiently. Furthermore, some consumers are aware that a service provider may market a better offer but stay due to the uncertainty of switching and the predictability and comfort of their current service. The internet and digitization, in general, have changed the way consumers seek information and their buying behavior. Most products and services are available online, including financial services. There is a level of openness in an open banking market that stems from the platform business model (Zachariadis & Ozcan, 2017). It also has implications for switching costs as customer data is available between competitors to a much higher degree. The authors

argue that it can increase competition and lead to diminishing switching costs. These changes imply that it coheres with increased customer mobility, as the Payment Service Directive 2 (PSD2) and platform models further reduce switching costs (Zachariadis & Ozcna, 2017). Although digitization has given consumers better access to products and services, scholars argue that switching costs are still present where previous purchases can still influence your online purchase. By generating lock-in effects, service providers can create costs for customers if they decide to switch from one service to another (Shapiro & Varian, 1999).

## 2.3 Banking-as-a-platform (BaaP)

The platform revolution has not spared the financial sector, and multiple platforms have risen that provide financial services. Also, in regards to the newly introduced regulatory frameworks, PSD2 in the EU and the Open Banking initiative in the UK. The term "Banking-as-a-platform" (BaaP) describes the premises upon which banks can adopt a platform strategy model and change the rules of competition. In doing so, banks will need to revisit their role as financial intermediaries and prepare to become re-intermediaries by providing "online automated tools and systems that offer valuable new goods and services to participants on all sides of the platform" (Parker et al., 2016). Banks need to cultivate and manage growth in all sides of their platform and invest in some core applications central to their value proposition. The formation of such an ecosystem will increase the possibility of transaction costs staying low and leveraging the benefits of network effects (Zachariadis & Ozcna, 2017).

## 2.4 Platform entry strategies

The existing literature on entry strategies of challenger banks is almost nonexistent. This research presents challenger banks as digital platforms, and therefore the focus is on corresponding literature about platform entry strategies. Most of the literature about digital platforms tends to focus on existing platforms in the market from a static and not dynamic perspective (Gawer & Phillips, 2013). There has been limited research on platforms in their early stages when they are entering the market (Kim, 2018). Kim et al. (2013) explored entry strategies between an incumbent and a new entrant in the daily deals promotion industry. Their research shows how platforms compete dynamically in a two-sided market with open information structure. Zhu and Iansiti (2012) examined

the relative importance of platform quality, indirect network effects, and consumer expectations on entrants' success in platform-based markets. They suggest that the success of an entrant to a platform-based market depends critically on two parameters: the strength of indirect network effects, which measures how much consumers care about application variety, and consumers' discount factor of future applications, which measures how much consumers care about applications releases in the future. More specifically, they discovered that an entrant game console platform could overcome the incumbent platform with a technology installed-base advantage. Much of the literature on entry strategies focus on understanding the order of entry effect. Scholars tend to disagree on whether pioneers enjoy a first-mover advantage when entering a new market. However, some studies have indicated that late entrants have a significant competitive advantage over pioneers. Kim (2018) argues that it is vital that a platform business achieves a critical mass of users early to be successful. His research found that the activities of the core platform business participants group are essential in spreading platform businesses.

Staykova and Damsgaard (2015) quantitatively analyzed expansion and entry strategies for digital payment platforms. Their empirical results revealed that the timing of expansion and entry are equally crucial for platform development. Caillaud and Jullien (2003) investigated different applications of two-sided markets. They generated the optimal fees levied on the two sides of a platform by constructing a model with cross-sided network effects. Caillaud and Jullien (2003) discussed price competition between an incumbent and entry platform on the seller side, overlooking the endogenous entry sequence. Eisenmann et al. (2010) introduced "platform envelopment" by considering market entry issues and the interactions between different platform markets. They showed that late entrance platforms might overcome early-entry platforms because of the indirect network effects from other platforms markets. Wu and Chamnisampan (2021) examined when platforms should enter the market and what homing policies they should adopt as crucial strategic decisions for platform-based businesses. Their study revealed that early entry is not necessarily a dominant strategy for platforms and that a platform can endogenously determine its entry sequence.

## 2.5 Platform Competition

With the emergence of digital platforms, the nature of competition has changed. Many companies struggle to make sense of the new competitive threats of unexpected rivals coming from different directions. This new competitive environment has transformed the competitive landscape of many businesses (Parker et al., 2016). The five forces model of competition by Michael Porter mostly dominates previous literature about strategy and the strategic position of particular businesses. The model identifies five forces that affect the strategic position of a company:

- The threat of new entrants to the market
- The threat of substitute products or services
- The bargaining power of customers
- The bargaining power of suppliers
- The intensity of competitive rivalry in the industry

However, several strategy scholars have recently challenged the model by pointing out the new business models presented by digital platforms don't fit into the five forces model. In separate works, Richard D'Aveni and Rita Gunther McGrath have argued that, in an age of "hypercompetition" (D'Aveni's term), a sustainable advantage is unattainable. Technological advances drive shorter and shorter cycle times on everything from "microchips to corn chips, software to soft drinks, and packaged goods to package delivery services." (Parker et al., 2016).

Some scholars have researched the potential competition scenarios and the factors influencing them. Ruutu et al. (2017) identified three possible scenarios that might emerge in competition between platforms: (1) winner take all, (2) fragmented development and, (3) collaboration and competition. A winner-take-all market is where one platform can capture a substantial share of the market, while the remaining competitors have very little. When the scenario is fragmented development, no platform in the market can achieve the critical mass of users required to benefit from self-sustaining growth through feedback loops. As a result, the installed base of users across platforms gradually declines, and the platform market fails. Lastly, if the market scenario is collaboration and competition, a balanced competition between the platforms in the market emerges (Ruutu et al., 2017). Many scholars have pointed out that multihoming is an essential aspect of platform competition. Eisenmann et al. (2010)

argue that for a winner-take-all scenario to emerge, switching costs must be high and thus less incentive for users to multi-home.

Network effects are another subject of platform competition. According to Staykova and Damsgaard (2021), many platform owners believe that if they can attract a large enough user base to generate powerful network effects, they will effectively fend off competitors and rely on this competitive advantage as a defense against upcoming challenges. However, this often proves to be a challenge when existing competitors redefine their competitive actions and new, unexpected competitors emerge and challenge the platform's dominance. They argue that digital platform competition is an ongoing and unpredictable scenario that requires constant attention by the platform owner (Staykova & Damsgaard, 2021).

## Summary of Literature Review

*The emergence of Digital platforms has shaken up many industries in the past decade, facilitating the exchange of goods and information between different user groups in a new innovative way. The banking sector is one of these industries, where both incumbents and new emerging challenger banks have adopted digital platform business models. The design of entry strategies and how platforms compete with each other are different. Elements like network effects, switching cost, and multihoming are important for platform owners to understand. With everything being digital, the entry strategy focuses on acquiring customers with products and differentiation, and the competition can be more complicated where rivals can come from unexpected directions.*

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# Banks

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## 3. Banks

*This section defines essential concepts that are used frequently throughout this research. These are definitions of challenger- and neobanks, incumbent banks, the difference between challenger- and incumbent banks, and payment service providers.*

## 3.1 Challenger- and Neobanks

In 1994, Bill Gates said, "Banking is necessary. Banks are not". This saying was long before having digital technology as part of our everyday life, and a world without traditional banks was almost unimaginable. This famous quote has since come true. With the entrance of digital platforms disrupting incumbent industries, numerous fintech companies have challenged every aspect of banking and delivered better banking services directly to consumers. Today, challenger banks and neobanks are emerging globally. Neobanks are mobile banks that offer more customized services and focus on a niche market, having the main value proposition, the user experience (Weege et al., 2020). However, it needs to have a partner bank where they rely on an actual bank's infrastructure to work as an interface (BBVA Research, 2016). Challenger banks offer very similar services as traditional banks with lower costs since they build their infrastructure from scratch. They do not rely on another bank's banking license where they have their own license or are in the process of getting one (BBVA Research, 2016). Challenger banks and neobanks have as main differences: the banking license and the complete control on the core banking system. Challenger banks have more ability to innovate according to customer's needs since they don't rely entirely on third-party providers (Djelassi, 2017). The main challenges for neobanks are (1) the cost of customer acquisition and (2) the dependence on a partner bank, while for challenger banks is the first one (Trieu, 2015). Another possible classification is GAFA banks, which would exist if a Tech giant such as Google or Facebook created a bank.

Fintech startups are disrupting the existing products and services, focusing on user experience, extracting value from data, decreasing operating costs, and increasing efficiency with their business models, through advanced technology (Deloitte, 2018). As newcomers, challenger banks can rethink the banking business model and the technology behind it.

## 3.2 Incumbent Banks

The term "incumbent bank" refers to traditional banks as we know them, the leaders in the industry that possess the largest market share. Traditional banks may operate under different business models and offer a variety of financial products and services. They

differ in terms of market groups they represent; some are only for retail customers, while others are only for commercial customers. They may also work under a universal model and serve everyone. Furthermore, traditional banks' primary funding source is core deposits kept by individual savers or organizations (Temelkov, 2020). The primary income source for traditional banks is their interest income, while they also generate non-interest income from their secondary activities and services (Temelkov, 2020). Another essential characteristic of the traditional business model is that banks have developed a network of brick-and-mortar branches that enable physical interaction with their customers (Temelkov, 2020). Because of the large number of branches and the costs associated with maintaining a well-established network of ATMs, incumbent banks have high operating costs.

## 3.3. Challenger Banks vs. Incumbent Banks

The emergence of challenger banks represents a new exciting trend in the banking industry (Deloitte, 2020). These banks deviate from the conventional standards associated with banks and instead concentrate on driving innovation and improving customer service. Challenger banks use modern advancements such as the internet to gain an edge in the contemporary world. They can offer high-level customer services to unprecedented levels using automation, artificial intelligence, and advanced data analytics (Deloitte, 2020). They recognize the trend of consumers relying more and more on digital channels such as apps and built their services around these platforms. Through innovative apps, challenger banks can avoid costly brick and mortar branches and instead conduct a whole user banking experience through an app on their phone (Deloitte, 2020). This emergence of challenger banks comes at a crucial time in which mobile banking apps are to overtake online banking, with an estimated 72% of the population using banking apps in the UK by 2023 (Deloitte, 2020). While major incumbent banks have experimented with implementing new technologies to aid customers, there has been a reluctance to adapt to modern climates fully. This could be due to the legacy IT systems used by certain banks that date back decades (Luther et al., 2019). Challenger banks can also adapt and develop new offerings far quicker and with far less friction than their traditional banking rivals, who have large overarching business models compared to challenger banks. It suggests they can quickly adapt to new consumer demands and have them implemented into their services quickly, while

traditional banks are often slow to respond to market demand. That has allowed challenger banks to implement revolutionary features. These features include recommendations based on the consumers' purchase data to help save more money, quick and easy payments to nearby friends, the ability to pinpoint on a map where exact transactions occurred, and even offering an automatic blocking feature on gambling transactions for people suffering from addiction (Ozcan et al., 2019). Challenger banks not only have a technological advantage over their incumbent rivals, but they also have more significant returns on equity, more flexibility in terms of lending, and lower operational costs. These advantages have led to challenger banks increasing their annual revenues year after year, while traditional banking corporations have been in a period of decline (KPMG, 2016). Key actors in the challenger bank sector are Starling Bank, Revolut and Monzo from the UK and N26, which is based in Germany but has expanded across Europe in recent years. They all offer current accounts, which include perks such as contactless cards, zero fees for foreign transactions, tiered membership systems with perks, and well-designed apps which allow you to complete all your banking tasks from your phone (Starling Bank, 2021; Revolut, 2021; Monzo, 2021; N26, 2021). The rise in popularity of the digital challengers has even attracted the attention of tech industry giants Apple, who has released their banking service named 'apple card' (BusinessCloud, 2019). Ultimately challenger banks are aiming to tackle the current state of customer inertia within the banking industry (PWC, 2019), which Solomon et al. (2013) describe as consumers who are at the low level of involvement with service and essentially make decisions out of habit as they lack the motivation to consider alternatives.

## 3.4 Payment Service Providers

A payment service provider offers shops online services for accepting electronic payments by a variety of payment methods, including credit card, bank-based payments such as direct debit, bank transfer, and real-time bank transfer based on online banking (Crede, 1995). PSPs make the experience of a money transfer straightforward for the customer and stress-free for the merchant. All of the relationships to the various payment schemes (be it credit cards, debit cards, mobile apps, Apple or Google Pay, or even AliPay) are managed by the PSP, giving merchants more time and energy to focus on the relationship with the customer (Heins, 2019). An example of a service of PSPs is

payment terminal and Point of Sale (POS) technologies. Lastly, the PSPs are responsible for the security of the payment transaction. PSPs have emerged as one of the primary challengers to the traditional banking monopoly. Thanks to recent regulatory shifts, various types of PSPs have materialized in response to market pressures. There are mainly two types of PSPs. On the one hand, we have large financial institutions that offer various PSP-related products and services. These companies provide merchants with in-store, online, and mobile payment acceptance solutions to operating domestic card schemes (Heins, 2019). On the other hand, we have specialized startups that offer specialized products and services within the PSP sphere of influence. The possibilities are endless, and the startups that do exist are constantly finding new gaps in the market where they can offer innovative solutions to existing problems. Although they operate on a smaller scale than the large financial institutions, they have significantly increased competition in the payments industry, exerting more pressure on incumbent institutions to innovate (Heins, 2019).

4

# Theoretical Framework

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## 4. Theoretical Framework

*This chapter presents the theoretical framework. The theoretical framework gives an in-depth analysis of the theories and frameworks used as the basis for the proceeding work of this thesis. The presentation is in five sections. Each section complements the others. At the end of the chapter, the main theoretical components of the thesis are summarized. The Entry and Expansion framework (Staykova & Damsgaard, 2015), the Digital Platform*

*Competitive Grid (Staykova & Damsgaard, 2021), The Minimum Viable Product (Ries, 2011), PESTEL Analysis (ProcessPolicy, 2021), and SWOT analysis (Academy, 2020) are the theories and frameworks that form the combined theoretical framework.*

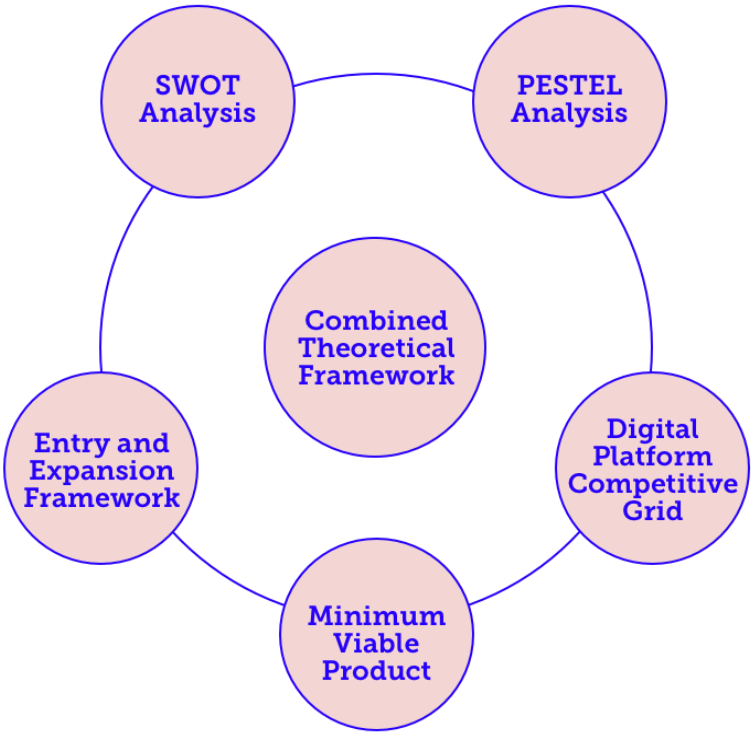


*Figure 2 - Combined Theoretical Framework (Figure is a production of thesis authors)*

## 4.1 PESTEL

PESTEL analysis is a framework used to analyze and monitor the macro-environmental factors that may profoundly impact an organization's performance. This framework is a tool used by companies to track the environment they're operating in or plan to launch a new business or enter a foreign market (*ProcessPolicy, 2021*). For this research, the PESTEL analysis evaluates the Icelandic financial market and assesses the competitive landscape. PESTEL is an acronym that stands for Political, Economic, Social, Technological, Environmental, and Legal factors.

***Political Factors*** - What are the political factors that are likely to affect the business? These are political factors related to the pressures and opportunities brought by political institutions and to what degree these political factors and government policies

impact the business. This research looks into the politics behind the three big banks and other aspects affecting the Icelandic landscape.

***Economic Factors*** - What are the economic factors that will affect the business? These are economic factors related to economic structures, economic policies, and how the economy impacts the business. For the Icelandic financial market, this can include growth, the local economy, the financial crisis, and inflation rates.

***Social Factors*** - What cultural aspects are likely to affect the business? Social factors relate to the cultural beliefs, aspects, and attitudes that can affect how the business operates and the demand for a company's product or services. Consumer behavior and perception towards financial services and products in Iceland are analyzed.

***Technological Factors*** - What technological changes may affect the business? Factors related to technological innovations, aspects, barriers, and incentives, and to what degree do these factors impact the business. The technology advances and maturity of the main competitors are analyzed, and the shared IT infrastructure of the biggest banks and its impact on Lunar entering the market.

***Environmental Factors*** - What are the environmental considerations that may affect the business? These are factors related to the environmental and ecological aspects that will affect the demand for a company's products and how that business operates. The increased demand for the sustainability of financial products and services is an example of environmental factors that affect financial companies.

***Legal Factors*** - What current and impending legislation will affect the business? These are legal factors related to laws, legislation, and regulations that will affect how the business operates. Laws and regulations that affect the financial market in Iceland.

## 4.2 SWOT analysis

Originated by Albert S. Humphrey in the 1960s, SWOT analysis is a basic, straightforward model that assesses what an organization can and cannot do and its potential opportunities and threats. The method evaluates the strengths, weaknesses,

opportunities, and threats involved in a marketing or business project. First, you specify the objective for the project and then identify the internal and external factors that will have a positive and negative impact on the objective (*Academy, 2020*). As Figure 3 shows, analysis of strengths and weaknesses focuses on the internal factors, whereas analysis of threats and opportunities gives an understanding of external factors. The purpose of using the SWOT matrix in this research is to identify the strategies that Lunar can use to exploit external opportunities, counter threats, and build on and protect its operations, including strength and eradicate its weaknesses.

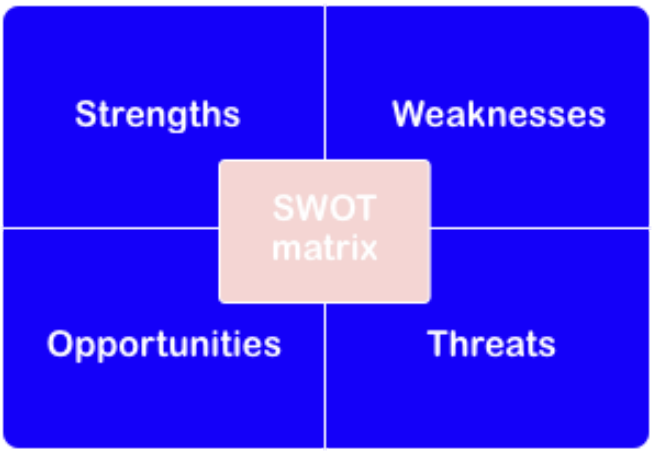


*Figure 3 - SWOT analysis (Figure is a production of thesis authors)*

## 4.3 The Entry strategy framework

Staykova and Damsgaard (2015) introduce the Entry and expansion strategy framework in "The race to dominate the mobile payments platform: Entry and expansion strategies" (Staykova & Damsgaard, 2015). They empirically studied the entry and growth strategies of digital payment platforms and built a framework to analyze digital payment solution providers' entry and expansion strategies. Their study found that the timing of entry of the first-mover speeds up the early followers' entry, thus determining the order of entry. The timing of expansion is equally important as the timing of entry. If the expansion is not executed within the optimal time, the previously gained competitive advantage can be annulled. They further found that an entrant platform had to differentiate its strategies to gain market leadership. In the study, they investigated the entry and growth strategies of three alternative digital payment platforms launched in the Danish market over eight months. The platforms offer similar solutions with almost identical functionality, and they compete for the same customers. Because of this,

their initial success or failure was determined by when and how they entered the market and how fast they managed to acquire a critical mass of customers.

In the table below is the entry and expansion strategy framework introduced in the paper:

| Entry and Expansion Strategy | | |
|---|---|---|
| Timing of Entry | Order of Entry | Design of Entry |
| Timing of Expansion | Order of Expansion | Design of Expansion |

*Table 1 - Entry and Expansion Strategy Framework*

### 4.3.1 The Entry Strategy

The Entry strategy explains the factors that determine the timing of entry of the first-mover, the impact of that entry on the timings of entry of its rivals, and how the timing of entry influences the mode of entry of a digital payment solution.

#### 4.3.1.1 Timing of Entry

The timing of entry is very important and can bring a significant competitive advantage. A company's decision to enter a market attributes to different factors such as changes in the economy or changes in customer preferences. The decision to enter also depends on beliefs about how many rivals will enter the market. The market signals sent by various competitors shape the competitive market dynamics. Pre announcing a new product is a tool that signals different intentions to the market, and it may have particular importance in markets characterized by network effects and switching costs. The entry of the first-mover often triggers a response from its competitors, who have to make a strategic entry choice. Followers respond by trying to reduce lead time by entering the market soon after the first-mover or delaying their entry to optimize performance.

#### 4.3.1.2 Order of Entry

Staykova and Damsgaard investigated the order of entry in terms of whether the first-mover can gain substantial competitive advantage and if that advantage can be sustained over time by later entrants. A follower's response also depends on whether

the first-mover got a significant competitive advantage upon entry. The authors assume that if a follower estimates that the first-mover accumulates competitive advantage, it is more likely to enter the market sooner than later. Industries with strong network effects will have a significant first-mover advantage over their rivals if they manage to get a large installment base. The authors further argue that the presence of a strong network effect constitutes a barrier to entry for followers. An increased installed base can lead to less market entry in markets where switching costs or brand loyalty locks in the customers, and delayed entry is likely to reduce the early-mover advantage. If the followers delay their entry, it can give the first-mover a better opportunity to lock in customers. High switching costs put late entrants at a disadvantage because they will have to invest more resources to attract customers away from the earlier entrants. But at the same time, a low switching cost may reduce the first-mover advantage. By mapping out the different response times to the first-mover market entry, Staykova and Damsgaard provided evidence for the presence of first-mover advantage in a digital payment market.

#### 4.3.1.3 Design of Entry

Aside from choosing when to enter the market, a company must also decide on the product's positioning, or whether to launch, and when to launch it. The authors investigated whether there is a connection between the timing of entry and the design of entry. They found that if a first-mover is pressured to enter as soon as possible, the followers may enter with a simplistic solution. At the same time, if a follower decides to enter shortly after the first-mover with a short response time, it may not have time to develop a mature solution. They argue that new digital payment solutions should enter as one-sided platforms, then transform into two-sided and eventually into multi-sided platforms. A one-sided platform consists of the platform provider and just one group of users who are subject to strong same-side network effects.

### 4.3.2 The Expansion Strategy

The Expansion Strategy explains the importance of a critical mass of users for achieving a substantial growth of the platform. The timing of expansion must be executed with the right speed for a company not to lose its competitive advantage. A digital payment platform should enter a market as one-sided and then be transformed into two-sided or

multi-sided to be successful. One-sided platforms most often have low lock-in effects and thus low switching costs.

#### 4.3.2.1 Timing of Expansion

The theory recommends digital platforms to enter as one-sided and then evolve into two-sided and finally multi-sided platforms. Because the platform is first one-sided, it offers a limited number of features, which could imply low switching costs and low lock-in effects during the entry stage. Because of this, the timing of expansion is critical for ensuring the platform's success as it has to gain strong lock-in effects by introducing new features and sides. If the platform owners miss the optimal time to expand their platform, they will miss the opportunity to reinforce their market supremacy, and that can neutralize their first-mover advantage.

#### 4.3.2.2 Order of Expansion

The expansion of a platform by first-movers by adding new sides and features sends a signal to its competitors. By measuring the response time of the followers after the expansion of the first-mover, whether the first-mover can sustain its first-mover advantage can be analyzed. Followers can choose between two strategies when expanding, either imitation or innovation. By comparing the follower's response time to both entry and expansion of the first-mover, potential differences can be spotted, which could signal a change in the follower's strategy. If a platform can attract a second side, it can gain a competitive advantage over late entrants. Even if the pioneer expands within the optimal time, the late entrant may leverage its large user base or add an innovative feature, which will give the follower an advantage. Thus previously gained first-mover advantage upon entry in a new market can be neutralized during expansion.

#### 4.3.2.3 Design of Expansion

Evolvability is the ability to evolve by adding new features and sides and is characterized by digital platforms. If this is executed right, it can have a significant lock-in effect for the users. A digital platform should enter a market as one-sided to become successful. The size of the installed base of one distinct group and strong same-side network effects can attract a second distinctive group. The success of a new platform depends on the indirect network effect between the two groups, in the case of

digital payment platforms, of consumers and merchants. The strength of the indirect network effects correlates positively with the strength of the same-side network effects that a digital payment platform initially exhibits. A follower's response to the expansion of the first-mover can either imitate the design of expansion undertaken by the first-mover or respond by adopting an entirely new expansion design.

## 4.4 Digital Platform Competitive Grid

Digital Platform Competitive Grid is a *Playbook* developed by Staykova and Damsgaard, where they looked at the competitive landscape of mobile payments in Denmark (Staykova & Damsgaard, 2021). Platform owners often believe that the most crucial strategy when entering a market is to attract a critical mass of users quickly to create strong network effects and gain a competitive advantage over competitors. It comes as a surprise to these owners when a previously obtained competitor gains momentum or a new entrant challenges their dominance. Digital platforms that seek and provide variously related and unrelated functionalities often compete simultaneously at multiple markets, facing both existing and emerging competitors. Most platforms begin by competing in a single competitive area. As they evolve and expand the scope of their offerings to attract more users and lock in existing ones, they span across related and unrelated markets. The ride-sharing platform Uber is an excellent example of this. They started by competing in the ride-sharing market, and today they also deliver food and therefore have entered the food delivery market facing new competitors. Digital platforms encounter different competitors at various new markets they enter. Those competitors possess other characteristics and capabilities in terms of the user base, portfolio functionalities, technology capabilities, finance resources, and more. The more diverse competition, the more important it is for platform owners to adapt their competitive approaches.

Additionally, as digital platforms operate in highly uncertain and unpredictable environments, it is difficult for owners to design long-term competitive strategies. They can only rely on temporal competitive advantages, which can erode quickly. Platform owners need to be flexible and quick to launch proactive measures against diverse competitors and respond to their competitive actions. The digital platform competitive grid outlines four different approaches that digital platforms can adopt to compete

successfully against diverse existing and emerging competitors. The grid, together with the seven recommendations for inter-platform competition that the authors propose, constitutes a Digital Platform Playbook, which can help owners of both defending and challenging platforms compete successfully. Depending on the characteristics of competitors, they are categorized along two dimensions—first, industry indigeneity, where they are either native or non-native. Second, whether they are customer-focused or infrastructure-focused, the grid can be helpful for any platform owner who would like to position its competitors vis-á-vis its characteristics to decide on the best competitive approach.

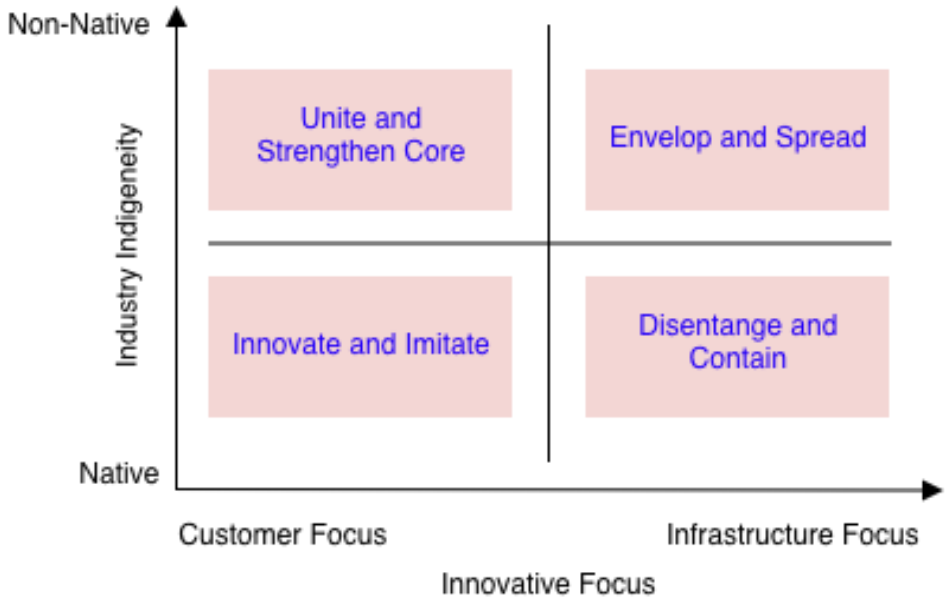


*Figure 4 - The Digital Platform Competitive Grid (Figure is a production of thesis authors)*

The first step in using the grid is to figure out where to situate the platform alongside the two dimensions. After establishing the key characteristics of your platform, the subsequent mapping of the competitors then entails determining how similar or different a competitor is to your platform. To identify where to position Lunar and each competitor in the analysis, the authors will use the help of PESTEL and SWOT framework.

***Innovate and Imitate - Native & Customer Focused -*** Digital platforms are likely to adopt an Innovative and Imitate approach towards competitors with similar characteristics, with whom the platform engages in head-to-head battle at multiple markets. When adopting this approach, platform owners should emphasize actions such as market entry, signaling, and platform functionality release. Additionally, the imitated competitive actions include decisions related to functionalities, pricing, and entering into partnerships.

***Disentangle and Contain - Native & Infrastructure Focused -*** When a digital platform encounters a native competitor offering infrastructure-focus innovation, the owner should follow a Disentangle and Contain approach. Such competitors are often initial platform providers or provide the underlying infrastructure upon which the platform operates. The Disentangle and Contain approach emphasizes competitive actions such as capability building, which should be central in the owner's competitive collection. For example, when the infrastructure for your platform turns into a competitor, the platform engages in a series of competitive actions that aim to disentangle its platform from the provider's infrastructure and build corresponding capabilities on its own or in collaboration with other infrastructure providers. Reducing dependency from the provider-turned-competitor makes the platform less vulnerable to competitive attacks. The owner enveloped some of the core businesses of its competitor to contain their competitor and discourage further competitive attacks.

***Envelop and Spread - Non-native & Infrastructure Focused*** - Competitors that are non-native focusing on infrastructure innovation should be approached with the Envelop and Spread approach. This approach focuses on competitive actions related to envelopment as part of its competitive repertoire.

***Unite Supporters and Strengthen Core - Non-native & Customer Focused*** - When facing competitors who are non-native but offering customer-focus innovation, platforms should adopt a Unite Supporters and Strengthen Core competitive approach. An example of this is Apple and Google entering the digital payment market with ApplePay and GooglePay. Current platforms in that market should use this approach and

unite forces with each other under similar threats from these entrants and strengthen key competencies through capability building.

### 4.4.1 Seven Competitive Actions

Digital platforms, often operating in dynamic and unpredictable environments, have to fend off diverse competitors at various markets. Digital platforms should rely on seven unique competitive actions to do so, which are market entry, signaling, platform functionality release, pricing, envelopment, capability building, and interoperability. Instead of using long-term competitive strategies that are fixed and inflexible to rapid changes in the competitive environment, platform owners can instead mix and match these competitive actions to form competitive repertoires enacted at specific markets. As platform owners can compete simultaneously against several competitors with different characteristics and at a specified market, owners can simultaneously act out more than one competitive approach.

***Market Entry*** - Market entry as a competitive action refers to decisions about the platform's strategic initiatives when entering a market. That includes deciding the timing of entry, order of entry, and expansion, as discussed in more depth earlier. In terms of competition, the timing of entry can be essential for the platform to gain a competitive advantage in the form of a first-mover advantage.

***Signaling*** - Signaling are competitive market signals conceptualized as announcements or previews of potential actions intended to convey or gain information from competitors (Heil & Robertson, 1991). Preannouncement of a new product in advance of market introduction can have many consequences; other competitors can then rush their product and decide to wait or retreat.

***Platform functionality release*** - A release is the distribution of software to the consumer. A digital platform can have numerous and continuous releases throughout its lifecycle. It can be bug fixes, new functionality releases, or a new feature.

***Pricing*** - Building a vibrant network has always required making choices about charging users and which users to charge. The functionality of digital platforms offers

increased flexibility in making pricing choices, and platform entrepreneurs have more scope to challenge industry norms. Pricing can be pay-as-you-go, subscription, premium, and user subsidies, which are discounts and promotions to encourage consumers to try new offerings (Edelman, 2015). Pricing for digital platforms can even sometimes be free for some part of the platform.

***Envelopment*** - Platform envelopment refers to one platform provider moving into another platform's market, combining its functionality with the target's, to form a multi-platform bundle (Eisenmann et al., 2010). The markets which evolve rapidly are rich in enveloping opportunities, and the companies in these markets are under the continuous threat of becoming obsolete. An example of this is the mobile phone market which used to be a different market, but the boundaries between them and music players have blurred. When a business is threatened with an envelopment attack, it has few options but to change the business model or sell it to the attacker.

***Capability building*** - Capability building refers to the skills and knowledge required for a particular task. A digital platform may have the capacity to change but lack specific key capabilities (Are We Building Capacity or Capability?, n.d.). The digital platform's key capabilities for digital platform survival are system orchestration, ecosystem preservation, system reformation, and ecosystem diversification (Blaschke et al., 2018).

***Interoperability*** - According to Urs Gasser, interoperability is "the ability to transfer and render useful data and other information across systems, applications, or components." (Gasser, 2015). In other words, interoperability is about making different systems or infrastructures compatible with one another by making them mutually legible and able to interconnect. For digital platforms, in particular, the UK Competition and Markets Authority (CMA) has defined "platform interoperability" as "the ability of platforms to exchange data and different forms of functionality across their services." (Competition and Markets Authority, 2020).

## 4.5 Minimum Viable Product - The Lean Startup Method

The lean startup approach was first proposed by an American entrepreneur Eric Ries, in September 2008 through his popular blog Startuplessonslearned.com. In his bestseller "The Lean Startup: How Constant Innovation Creates Radically Successful Businesses,"

Ries argues against the then-common notion that hard work, good timing, determination, and most importantly, good product or service alone ensure success (Ries, 2011). In his book, he supports his doubts by using real-life examples from experiences of his own and others, where promising startups eventually failed. Minimum Viable Product is a specific term that refers to the core lean startup principles that Ries introduced in his book.

Before introducing the Lean Startup Method, it is important to understand, according to Ries, what is to blame for the failure of so many startups. The problems associated with the old way of starting a business are 1. Extended lead time in the development process; 2. High initial cost; 3. Excessively high confidentiality concerning product and service features. It used to be common that companies would spend a lot of time developing a product with little or no customer insights.
In some cases, it would take years to convert an idea into a product. The traditional innovation process consisted of a single launch of a product or service that matched customers' needs. All of this required high initial investments from companies, not only in terms of money but in resources and time as well. These investments also carried high risks, as there was little or no space for errors due to the long and expensive development process and essentially a single change to win customers' trust.

In response to the traditional innovation process, Eric Ries proposed a method for creating and managing startups, backed up by research, coined the "The Lean Startup method" (Ries, 2011). This approach is an application of lean thinking of innovation process and includes the following three characteristics:

- Customer development through a ferocious customer-centric focus centered on rapid iteration
- Application of agile development methodologies
- Use of platforms enabled by open source and free software

The approach is, in its simplest form, described as rapidly building and testing a product. Then based on customer feedback, quickly refine the promising concepts and ruthlessly change direction. To quote Ries in his very first blog post on Lean Startups

(September 8th, 2008), he describes this well: "My belief is that these lean startups will achieve dramatically lower development costs, faster time to market, and higher quality products in the years to come. Whether they also lead to dramatically higher returns for investors is a question I'm looking forward to getting answered".

In his blog and book, Eric Ries used specific terms to refer to the core lean startup principles. One of the terms is a minimum viable product (MVP), the "version of a new product that allows a team to collect the maximum amount of validated learning about customers with the least effort." The goal of an MVP is to test fundamental business assumptions or hypotheses and help entrepreneurs begin the learning process as quickly as possible. For example, in his book, Ries talked about the online footwear retail company Zappos and its founder Nick Swinmurn and his willingness to test the hypothesis that customers were ready and willing to buy shoes online. Instead of building a website and an extensive database of footwear and warehouses, he approached local shoe stores, took pictures of their inventory, and posted the pictures online. He bought the shoes from the store at full price after he'd made a sale and then shipped them to customers. By doing this, Swinmurn deduced that customer demand was present, and Zappos would eventually grow into a billion-dollar business based on the model of selling shoes online.

While the word startup in the Lean Startup Method suggests that such an approach is only for startups, that is not necessarily the case. Empirical evidence support that mature companies can apply such methods to foster innovation processes. Despite the methodology's name, in the long term, some of the biggest payoffs of the lean method may be gained by the large companies that embrace it as well as companies then launching in an entirely new market.

## Summary of the Theoretical Framework

*Having unpacked the selected theories and approaches separately, how they complement each other and help answer the research question is explained.*

*SWOT matrix and PESTEL model provide a complete overview of inside and outside risks and opportunities that businesses find helpful when formulating their strategy. The SWOT analysis assists in analyzing the case study of Lunar, and the PESTEL framework analyzes*

*the Icelandic market and answers the research question about the infrastructure of the Icelandic financial market.*

*The aim of the thesis is to understand which entry strategy Lunar should implement if they were to launch in Iceland to succeed in the market as the first digital challenger bank. The authors argue that the Entry and Expansion Strategy Framework introduced by Staykova and Damsgaard is beneficial in answering which strategy to implement, where the focus will mainly be on the entry strategy and less on the expansion strategy. To understand the competitive landscape in terms of foreign and domestic players in the Icelandic financial market, the authors argue that the Digital Platform Competitive Grid by Staykova and Damsgaard is good for that purpose.*

*Lastly, to answer the sub research question on what should be Lunar's minimum viable product according to market opportunities, the Lean Startup Method helps us understand the approach of lean thinking of innovation process and customer-centricity when launching a new business—especially focusing on MVP or minimum viable product to achieve this, which is a version of a new product that allows collecting the maximum amount of learning about customers with the least effort.*

5

# Methodology

Contents



## 5. Methodology

*This chapter presents the methodology and research methods. The purpose of this chapter is to account for the construction of the thesis. This brings the reader in a position where he or she gains insight to the foundation of the thesis, hereunder how the research question will be answered, and how the conclusions are reached.*

## 5.1 The Research Onion

When conducting research, we are developing knowledge in a particular field by addressing a specific problem. Whether we are consciously aware of it or not, we will make a number of assumptions at every stage of our research (Burrell & Morgan, 1979). There are three types of research assumptions to distinguish research philosophies and these are; ontology, epistemology, and axiology. Ontology refers to assumptions about the realities we encounter in our research. Epistemological assumptions are about human knowledge and lastly, axiological assumptions address the extent and ways our own values influence our research process. These assumptions inevitably shape how we understand our research question, the methods we use, and how we interpret our findings (Crotty, 1998). A well-thought-out and consistent set of assumptions will constitute a credible research philosophy, which will underpin our methodological choice, research strategy, and data collection techniques and analysis procedures. This will allow us to design a coherent research project, in which all elements of research fit together (Johnson & Clark, 2006).

To give a simple explanation of the research design of this study, the authors were inspired by Saunders et al. (2009) 'research onion' and created their own version of this model to present the overall research methodology and design (Figure 5). The following layers of the research onion visualize a structure of the different stages that the researchers need to go through when framing the methodology of the study.

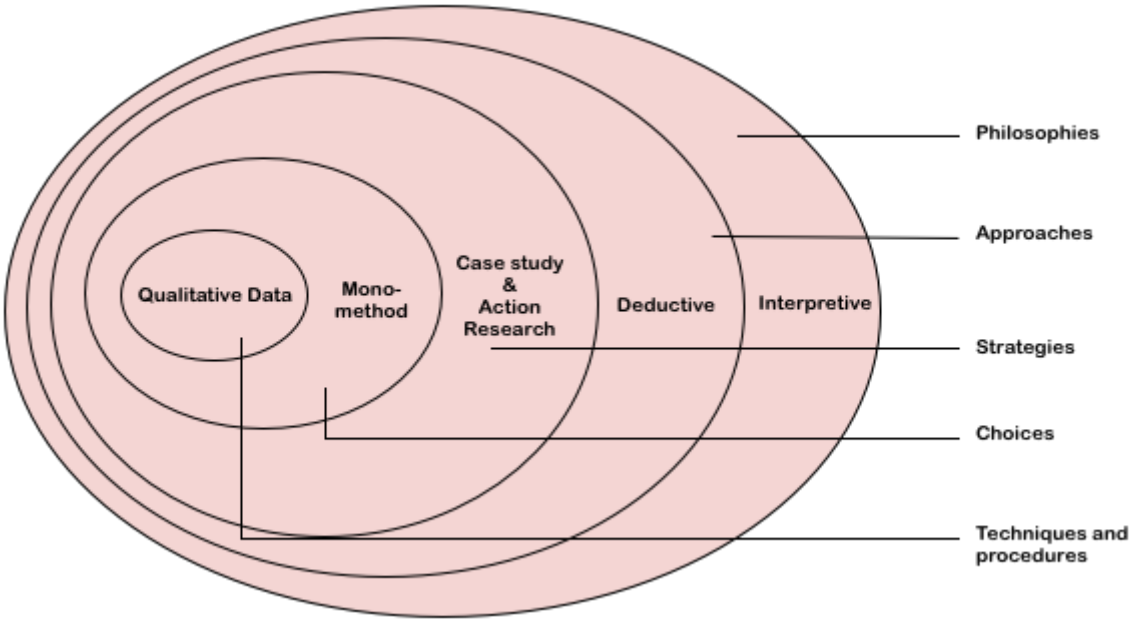


*Figure 5 - The Research Onion (Figure is a production of thesis authors)*

## 5.2 Research Philosophy

The first layer of the research onion involves the choice of research philosophy. The philosophical stance of the research regards the way in which the researcher can collect and analyze data based on the way data is perceived and developed. This research adopts the assumptions of relativism. Relativism in philosophy means that there is no ready consensus on any one definition, which is also why the foundation of this research is placed within the epistemology interpretivism. The development of interpretivism philosophy is based on the critique of positivism in social sciences and argues that human beings and their social worlds cannot be studied in the same way as physical phenomena (Saunders et al, 2009). Interpretivist is critical of positivists' grounds to discover universal laws that apply to everything as people make different meanings and create and experience different social realities. Interpretivism rather believes that research is to create new, richer understandings and interpretations of social worlds and contexts (Saunders et al. 2009). Therefore, there is no “right” way, but instead multiple ways of interpreting the world.

## 5.3 Research Approach

The second layer of the research onion concerns the research approach which discusses whether the study should take a deductive, inductive or abductive approach to the theory development. The deductive approach requires the researcher to take a clear theoretical position at the beginning of research by testing and comparing previous literature to the argument made (Saunders et al., 2009). In contrast, the Inductive approach argues that using hypotheses based on existing theory may prematurely close off possible areas of enquiry (Malhotra et al., 2017). Induction allows for the collection of data in order to establish a general understanding of the nature of the problem and make sense of the qualitative data collected for the analysis (Saunders et al., 2009). The conclusion may still yield the same result, however, in an inductive approach the theory follows the data from the bottom up and deductive approach follows a theory to data top down. The abductive approach allows not only for a selection of either top-down or bottom up, but rather a mixture where the theory can be developed through an iterative process, thus in effect becoming a combination of deductive and inductive approaches (Saunders et al., 2009). Abductive research is indicative of surprises that come into form at any stage of the research process and thus could be complemented by deduction and induction as logic for testing possible theories (Saunders et al., 2009).

The aim of the research is to develop an entry strategy for a new platform challenger bank into the Icelandic market. Previous literature concerning entry strategies of digital platforms was analyzed to gain knowledge about the context of the research. A theoretical framework was developed from previous literature and therefore this research finds itself taking a deductive approach as it moves from a theoretical perspective in search of an understanding of the research question (Saunders et al., 2009). After examining the existing literature surrounding the research objective, data was collected using a qualitative research approach in the form of semi-structured interviews.

## 5.4 Research Strategy

The research strategy describes how the researcher intends to carry out the work (Saunders et al., 2009). The strategy can include a number of different approaches, such

as experimental research, action research, case study research, interviews, surveys, or a systematic literature review.

The goal of this research is to develop an entry strategy for Lunar in the Icelandic financial market. To achieve that, the research will be both a case study and an action research. The case study is a research strategy that focuses on understanding the dynamics present within single settings (Eisenhardt, 1989). It calls upon us to generate insights through intensive research of our case company Lunar and the Icelandic financial market to identify what is happening right now, and to understand the effects of the current situation, which altogether gives implications for action. Action research can be defined as "an approach in which the action researcher and a client collaborate in the diagnosis of the problem and in the development of a solution based on the diagnosis" (Bell, Bryman & Bell, 2018). Where this research is taking an interpretivism approach, the action research perceives business reality as socially constructed and focuses on specifications of local and organizational factors when conducting the research. This research is done in collaboration with Lunar about its potential to launch in the Icelandic financial market. Although as far as the authors know Lunar does not plan on launching in the Icelandic market in the near future, and thus this research is purely theoretical.

## 5.5 Methodological Choices

The research onion suggests mono-method, mixed method and multi-method as possible choices for conducting research. The mono-method comprises only one method for the study. The mixed method is based on the use of two or more methods of research mixed together. Finally, the multi-method uses two or more methods (Saunders et al., 2009). These methods can be either quantitative, qualitative or mixed (Saunders et al., 2009). In broad terms, the nature of quantitative research usually includes numeric data in an attempt to reveal the relationship between theory and the research question. Most often the research strategy of quantitative research is deductive, objectivism and derives from positivism. On the other hand, qualitative research usually collects and analyses words or non-numerical data that has not been quantified. Qualitative research strategies are usually inductive, constructionist, and derived from interpretivism (Bryman, 2016). However, qualitative research can take the form of a deductive

approach by analyzing previous literature for theory development (Saunders et al., 2009).

The research question indicates that a qualitative research approach is suitable for this particular research where it asks what and how (Cooper et al., 2006). To understand what entry strategy Lunar should implement, non-numerical data is needed. Additionally, the sub-questions ask how and what which also will not be answered by numerical data. Therefore a qualitative research method was found to be most suitable for this research.

## 5.6 Data Collection Methods

Data collection methods include the techniques and procedures concerning the practicalities of the research. This section covers the process behind the observed results. Both secondary and primary data were collected to address the overall research objective.

### 5.6.1 Secondary Data

The first step of the research was to collect secondary data. Secondary data was used with the purpose of gaining a full understanding of the context of the research. It is especially relevant for the discussion chapter of the research, where previous literature is analyzed and compared to the findings of the research. Saunders et al. (2009) distinguish secondary data into three groups; data based on documents, surveys and multiple sources. The secondary data collected in this research includes emergence of digital platforms, platform entry strategies, platform competition, and relevant previous empirical studies. The secondary data was mainly collected from academic books and published articles in academic journals. The aim was to include the most relevant discussion, development, and research related to the objective of this research.

### 5.6.2 Primary Data

The primary data for this research will be collected with the specific purpose of supporting the research problem. When limited secondary data surrounding the context of the research is available, a combination of both secondary and primary data is needed. The advantage of extracting and using primary data is the specific and relevant

knowledge that derives from interviews, data that cannot otherwise be found within secondary data sources. By extracting or generating primary data, the ability to;
formulate interview questions and ask follow up questions or choose different formats, is generated. This will ensure that the authors gain a full understanding as well as the competencies to find underlying problems and assumptions which may prove beneficial or even crucial for the quality of our research. As aforementioned, this research conducted qualitative interviews for primary data collection. Due to the COVID-19 pandemic, all interviews were conducted online using the communication software Microsoft Teams, where all data was recorded. The interview design, sample, and implementation will be further discussed in the following sections.

## 5.7 Interview Design

There are various forms of interview design that can be developed to obtain thick, rich data utilizing a qualitative approach. The following section outlines the interview design used in this research.

### 5.7.1 Semi-structured interviews

For this research semi-structured interviews were conducted. Semi-structured interviews involve the researcher having a list of themes and questions to be covered, although they may vary from interview to interview. The interview guide was based on themes found in the theoretical framework and can be found in the Appendix B. This interview approach provided the possibility to pursue other interesting areas expressed by the subjects, potentially beyond derived concepts, while remaining focused on the overall theme and objective. This open-ended approach is very important in order to give participants the ability to shape the discourse and present their understanding of the matter at hand (Whiting, 2008). Both authors of this research participated in the interviews, there was no focus on specific roles such as timekeeping or who asked the questions, but rather on attempting to construct an open dialogue and easy atmosphere.

### 5.7.2 Sampling

In order to answer the main research question about what entry strategy Lunar should implement if entering the Icelandic financial market, Icelandic specialists in the financial sector were interviewed. The selected sample had to have extensive knowledge about

the financial market and the recent and current digital developments that have been disrupting the industry in the last decade. Using the Digital Platform Competitive Grid, which is explained in the theoretical framework of this paper, the key players in the Icelandic financial market were identified. To get the most holistic view of the Icelandic financial market and the competitive landscape, it was important to interview a representative from each corner of the grid as well as other nonsubjective experts. The process of selecting the interviewees was an iterative one where it was not decided beforehand how many interviews were needed to meet the criteria mentioned above. First, four interviews were lined up in which three of them were representatives of three key players in the market and one nonsubjective expert. These three key players can be placed at three different corners of the Digital Competitive Grid. There was still a need for more information and the perspective of a representative from the forth remaining corner of the grid. Then the second round of interviews were lined up which included one nonsubjective expert and two additional players in the market in which one of them filled the fourth corner that was missing. After the second round a further understanding of the infrastructure of the banking systems in Iceland was still missing, as well as more aspects from the incumbent banks. That's where the third and last round of interviews were lined up which were from the incumbent bank and the main IT company that provides the infrastructure of the Icelandic financial market.

In total nine interviews were conducted and the authors felt that their knowledge had been saturated and concluded it to be sufficient.

Below is a table of the specialists that were interviewed in the order they were conducted, and in which of the four categories of the digital competitive grid each one fitted.

| Order of interview | Interviewee | Employment | Competitive corner |
|---|---|---|---|
| 1 | Eva Björk Guðmundsdóttir | Chairman of the Board on Fintech Association in Iceland, also worked for Meniga (PFM tool), and now at Vörður | Other expert |
| 2 | Vilhjálmur Alvar Halldórsson | Head of Digital Development and Open Banking at Arion Bank | Native & Infrastructure Focus |
| 3 | Sverrir Jolli Hreiðarsson | CEO of Aur | Non-Native & Infrastructure Focus |
| 4 | Haukur Skúlason | CEO of Indó | Native & Customer Focus |
| 5 | Thorhildur Jetzken | Assistant Professor in Economics at Háskóli Íslands | Other expert |
| 6 | Viðar Þorkelsson | Former CEO of Valitor | Native & Infrastructure Focus |
| 7 | Gunnar Hafsteinsson | Managing Director of Síminn Pay | Non-Native & Customer Focus |
| 8 | Logi Karlsson | Íslandsbanki | Native & Infrastructure Focus |
| 9 | Ragnhildur Geirsdóttir | CEO of RB | Native & Infrastructure Focus |

*Table 2 - Specialists in Iceland interviewed*

Figure 6 below illustrates an overview of the interviewees and where they are on the competitive grid:

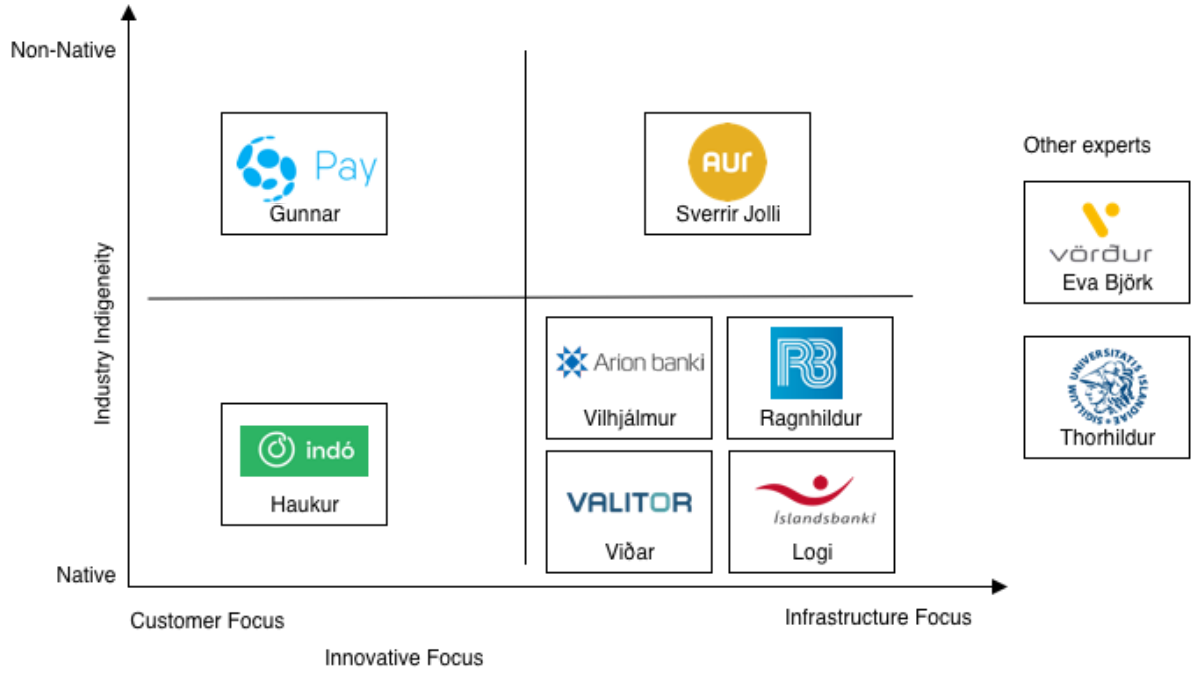


*Figure 6 - Interview overview based on the Digital Platform Competitive Grid (Figure is a production of thesis authors)*

## 5.8 Data analysis

All interviews were recorded by audio and transcribed in the same language in which they were conducted, in Icelandic. For this research, writing a transcript of every word spoken was not essential. Instead, summaries were written that provided a clear statement of what was talked about in the interview, rather than detailing particular opinions or anecdotes. If the interviewees provided an interesting statement it was added as quotes to the summary.

## 5.9 Coding Process

Following a deductive approach, the coding themes were predetermined. Each code was assigned a color to make the coding process easier, as it can be hard to remember each code. Table 3 demonstrates the codebook.

| Codes | Description |
|---|---|
| Entry Strategy | Changes in the economy, changes in customer preferences, believes about how many rivals will enter the market, signaling, first-mover advantage, network effect, switching cost, one-sided/multi-sided, multihoming |
| Minimum Viable Product | Product opportunities, design of entry, consumer demand, underserved market segments, pilot market |
| Competition | Competitors, platform functionality release, pricing, envelopment, capability building, and interoperability. |
| PESTEL | Infrastructure, politics, tax, currency, laws & regulations, consumer behavior, environmental issues, economy |
| Garbage Can | Important information that does not fit into any code |

*Table 3 - Code Book*

The authors coded the first interview together in order to coordinate their coding process. Next, the eight remaining interviews were split between the authors and coded separately. Coding was only conducted once as the authors felt there was accuracy in the coding process.

6

# Case description

Contents



## 6. Case Description

*This chapter provides an analysis of the case company Lunar. A semi-structured interview with Ken Willum Klausen, the CEO of Lunar, was conducted. To better understand the company, its business model, product offerings, and previous strategies and learnings from entering into new markets (See Appendix A). Further, to get a more comprehensive overview of the company, a SWOT analysis is presented.*

## 6.1 Lunar

Lunar is a digital challenger bank founded in 2015 by the Danish entrepreneur Ken Villum Klausen. Lunar started as a fintech company where the goal was to use technology to change the way people think about and spend their money. Like many other fintech companies and neobanks, they partnered up with a bank to provide banking services that required a banking license where Lunar put a digital layer on top of the traditional banking experience. Their first bank partner was Københavns Andelskasse. In 2016 they switched to Nykredit. However, in 2019 they obtained a European banking license and relaunched Lunar as an independent bank. According to Ken, the reason they went for their own banking license was to control the entire process and provide their customers with new and exciting products and features quicker. This way, they can compete with the incumbent banks on an even playing field and continue to challenge and rethink the experience of banking (Klausen & Smith, 2019).

Lunar differentiates from other challenger banks because they have always had a regional focus on the Nordics. They do not have any ambitions to go to Germany, Holland, France, or other large European countries. As Ken put it, *"We have Nordic ambitions"* (Appendix A). In 2018 and 2019, Lunar became a Scandinavian banking app with offices in Stockholm and Oslo, making it possible for Danes, Swedes, and Norwegians to manage their finances. Now they have over 200.000 users spread across Denmark, Sweden, and Norway.

## 6.2 Business Model

*Revenue Streams* - As aforementioned, digital challenger banks and neobanks have different business models as traditional banks. Being fully digital, they have lower operating costs and can swiftly adapt to changes in customer preferences and behavior with the usage of data. The business model of Lunar differs from other challenger banks, where their revenue stream does not primarily come from interchange fees. They have five monetization streams distributed more or less evenly, each accounting for 20 percent of total revenue. In addition to interchange fees, they have customer tiers. Customers can open an account for free or upgrade and get more exclusive benefits. They offer private customers to choose from a free account, premium account, or pro account. Thirdly, there are business tiers. Their business accounts are tailored to small businesses and entrepreneurs, and they can choose between a solo account or a grow account. The fourth revenue stream is the financial products like buy now pay later solution, credit, etcetera. Lastly, the service bracket includes shared accounts, multiple accounts, and stock trading (See Appendix A).

*Products & Services* - Lunar is not focusing on any specific group of customers; they are trying to fulfill all banking customers' needs exclusive of wealth management and private banking. They want to make it easier for small and medium-sized enterprises (SMEs) and entrepreneurs to get a banking account, as it can be difficult for them at the traditional banks (See Appendix A). Ken mentioned that Lunar is offering many products that the traditional banks are already offering, but they can actually cater to the customer's needs instead of just saying that they do (See Appendix A). They create solutions for all kinds of customers, rainbow families, young people, older people, families with children, and roommates living together. They offer deposit accounts and debit cards. The cards are made of metal, and customers can choose to become part of Project Blue that helps to ensure clean seawater and save animal life. Every time a Lunar customer uses their Visa card, they support Seabins, which clean the sea in Denmark, Sweden, and Norway. Customers can activate Google Pay and Apple Pay. The app has an expenditure overview, goal setting, subscription-manager, and savings accounts. Lunar believes that they need to stick to what they are good at, develop the best banking app, and find partners who are good at other things. That's why they are partnering with

some of the best in insurance, investment, and much more, so they can offer the best products specially made for Lunar's users. Examples of this are products available in the app like travel and luggage insurance, investments, and, buy now pay later. Lunar aims to become the number one financial marketplace of the Nordics (See Appendix A).

## 6.3 Lunar's Former Entry Strategies

As mentioned before, Lunar has a Nordic focus, which means that they want to operate in the Nordic countries solely. According to Ken, the Nordics are the most profitable banking landscape in the world. The majority of the population only holds one banking relationship where they buy all their products. The landscape is very defensive, and it can be challenging to get into the infrastructure. The total addressable market is only 27 million people, which is a fraction of what you have in Germany and France combined. However, it is more profitable. Million nordic customers will give you the same economics as 10 million customers scattered across the world (See Appendix A). Lunar does not see any outside challenges in the Nordics. The nordic consumer can open bank accounts at European challenger banks like Revolut, N26, and Monzo, but they are not part of the national infrastructure. They don't have national payments, national accounts, national KYC, and authentication. Lunar is, therefore, the only challenger bank in the Nordics at the moment.

Lunar entry strategy to the Swedish and Norwegian markets was pretty similar. Unlike other challenger banks in Europe, Lunar has a vertical entry strategy. They go in-depth in the market to understand the market dynamics, product needs, population, and infrastructure. They want to know how payroll works, credit laws, KYC and integrating themselves into the national infrastructure. They partially tailor their products to each market to get the national feeling for customers.

They enter with a soft launch, meaning that in the beginning, they only offer limited product offerings and put their efforts into brand awareness marketing to acquire customers. To keep the customer, they focus on engagement, have them try their products, and promote them with different services—personal recommendations based on their behavioral data. For example, if a customer uses online shopping, they will prompt him with a premium card with no currency exchange markups. It's a matter of

getting the customer engaged. If they have them activated and engaged early on, they tend to stay active and engaged with Lunar over time. Product developments show users that this is the bank of the future. Lunar wants to grow with their customers as the expectations of their customers succeed; Lunar grows with them. The focus is also on bringing new types of products that fit the way we live today more than in traditional banks, and how they can re-engineer financial products. They are thinking about leasing, helping people with leasing things instead of buying. They have offices in each country where most of the employees work on customer support, compliance, control management, and marketing.

When asked about the main challenges of entering a new market, Ken said it is the national understanding. *"People tend to think that the Nordics are all the same, same infrastructure, same population, but that is not true."* (See Appendix A). Each country has a different infrastructure, different technical systems, and financial behavior. That is why infrastructure is their biggest challenge. Another challenge is the perception of banks from the Nordic population. Nordic customers are not satisfied with their bank, but they have also never considered changing. Ken thinks that is because all the nordic banks are similar, exact pricing, same application, and same feeling and understanding (See Appendix A). They deal with these challenges by powering through integrating into the infrastructure and selecting the right partners. It is very time-consuming but something that needs to be done.

Regarding the consumer perception of the banks, they think it's about educating. They present themselves as your other bank, where you can try out Lunar without changing your bank. Then they will automatically try to get you over to use them as the full service over time. Ken said that if they were to consider entering the Icelandic market, they need to be sure that the economics are planned. They would like to know if they will capture 80.000 users within the first two years (See Appendix A).

## 6.4 SWOT Analysis

A SWOT analysis of Lunar was conducted to develop a full awareness of all the factors involved in deciding on entering a new market. The SWOT analysis is a compilation of Lunar's strengths, weaknesses, opportunities, and threats.

### 6.4.1 Strengths

Lunar is first and foremost a digital bank without any physical branches, which means their operational cost is much lower than for traditional banks. Therefore they can provide their customers with lower commissions and more dynamic service. This low marginal cost also allows them to be more flexible in testing new products. They have a customer-centric strategy that means that they want to develop and launch products their customers need and want. By starting with a small product portfolio, they can grow with their customers and learn from them what they need at each point of their lives. They have been awarded as the number one banking app in Denmark with their easy-to-use app that gives users a great user experience. The app allows users to customize it to their own needs and includes various advanced digital products that are not available at other banks. Customers are also pleased with the app and have rated it above four stars on most rating sites. Users have 24-hour access to customer service.

### 6.4.2 Weaknesses

Although being fully digital is considered a strength, their lack of physical branches and human interaction could also be considered a weakness for some less tech-savvy consumers. The product portfolio of Lunar is not as extensive as that of traditional banks. For example, they do not offer mortgage loans. Another weakness is their low brand awareness. They do not have the same brand awareness as the established traditional banks. Lastly, they have not become profitable yet.

### 6.4.3 Opportunities

The opportunities of Lunar are many. As a fully digital bank, they can provide new types of innovative financial products and make banking more approachable to the average consumer. There is an opportunity in the market to serve underserved markets. Lunar has found that traditional banks are neglecting SMEs and entrepreneurs. They have also found a need to help consumers with their finances and increase financial literacy—the opportunity to develop an innovative culture and broaden the product range to differentiate themselves from others. Changing consumers' attitudes towards the banks also has room for improvement and raising awareness of the benefits of digital banking and available products and services.

### 6.4.4 Threats

Firstly, some consumers might have a distrust of apps and other digital solutions. Cybersecurity threats could affect this distrust and be a threat to Lunar. Second, there is this chance of inability to create a long-term customer base. Customer retention is complex and costly and is one of the main challenges of challenger banks. Lastly, as Ken mentioned in the interview, consumer perception of banks in the Nordics is not good, which adds to the customer acquisition and retention challenges of challenger banks.

| Strengths | Weaknesses |
|---|---|
| • Fully digital<br>• Lower operational cost<br>• Flexibility in product development<br>• Customer centricity<br>• Ability to grow with customers<br>• Award winning app | • Lack of physical branches<br>• Fewer products<br>• Low brand awareness<br>• Not profitable yet |
| **Opportunities** | **Threats** |
| • Develop innovative financial products<br>• Identify underserved market segments<br>• Educate consumers (financial literacy)<br>• Make banking more approachable | • Distrust of apps and digital solutions<br>• Cyber security threats<br>• Inability to create a long term customer base<br>• Negative perception of banks |

*Table 4 - SWOT Analysis Lunar*

## Summary of Case Description

*This chapter provided an in-depth analysis of the case company Lunar. Lunar is a challenger bank from Denmark that has since it was founded in 2015 entered both Sweden and Norway. They have a nordic focus and want to become the number one financial marketplace in all the Nordic countries. What differentiates them from other challenger banks is that they integrate into the national infrastructure of each country they enter. That means that they do national tailoring of their products in each market and provide national accounts, payments, KYC, etc. They are currently the only challenger bank in the Nordics. A SWOT analysis was conducted of the company, and to summarize, the main strengths of Lunar are their digital innovative products and customer-centricity. Lack of physical branches can be considered a weakness and low brand awareness, and not being profitable yet. Lunar has many opportunities, including identifying underserved market segments to serve, continuing to innovate, and changing the way banking is done. Lastly, the threats of Lunar were observed. They mainly concern distrust of digital solutions and the possibility of cybersecurity threats. Additionally, the main challenge of challenger banks like Lunar is customer acquisition and dealing with the negative consumer perception of banks in the Nordics.*

7

# Icelandic Financial Market Analysis

Contents



## 7. Icelandic Financial Market Analysis

*This chapter presents an overview of banks and other financial services in Iceland to introduce the competitive environment of the Icelandic financial market and its main players that Lunar would compete with if they were to enter the market. The structure of*

*this chapter is in line with the Digital Platform Competitive Grid, where each potential player is listed in the relevant corner, following with a PESTEL analysis that analyses banks' macro environment in the Icelandic financial market and aims to help us understand the factors that may profoundly impact Lunar in Iceland.*

## 7.1 Competition Overview

To understand the competitive environment of the financial market in Iceland, the Digital Platform Competitive Grid, presented in the theoretical framework, is used to identify potential competitors and further help us develop an entry strategy for Lunar (see Chapter 4.4.). The authors position Lunar in the center of the grid and possible competitors in one of the four corners depending on where they come from and what their focus is. At least one representative from each corner of the grid was interviewed to get their perspective of a challenger bank entering the market and the competitive dynamics that would entail. The competitors that were identified according to their position in the Digital Competitive Grid are presented in the figure below. This is not an exhaustive list of all the competitors in the Icelandic financial market. The interviewees of this research are representatives from the competitors that are marked with dotted boxes.

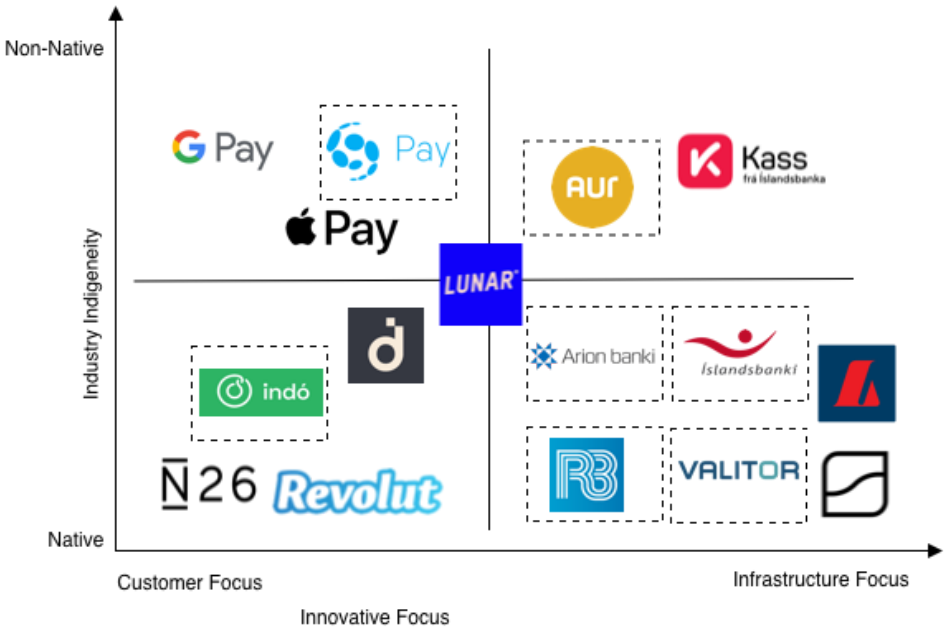


*Figure 7 - Lunar's main competitors in the Icelandic financial market (Figure is a production of thesis authors)*

### 7.1.1 Innovate & Imitate - Native & Customer Focused

These are competitors with similar characteristics as Lunar, with whom Lunar will compete in a head-to-head battle. Positioned in this corner of the grid is Indó, a new Icelandic challenger bank that has yet to enter the market but has signaled its arrival. There is also Auður, a neobank that operates under the banking license of the investment bank Kvika. Lastly, the challenger banks Revolut and N26 are competitors in this corner due to them operating in the Icelandic market, although they are not part of the Icelandic financial infrastructure.

**Kvika & Auður**

Kvika is a specialized bank focusing on asset management and investment services. It was established in 1999 as MP Bank. In 2003 it received an investment banking license, but it was not until October 2008 when it became a deposit institution and received an operating license as a commercial bank. Straumur investment bank merged with MP Bank in June 2015, and that's when it changed the name to Kvika Bank (Kvika, n.d.). Kvika launched its daughter bank, Auður, in 2019. Auður classifies as a neobank where it is an online bank operating on the banking license of Kvika. They entered the market offering savings accounts with the highest interest rates on the market (Auður. n.d.). That has since been their only product. Recently Kvika acquired Aur, a peer-to-peer payment platform, the car loan provider Lykill and the insurance company TM. Which has signaled the market to the possibility of a new product launch from Kvika or Auður, which if Lunar were to launch, they need to keep an eye out (Hf., 2021).

**Indó**

Indó is a fintech company that is currently working towards obtaining a commercial bank license. According to the CEO, they are well on their way to getting the license (See Appendix L). The bank will offer customers a current account, a debit card, and an easy-to-use app. They claim that customer deposits are 100 percent safe, meaning the money is entirely backed by government-issued securities and kept risk-free at the Central Bank of Iceland (Indó Services, n.d.). Transparency with no annual or hidden fees, Indó would be the first challenger bank in Iceland if they are to launch.

**Revolut & N26**

Revolut and N26 are both European neobanks. Revolut is headquartered in London and offers personal finance management, cross-border payments, investments, and more (Revolut, n.d.). N26 is a German neobank headquartered in Berlin, Germany. N26 currently operates in various member states of the Single Euro Payments Area and the United States. It provides a free basic current account and a debit card, with available overdraft and investment products and premium accounts for a monthly fee (N26, n.d.). Icelandic consumers can open accounts at both of these banks, but they are not part of the national infrastructure. Iceland is not part of the European Union and does not use the Euro as a currency. Therefore, it is not considered to be part of the competitive environment of the financial market. The above-mentioned challenger banks are the most prominent ones in Iceland, although there might be other challenger or neobanks that are available to consumers in Iceland, they are not included in this research.

### 7.1.2 Disentangle & Contain - Native & Infrastructure Focused

These are often competitors that are initial platform providers or offer the underlying infrastructure that the platform operates in. These are the three biggest banks in Iceland, Arion Banki, Íslandsbanki, and Landsbankinn. Reiknistofa Bankanna or RB is also a part of this corner as that is the IT service provider for Icelandic financial institutions, which offers the infrastructure.

**Landsbankinn**

Landsbankinn hf was established in its current form on October 7th, 2008, but its roots date back to 1886 when Landsbanki Íslands began operations. In 2001 it merged with the fund management company Landsbréf hf. The state sold half of its shares in Landsbankinn. Following, the bank expanded rapidly and began to expand abroad, operating in twelve countries by 2005. After the bank collapsed in 2008, The Financial Supervisory Authority took over the bank's operations and was fully owned by the Icelandic state. The current owners of the bank are the Icelandic state (98.2%) and other shareholders (0.2%) (Landsbankinn, n.d.). In recent years, Landsbankinn has had the largest market share of the three banks, according to their 2020 annual report it was 38,5 percent (Landsbankinn, 2021).

Digital development has been part of the bank's policy since 2017 (Landsbankinn, n.d.). According to the bank's 2020 annual report the bank wants to simplify life for customers and take the initiative to offer the services that suit everyone. By developing simple and accessible solutions and by using data to provide clients with personal and professional advice. According to Landsbankinn it differentiates itself from the other two banks in that, while customers can take advantage of digital solutions to handle almost all of their banking transactions, it also offers quality personal advice and services throughout the country. The bank has taken a different path than the other two regarding the bank's branch network. Instead of reducing the number of branches significantly, the bank maintains branches in many of the main residential areas of the country. The bank has 36 branches nationwide (Landsbankinn, n.d.). Since its app was introduced in 2018, its usage has increased steadily. In December 2020, around 70,000 individuals used the app to handle all banking services, pay bills, view the status, change sources, access card information and more (Landsbankinn, 2021). Landsbankinn has the largest market share of the three dominant banks, as of 2020 their market share was 38.5%. Additionally they ranked at the top in the Icelandic Satisfaction Scale which measures customer satisfaction.

**Íslandsbanki**

Íslandsbanki was originally established in 1904 under the name Gamli Íslandsbanki and was the country's first corporate bank. In 1990, the bank merged with four other banks, and together they formed the largest private bank in the country, Íslandsbanki hf. In 2006 the bank adopted the name Glitnir and had already expanded their operation to foreign markets, e.g., the Nordic countries, the United Kingdom, Luxembourg, China, and the United States. After the bank collapsed in 2008, Nýi Glitnir was established under Icelandic ownership of the state, and the following year the bank received its current name, Íslandsbanki (Íslandsbanki, n.d.).

Íslandsbanki offers its customers various digital solutions, and they have been increasing digital offerings steadily in recent years. The beginning of the bank's digital journey tracks back to the beginning of 2016 where the bank set an ambitious goal of being number one in service (Íslandsbanki, 2021). They partnered up with the financial technology company Memento and released the mobile payment app Kass. The other

banks have not responded with similar solutions, but it has another competitor in the market which offers the same solution, Aur.

The bank's strategy for gaining a competitive advantage in the future is threefold: a data powerhouse, open banking specialties, and becoming a leader in sustainability. Placing an emphasis on using data cleverly to service customers digitally and understand customer needs to provide them with customized services, products and prices. They have laid the foundation for an open banking environment by updating their app to its standards. Íslandsbanki is the first Icelandic bank to present a sustainable financial framework. The newest sustainable product is the CO2 calculator in the app (Íslandsbanki, 2021).

According to the 2020 annual report, Ísladsbanki holds 32% market share and there were 32 million visits to the app and online bank combined. The bank's branches and full-time equivalents have decreased considerably in recent years (Íslandsbanki, 2021).

**Arion banki**

Arion banki was originally established in 1930 as Búnaðarbanki Íslands. In 2004 it merged with another bank named Kaupþing and was renamed Kaupþing Bank. As with the other two banks, the Financial Supervisory Authority took over the bank's operations after the financial crisis in 2008, and it was renamed again as New Kaupþing Bank. Today, Arion banki is not owned by the government. The bank's most prominent owners are Kaupskil holding 20 percent of shares, and the investment company Taconic Capital owns 16,03 percent (Arion banki, n.d.).

The Bank has been a leader in the field of digital solutions and innovation, and a number of new digital solutions have been introduced in recent years. The core of the bank's policy is to put itself ahead of others with smart and reliable financial solutions that create value for customers, shareholders and society in the future. The Arion banki app has been voted the best for the fourth year in a row by Icelandic consumers. An audit by Finalta, a subsidiary of the international consulting firm Mckinsey, also shows that Arion Banki is one of the small groups of global financial companies that are at the forefront of digital development. The bank received special recognition at the Icelandic Web Awards

as leaders in digital development, and the in-app insurance was chosen as the best technology solution of the year (Arion banki, 2021).

In line with this digital journey, branches and full-time equivalents have reduced. In 2016, there were 24 branches, but now there are only 18. In 2020, 99 percent of service contacts were digital and the bank as 86,200 active app users (Arion banki, 2021)

**Valitor & Salt Pay**

Valitor and Salt Pay are payment service providers that offer shops and online services for accepting electronic payments by a variety of payment methods, including credit card, bank-based payments such as direct debit, bank transfer, and real-time bank transfer based on online banking. Valitor and Salt Pay in Iceland manages most of the relationships to the various payment schemes (be it credit cards, debit cards, mobile apps, Apple or Google Pay, or even AliPay). Payment Service Providers (PSPs) have emerged as one of the primary challengers to the traditional banking monopoly. Thanks to recent regulatory shifts, various types of PSPs have materialized in response to market pressures. Therefore they are considered to be a possible competitor of Lunar in the Icelandic market.

**Reiknistofa bankanna (RB)**

Reiknistofa Bankanna (RB) is an IT service provider for Icelandic financial institutions. It was founded in 1970 by the commercial banks' managers and the Central Bank of Iceland to create a common calculation center. Their first project was called "the check project," which made it possible to mechanize all reading of checks and at the same time process daily settlements between banks. Due to this collaboration between the banks, the company offered a real-time payment system back in 1985. It was the first of its kind in the world, allowing for real-time payments between banks (RB, n.d.).

Today RB provides core banking systems on an outsourced basis to financial institutions. All the Icelandic banks use the same deposit and payments systems developed and programmed by RB. The banks have since knitted their additions to the systems. RB allows the banks to achieve economies of scale and cost distribution for the

Icelandic financial industry. It is also what makes the competitive environment special in Iceland (See Appendix Q).

In 2015 RB decided to renew their core system and entered into an agreement with the software company Sopra Banking Software which all of Iceland's financial institutions will support. The project is one of the most extensive that the banks have undertaken and requires enormous manpower, and could have delayed digital development (See Appendix Q).

In addition to the centralized deposit and payment system, RB created a central claim system called "Kröfupottur" (e. claim pot). Various kinds of payment requests are sent into the RB system with the customer's unique ID (kennitala) and are accessible to the customer at any Icelandic online bank. A new entrant into the banking market would have to go through RB and connect to Sopra if they want to offer national and real-time payments between banks and have access to the claim pot. Since Icelandic customers are accustomed to having this service, a new entrant must have it as well. RB will have to change its systems in the future to allow new entrants to have their own deposit and payment system while also being able to offer real-time payments (Appendix Q).

### 7.1.3 Envelop & Spread - Non-native & infrastructure focused

These are competitors that are non-native to the financial industry and focused on infrastructure. That would be Aur, a peer-to-peer mobile payment provider similar to MobilePay in Denmark.

**Aur**

Aur is a peer-to-peer payment solution that offers real-time payments using phone numbers, which is similar to MobilePay in Denmark. Aur was the first mover in the market. It was founded by the telecommunication company Nova and is therefore non-native to the financial market. Although real-time payments have been part of the Icelandic financial system for decades, Aur was the first to introduce payments using phone numbers and it was considered a success. Today they have over 80.000 active users on the platform and have extended their product offerings to short-term loans, b2b solutions, and debit cards (See Appendix K).

### 7.1.4 Unite Supporters & Strengthen Core - Non-native & Customer Focused

These are competitors that are not native to the financial market but customer-focused. For the Icelandic financial market, these are Síminn Pay, Google Pay, and Apple Pay.

**Síminn Pay**

Síminn Pay is a payment service provider founded by the telecommunication company Síminn. It is an app where users can register their credit and debit cards to pay with the app and also offers buy now pay later solutions within the app. Síminn Pay has been extending its product portfolio, entering various competitive battlefields. They want to become a marketplace where users can shop for products and other things within the app (Appendix O).

**Apple Pay and Google Pay**

Apple Pay is a mobile payment and digital wallet service by Apple Inc. that allows users to make payments in person, in iOS apps, and on the web using Safari, and most Apple devices support it (Apple, n.d.). Google Pay is a similar solution only provided by Google, and Android devices support it (Google, n.d.).

## 7.2 PESTEL Analysis

*This is analysis of the macro environmental factors influencing the Icelandic financial market.*

### 7.2.1 Political

The banking sector appears to be very powerful, but it is vulnerable to a bigger power; the government. Government laws affect the banking sector in many ways, and the government can intervene in its matter whenever they see fit, leaving the industry susceptible to political influence.

Iceland has experienced significant political turmoil in the aftermath of the 2008 financial crisis. The government owns a more substantial proportion of its country's banks than any other government in Europe (Aim to Sell 25% of State-Owned Íslandsbanki at First, 2020). Íslandsbanki, Landsbankinn, and Arion banki were

established as state institutions following the collapse of other banks that had become insolvent during the 2008 crisis. Arion banki has since passed into private hands, while the other two are still state-owned. Reducing state ownership of financial institutions has been an aim of Iceland's financial policy in recent years and is part of the current coalition's government agreement. The sale of Íslandsbanki has been in discussion for some time, and the Ministry has reported that they will initially be selling 25% of their share (Aim to Sell 25% of State-Owned Íslandsbanki at First, 2020). Government ownership of banks can have a political impact and increase the risk of corruption within the financial system, as politicians could be involved in lending decisions and other important matters.

In 2010 the government introduced a special tax on financial companies. The obligation to pay special tax rests with financial companies that have been granted an operating license as a commercial bank, savings bank, or credit company and with others that have a license to accept deposits (Skattar vegna fjármálaþjónustu, 2021).
The special tax was initially set at 0.041 percent, but it has since risen significantly; for example, in 2013, the government increased it to 0.376 percent in response to the government's action on the principal adjustment of indexed mortgages. The tax was decreased in 2020, as the economy was less resilient due to the COVID-19 pandemic response. The tax, however, remains higher than when it was first introduced in 2010, standing at 0.145 percent today (Júlíusson, 2019). As compared to other European countries, the tax in Iceland is higher. The same is true for the income it generates for the Treasury, which is proportionally higher in Iceland than in other nations. The banks claim that the special tax distorts their competitive position and gives other parties in the financial market who are not subject to the tax an unfair advantage (Sævarsson, 2020).

### 7.2.2 Economical

The Icelandic economy is an open high-income economy combining a free market with a welfare state and is sometimes called The Nordic Model. Iceland's economy is small and subject to high volatility, with a population of 368,792 (2021). The GDP was 20.20 billion USD in 2020, or 49,000 USD per capita (Hagstofa Íslands, 2021). Iceland ranks high in terms of GDP per capita and has experienced rapid growth over the last three

decades. Iceland ranks highly in various cross-country indexes, including gender equality and peace (The Icelandic Economy, 2020).

In January, inflation rose to 4.3 percent due to COVID-19, making it the first month since December 2013 that inflation has exceeded the Central Bank's upper deviation threshold of the inflation target. Despite this, there are indications that inflation will decline rapidly soon, as the economy has significant slack and inflation expectations have remained relatively stable. Unemployment has also risen in Iceland, where it's nearly 11% in December, up by 6.4 percentage points since the previous year (Central Bank of Iceland's Interest Rates to Remain Unchanged, 2021).

Iceland is not a member of the European Union and does not use the Euro. Instead, it has its currency, the krona. The country's central bank regulates the krona and it is a low-volume global currency. Its value in terms of other currencies has fluctuated significantly, and some may argue that it is pretty unstable. Adoption of the Euro could theoretically have many advantages. It could help prevent instability in international financial markets and lower long-term interest rates, which would boost capital spending and labor productivity (Sigurðursson, 2009). It could also lower entry barriers for international companies to enter the market, increase competition, and offer better goods, services, and prices. At the same time, it has advantages for companies in Iceland, where external attempts to enter the market and take their market share are rare (Sigurðursson, 2009).

#### 7.2.2.1 Recovery from The Financial Crisis

The Great Financial Crisis (GFC) in 2008 hit Iceland very hard. A combination of large macroeconomic imbalances caused the crisis that had been building up in the pre-crisis period and an oversized banking system. Icelandic banks had favorable international credit ratings before the crisis, and Iceland's membership in the European Economic Area (EEA) enabled them to obtain cheap foreign credit. For context, by the end of 2007, the Icelandic banking system had grown to almost nine times the size of Iceland's GDP. As aforementioned, the three big banks collapsed within a week in early October 2008, shortly after the fall of Lehman Brothers. To save the banks, the Parliament of Iceland passed an Emergency Act that allowed the Financial Supervisory Authority (FME) to

take over financial companies experiencing extraordinary financial and/or operational difficulties. The Emergency Act prioritized the preservation of domestic and foreign deposits. Crisis management focused on protecting the sovereign's credit and maintaining uninterrupted domestic banking operations (Ten Years Later - Iceland's Crisis and Recovery, 2018).

Three new banks, Íslandsbanki, Arion Banki, and Landsbankinn, were established. These new banks took over the domestic activities of the three old ones. The government declared that all deposits in Iceland were guaranteed in full to instill confidence. The government adopted an economic stabilization program in cooperation with the International Monetary Fund (IMF). The IMF program had three key goals: stabilizing the exchange rate, fiscal sustainability, and reconstruction of the financial sector. In November 2008, as part of the program, the government introduced capital controls to prevent excessive capital outflows and stabilize the krona (Ten Years Later - Iceland's Crisis and Recovery, 2018).

Now more than a decade later, Iceland has risen from the wreckage of the crisis. Tourism has emerged as the primary source of foreign exchange earnings. For a small country, Iceland attracts massive numbers of tourists, more than 2.2 million a year, or seven for each domestic resident. The GDP growth rate exceeds 7%, among the highest in the world; the World Bank Group notes that GDP has bounced back from a 2009 low of $12.9 billion to more than $20 billion today (Ten Years Later - Iceland's Crisis and Recovery, 2018).

### 7.2.3 Social

The Icelandic market is relatively homogeneous in their purchase and consumer habits and with strong herd behavior (Árnadóttir, 2017). Many Icelanders struggle with their finance and financial literacy, where the problem is the overflow of information and how challenging it can be to inform yourself and make good decisions (Kolostyak, 2019). An example of limited financial literacy is that there has been a significant rise in applications for financial assistance for the age group 18-20, from being 5% of applicants in 2012 to 27,3% in 2018 (Umboðsmaður skuldara, 2020).

The general public of Iceland is not too happy with their bank. A survey of public attitudes towards the banking system in Iceland, conducted by Gallup for a working group on the White Paper, reveals that high-interest rates and expensive services are one of the main complaints of the majority of respondents. Many also mention greed, high wages, and high costs. (Rúnarsson et al., 2018) Therefore, it is clear that the public feels that financial services are too expensive and believes that, in many cases, this contributes to the fact that the financial system is inefficient and unnecessarily costly. Similar issues are burning for the general public when asked how it is possible to increase confidence in the banking system in Iceland. The vast majority mention better terms and lower lending rates. It is also noticeable how many people believe that measures aimed at moderate wages, improved working methods, and increased transparency would be best suited to increase confidence in the banking system (Rúnarsson et al., 2018).

Mistrust in the Icelandic banking system is mainly due to reduced business confidence. Customers of financial companies do not seem to trust them to offer reasonable services on favorable terms and to ensure that the companies are run efficiently with the interests of customers in mind (Rúnarsson et al., 2018).

### 7.2.4 Technological

With the help of the internet, technology has caused the most significant shift in the banking sector in hundreds of years, changing how banks engage with customers and each other (OECD, 2020). Therefore, it is essential to understand the technological infrastructure in Iceland to help make an entry strategy for Lunar into the market.

Iceland has a highly developed internet culture, with around 98% of the population having internet access, the highest proportion in the world (Iceland Holds the World Record in Internet Use: 98% of Icelanders Are Online, 2016). Mobile usage in Iceland has doubled in minutes based on data usage, before and after the COVID-19 lockdown, according to Siminn, one of the biggest telecommunication companies in Iceland (mbl.is, 2020).

#### 7.2.4.1 Digital Transformation

The Icelandic financial market has not been spared from the digital transformation and changes that have taken place in international markets in the last decade. The three banks are well on their way to a digital journey. They all provide digital banking apps and online banks where customers can perform all significant banking operations. Furthermore, they also offer payments with smartphones and watches (Arion banki, Íslandsbanki, Landsbankinn, 2020). At a glance, the digital solutions that all three banks offer are chemically similar in users' eyes even though the solutions have not been published at the same time by the banks (See Appendices I, P, and K).

The magazine of the Association of Employees in Financial Activities (2017) states that the number of branches of Icelandic commercial banks decreased by 26 in 2012–2017, from 110 to 84 nationwide. According to Benedikt Gíslason, the CEO of Arion banki, the laws and regulations about anti-money laundering and personal privacy are a big part of why banks have been digitizing. Traditional bank's business models are under pressure from their competitors due to increased digital solutions. Many of the bank's infrastructure, including RB systems, are old, and it is expensive to develop digital solutions for such infrastructure (Jónsson, 2019).

### 7.2.5 Environmental

Financial institutions play an essential role as cornerstones of the economy, and as such, they need to carry out a certain responsibility to meet growing demands of increased sustainability (Khalil & O'sullivan, 2017). Sustainability is about meeting the needs of the present without compromising the ability of future generations to meet their needs. The United Nations (UN) Global Goals are based on three pillars of sustainable development; economic, social and environmental (United Nations, n.d.). The activities of financial companies affect many different aspects of the economy and inevitably affect most global goals. The greatest climate impact of financial companies, especially banks, is their loan and asset portfolios (Khalil & O'sullivan, 2017). There are enormous opportunities for banks to positively impact the interests of sustainability through the projects in which they choose to lend or invest. Digitization changes the way financial institutions do business. Disruptive technologies challenge the status quo and allow us to experiment with new innovative business models. The demand for more sustainable

business and the financial technology disruption form an opportunity to create a modern sustainable financial industry. Digitization of financial services reduces the environmental footprint where customers can perform most banking activities online at home, and fintech companies are replacing old services that cause greater environmental pollution (Khalil & O'sullivan, 2017).

### 7.2.6 Legal

Financial companies in Iceland are to operate under relevant regulations in the field of financial markets. The primary laws that apply to bank's operations are the Act on Public Limited Companies no. 2/1995 (1995), Act on Financial Undertakings no. 161/2002 (2002), Act on Securities Transactions no. 108/2007 (2007), and the Act on Measures against Money Laundering and Terrorist Financing no. 140/2018 (2018).

*Act on Public Limited Companies* - The Icelandic Companies Act is largely based on European company law. Icelandic companies are obliged to register with the Directorate of Internal Revenue's Register of Companies and specify who sits on the board and who is the company's managing director, as well as handing over the company's articles of association.

The rules of the Public Limited Companies Act contain e.g. discussion of corporate activities, equities, organizational structure, annual general meetings, auditing, and management responsibilities.

*Act on Financial Undertakings* - Commercial banks operate in accordance with the Act on Financial Undertakings which deals with operating licenses, holdings and share capital, auditing, risk management and other internal regulations, and the competence of management.

*Act on Securities Transactions* - The legislation is based on the European Union (EU) Directive on Markets in Financial Instruments Directive (MiFID). This Directive entails extensive changes to the rules on securities transactions within the European Economic Area (EEA), affecting the relations between financial undertakings and their clients.

*Law on Measures against Money Laundering and Terrorist Financing* - The purpose of the law is to prevent money laundering and terrorist financing by obliging parties who engage in activities that may be used for money laundering and terrorist financing to identify the identities of their customers and their actions.

#### 7.2.6.1 Financial Supervisory Authority

The Financial Supervisory Authority and Central Bank (FME) of Iceland merged at the beginning of 2020 (Fjármálaeftirlitið og Seðlabankinn sameinast, 2020). One of the Central Bank of Iceland's main tasks is to promote a safe, stable, and effective financial system. The FME monitors supervised entities to ensure that their activities are in compliance with the law and with Governmental directives and that they are, in other respects, consistent with sound and appropriate business practices. Supervised entities are all financial undertakings. That includes credit institutions, securities depositories, pension funds, insurance companies, insurance brokerages, insurance brokers, electronic money institutions, payment institutions, debt collection agencies, etc. (Seðlabanki Íslands, n.d.).

#### 7.2.6.2 The Payment Service Directive 2

The Payment Service Directive 2 (PSD2) is a directive by the European Union that seeks to improve the existing EU rules for electronic payments. It takes into account emerging and innovative payment services, such as internet and mobile payments. The Directive sets out rules concerning: strict security requirements for electronic payments and the protection of consumers' financial data, guaranteeing safe authentication and reducing the risk of fraud, the transparency of conditions and information requirements for payment services, and the rights and obligations of users and providers of payment services. The Directive is complemented by Regulation (EU) 2015/751, which puts a cap on interchange fees charged between banks for card-based transactions. This is expected to drive down the costs for merchants in accepting consumer debit and credit cards.

The aim is for the PSD2 Directive to be enacted in Iceland by 2021 with the enactment of a new comprehensive law on payment services. Draft of new legislation has already been presented in the cabinet's consultation portal, and a bill has been submitted. To

prepare for the changes, the FME will provide information and guidance to financial market participants and stakeholders. A recent study on the possible impact of the Directive on the Icelandic financial market shows that it will create more diverse and cost-effective payment solutions, new members will enter the market, competition will increase and the best and most efficient solutions will succeed but others will disappear from the market (Ingibergsdóttir, 2018).

Below is a table that summarizes key components of each factor in the PESTEL analysis:

| **Political** | **Economical** |
|---|---|
| • Government ownership of banks and possible corruption<br>• High special tax compared to neighboring countries (0,145%) | • Small economy with high volatility<br>• The krona (Iceland's currency) is unstable and can be an entry barrier |
| **Social** | **Technological** |
| • Homogeneous market in the purchase and consumer behavior<br>• Icelanders struggle with financial literacy and stable finance<br>• Attitude towards the banks is not great, especially in terms of high interest rates and expensive services | • Highly technology developed country<br>• Advanced IT infrastructure for banks<br>• All banks provide digital banking where customers can perform all major banking needs |
| **Environmental** | **Legal** |
| • Growing need for sustainable and environmental products and services | • Highly regulated country for banks<br>• Mostly following EU regulations<br>• PSD2 has yet to come into effect |

*Table 5 - PESTEL Analysis of the Icelandic Financial Market*

## Summary of the Icelandic Financial Market Analysis

*This chapter analyzed the Icelandic financial market in terms of the competitive environment and the macro-environmental factors affecting companies that operate in it. The Digital Competitive Grid allowed us to classify the different market competitors, who were divided into four groups based on whether they were native or non-native to the market and centered on infrastructure or customers. Native and customer-focused competitors include Icelandic neobanks Auður and Indó, as well as European challenger banks Revolut and N26. Digital wallets such as Síminn Pay, Google Pay, and Apple Pay are*

*non-native and customer-focused competitors. The third group, native and infrastructure-focused, includes Iceland's three largest banks, RB, as well as the major payment service providers Valitor and Salt Pay. Finally, Aur, a mobile payment app, is non-native and infrastructure-focused. Each organization was given a brief description. In the next chapter, the findings of the research are presented with a more in-depth action plan for each of Lunar's competitors.*

*PESTEL analysis was conducted. For the* ***political*** *considerations, it was discovered that the Icelandic government had owned the three major banks in Iceland since after the 2008 financial crisis. This has an impact on the financial industry, where it can foster corruption. In Iceland, the taxation environment for banks is very strong, and there is a special tax on financial institutions that act as an inhibitor for businesses. The* ***economic*** *factors identified were mainly statistics about the Icelandic economy. It is small but with high volatility. Iceland has its own currency, the krona, which has been unstable throughout the years and acts as a possible entry barrier for foreign companies to the market. The main* ***social*** *factors are about the Icelandic consumer and how homogeneous the market can be in the purchase and consumer behavior. Related to finances, there is a lack of financial literacy, especially among young people. After the financial crisis, Icelandic consumers' overall attitude toward banks has been negative, especially in terms of high-interest rates and expensive services. Following that, the* ***technical*** *factors were analysed. Iceland is a technologically advanced nation with cutting-edge IT infrastructure in the financial sector. Most banks are well on their way on their digital journey, where most of their services can be consumed digitally. The key* ***environmental*** *factor was the growing demand for sustainable and environmentally friendly goods and services and the responsibility of financial institutions to be overall sustainable in their business decisions. Finally, the* ***legal*** *factors were discussed that are influencing the financial market, such as national regulations and laws for financial institutions and the European Union's PSD2 Directive, which has yet to be enforced in Iceland.*

8

# Findings

Contents



## 8. Findings

*This chapter presents the findings of the empirical data from nine semi-structured interviews with specialists in the Icelandic financial market. The analysis is divided into sections based on the Theoretical Framework, 1) The Entry Strategy, 2) Minimum Viable Product, and 3) Digital Competitive Grid. The chapter is split into two subsections. In the first subsection are, the 1)* ***Interview results*** *that present what respondents have informed about the topic. The second subsection, 2)* ***Construct from theory*** *applies the vocabulary from the Theoretical Framework chapter, demonstrating how the theory explains the observations.*

## 8.1 Interview Results

This section reports what the interviewees said about entry strategy, minimal viable product, and competition.

### 8.1.1 The Entry Strategy

***Timing of entry*** - According to the interviewees, most of the respondents agreed that being a first mover in the market would be important to gain a competitive advantage. But being a first mover is not enough. You have to provide something disruptive that could be in the form of a new product or service that is not available in the market (See Appendices I, J, L, and P). Eva said, *"I think it's very important to be first in the market. You often say that it isn't the most important thing, but it matters though"* (See Appendix I).

When asked if signaling the market before entering it had any impact, Haukur, the CEO of Indó, said that when they announced they would be entering the market as a bank, another company applied for a banking license to launch a similar solution (See Appendix L). However, incumbent banks have not acted yet. Both the interviewees from Íslandsbanki and Arion banki said they would probably not react in any particular way if Indó were to enter. Both of them were unsure about Indó's business model, whereas far as they know, they are focusing on deposits, and deposits do not generate enough income for banks due to low deposit rates (See Appendices J and P). Another aspect is that switching cost is still high for consumers where Logi said:" *It is still complicated to change banks, complicated to get a new card, a new account etcetera so that it would have to be something cool and different to get people to change"* (See Appendix P).

When Aur, a mobile payment provider similar to MobilePay in Denmark, entered the market, it signaled Íslandsbanki to make a similar solution. About six months later, they launched their product, Kass (See Appendix K). Even though Aur had become wildly successful and had acquired a lot of customers, Kass still managed to at some point gain a significant market share. However, Kass has since deteriorated its market share to the point that Aur does not consider them a threat anymore (See Appendix K).

Several interviewees mentioned changes in consumer preferences and argued that the average consumer has become more environmentally conscious, more focused on social impact and sustainable banking (See Appendices K, N, and I). Viðar put it nicely by stating, *"consumers today are more focused on values like sustainability and transparency and are more choosing services and products from that perspective. If someone would come into the market and offer something different from the others and focus on something like that, then it would work in the market"* (See Appendix N). The consumers are taking a more proactive approach to their finance where Eva said, *"Icelanders have reached a point where they are much more willing to start trading with foreign companies and banks. For example, as many Icelanders have started investing abroad and are following the FIRE (Financial Independence, Retire Early) movement."* (See Appendix I). Furthermore, consumers are starting to view financial products in a similar way to other products and services. They select a service or product depending on where they get the best value and thus having several different financial providers, rather than purchasing a bundle of products and services from just one provider, which has historically been the incumbents' business model (See Appendix I).

**Order of entry -** It is essential to be the first in the market, and that person must be the disruptor in the market. But if you're a follower, then it doesn't matter where in the line you are. But then it matters that the first one does it well and that he is offering disruptive services (See Appendix I). Like Eva said," *It will probably not matter much for bank three or four to enter the market because the disruption has already occurred, so when the first-mover enters with this perspective and does it well, I think it will be huge"* (See Appendix I).

Many of them mentioned the entry of the challenger banks Revolut and N26 to the Icelandic market. They agreed that they did not follow any specific entry strategy and didn't offer any disruptive services or products, and thus their entry was neither disruptive nor successful (See Appendices J, I, L, P, and K). These banks do not have accounts in Icelandic krona, and that does not serve the Icelandic consumer. Sverrir from Aur said: *"As much as we curse the krona, we are also protected by it when it suits us. None of these parties offer accounts in the Icelandic currency or trade in it, and no one*

*wants to take on the exchange rate risk. We are effectively trapped inside a fortress wall where we only compete with local parties"* (See Appendix K).

Another reason why a new entrant needs to offer a disruptive service or product, according to interviewees, is that Icelandic consumers will not switch banks unless it provides something revolutionary and different from the available services. That is due to their disdain of incumbent banks that all provide similar services. Eva said, *"The problem is that all banks are the same, which is why we (consumers) don't bother switching. If there is a genuine difference and a disruptor enters the market, it will happen."* (See Appendix I).

**Design of entry** - The interviewees concurred that when entering the market, the importance of gaining a critical mass of users pretty fast and worrying about monetizing the product later. That is, for example, what Aur did. They started as this free peer-2-peer payment solution but now offer a variety of products like short-term consumer loans and B2B payment solutions that they can take a commission off (See Appendix K). Sverrir, the CEO of Aur, said, *"We'll get users fast and worry about the business model later. That's exactly what we did, and we still today subsidize our basic services, which are transfers. But we have always looked at it as an acquisition cost. Just as if we were running a store, we would need retail space."* (See Appendix K). Haukur from Indó said their entry strategy is to start with deposits and grow with their customers and offer more products if there is demand for it by their customers. He said that it is important to be in close dialogue with the customer to provide them with the product they need instead of the product Indó wants to make (See Appendix L). Some also talked about banks becoming a financial marketplace for their customers. Vilhjálmur from Arion Banki mentioned that their mission was to focus more on constantly exploring partnerships with third parties to offer the best products and services to their customers (See Appendix J). Haukur from Indó said that they don't plan on building and providing everything from in-house but rather to help their customers find the right mortgage, insurance, stock, etc., by collaborating with third parties (See Appendix L).

### 8.1.2 Minimum Viable Product

According to the interviews, there are opportunities in offering financial services that support the values of individuals, such as sustainability, environmental awareness, and financial literacy. Along with unconventional financial services like that, you can rent a car, vacuum cleaner, and such things through your banking app (See Appendix I). Eva said, "*Being able to excel by helping people with all kinds of comparisons is something that matters,"* as well as *"you do not excel with types of cards, you excel by helping the person make informed decisions that reflect their values"* (See Appendix I). Sverrir from Aur talked about the need for financial literacy, helping consumers to make smart decisions about their finances and teaching them about investments (See Appendix K).

The interviewees were divided about underserved consumers in the Icelandic financial market. Some argued that the younger generation is underserved (See Appendices P, M, J, and Q), while others argued that young adults (people between the ages of 30-45) that are more concerned with their finances and more vulnerable to charges are underserved (See Appendices L and I). Eva described them: "*The target group is young and middle-aged consumers who are technologically savvy. They prefer self-service and consider having to go to a branch as a poor service."* (See Appendix I). Haukur from Indó also said that small and medium-sized companies and entrepreneurs or freelancers are underserved in the market in Iceland (See Appendix L).

What interviewees think is missing in the market is to invest in the foreign market, cross-border payments, and cryptocurrency market (See Appendices P, H, I and J). Vilhjálmur said: *"the purchase and sale of foreign securities. The banks in Iceland charge considerably more fees and the whole process is more difficult"* (See Appendix J). This is, to some extent, offered by the challenger banks N26 and Revolut. Vilhjálmur from Arion said, *"There (at Revolut) you can look for something that is not present at the Icelandic banks today,.., there we have access to the stock market, access to New York stock exchange and you can buy cryptocurrency. I'm using those services, but I'm not using their banking services because I'm pretty happy where I am."* (See Appendix J). Some interviewees have stated that there is a market demand for better mortgage loan rates, but the reason why no one has responded to that demand yet could be that pension funds are on the mortgage loan market in Iceland. They can give lower interest rates than financial

entities, and therefore it's almost impossible to compete with (See Appendices J, K, L, and M).

The incumbents tend to launch products that they think will be successful but are not developing solutions from the customer point of view (See Appendices I and L). Digital native companies like challenger banks are more customer-focused and, like Haukur from Indó said, *"We are going to communicate with our customers and develop products and solutions that they actually want, instead of developing products that we want to do"* (See Appendix L). Still, some of the incumbent players have realized the importance of meeting customer needs. They have developed products for their customers that they don't profit off but add value to their ever-changing customer needs. For example, Íslandsbanki recently released a C02 calculator in their app. Logi from Íslandsbanki said: *"But is it going to shake up the market and expect everyone to change banks? No, no way. But does it make current customers happier? Yes, I think they really appreciate it"* (See Appendix P).

Another related topic was how the small size of the Icelandic market could benefit companies as a pilot or testing market for a new product. As Eva said, *"Iceland is a perfect test pilot market, because it's very fast, consumers are easy to convince, homogeneous and tech-hungry. Both Costco and Meniga have used Iceland as a test market."* (See Appendix I). Gunnar from Síminn has also been testing new products and said, *"As with charities, we have been hosting charities for free, and we do not charge a percentage of anything. We're just helping charities advertise their charities, and you can go in and donate. This is just part of innovation. We are always trying something new"* (See Appendix O). Not all of our interviewees agreed with Iceland being a good test pilot market, where Viðar said that the market is too homogeneous and thus not ideal for a test pilot market (See Appendix N).

### 8.1.3 Digital Platform Competitive Grid

As outlined in the Theoretical Framework, this research uses the digital platform competitive grid to categorize the potential competitors of Lunar in the Icelandic financial market to provide a recommendation of different competitive approaches

towards different competitors. Figure 8 below shows the potential competitors on the Grid.

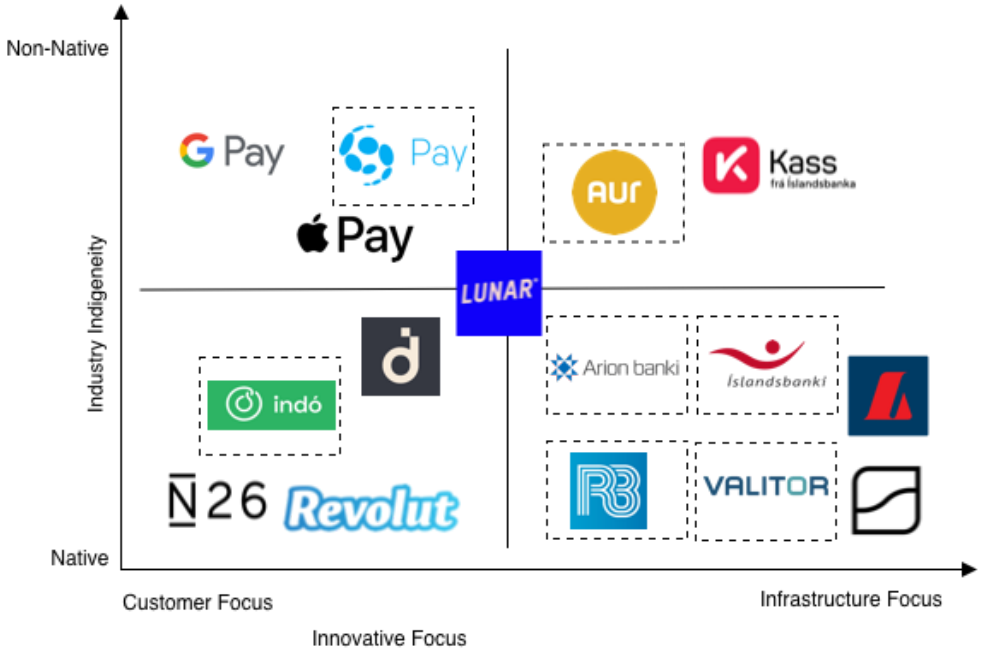


*Figure 8 - Digital Platform Competitive Grid Icelandic market (Figure is a product of thesis authors)*

The leading players in the financial market are not worried about competition in the market or potential entrants entering Iceland's financial landscape. Like Eva said, *"The banks will sit comfortably in their seats and not do anything until someone enters the market and shakes things up"* (See Appendix I). Both our interviewees from the banks had something similar to say. They both implied that they are comfortable in their position and do not feel they need to respond in any way if a new entrant would enter the market (See Appendices J and P). Vilhjálmur from Arion Banki said, *"The Icelandic banks are offering a hell of a lot of good solutions, and Arion, especially with the app, we have gained an advantage with the app, and then it's a bit difficult to compete with it. Of course, it's more fun at work when there is competition, and you want to see new entrants into the market, and that keeps you on your toes and so on, but I think it could be quite difficult."* (See Appendix J). Other interviewees who were not from the banks mostly agreed that the banks have an old mindset and should worry more because it's just a matter of time when someone will enter and disrupt the market (See Appendix I and L). The banks are comfortable in their position. Vilhjálmur from Arion Banki said how the market reacted to a new entrant: *"Aur has arrived, and there was no such reaction from the banks, Netgíró came and of course people are trying to come up with short-term loans,*

*but are still not in the same market. Kvika came in with Auður's deposit account, and there was no huge reaction from the banks. If Indó came into the market with a bang and gained a massive customer base, the banks would naturally respond. But nothing significant happened with N26 or Revolut. But what is happening with us is that we are consolidating and entering into more collaboration with third parties."* (See Appendix J). The banks in Iceland realize the importance of collaborating or partnering with third-party fintech companies. They understand that it's impossible to make everything in-house but instead see the potential of collaboration to offer a better user experience (See Appendices J, I, and P).

Some interviewees mentioned that the competition in financial services is mostly on cost structure and customer-centricity (See Appendices J, L and P). Challenger banks have that advantage over the incumbents, that they can more easily build new solutions upon their simple infrastructure. Like Vilhjálmur from Arion banki said: *"This is not a competition in innovation, because when companies like Starling Bank and Revolut come up with a solution, the other banks imitate and maybe a year later. Rather, this is a competition in cost structure, i.e., When banks are bringing some innovation on top of their systems, they have a new product but continue with the old cost structure, which are expensive and old systems that are difficult to maintain. These new members bring new products and innovations but at much lower costs and better systems."* (See Appendix J). Haukur from Indó said something similar: *"What separates us from the banks is this simple infrastructure, the cost is lower which means that we become more profitable much sooner and we can provide much more value for the customer"* (See Appendix L).

The interviewees weren't too concerned about a new entrant entering the market unless it was something completely new and disruptive that the incumbent players were not offering already. Instead they spoke about a possible change of direction into more invisible banking, where the big tech companies might be the biggest threat to the financial market in Iceland. Logi from Íslandsbanki said:" *The only companies that could threaten the current environment are that if any of these big tech companies were to enter the financial market as they already have customers and know a lot about them, that somewhere in the value chain they would offer customers some kind of financial solutions, such as loans, buy now pay later payments, etc."* (See Appendix P).

There have been some speculations in the market that there might be another financial competitor in the making with the merger of Kvika (the investment bank), TM (insurance company), Lykill (car loan company), Aur (P2P payments), and Netgíró (payment solution) (See Appendices Q, P, K, and J). None of our interviewees know what they are going to do, but the eyes are on them at the moment where they could enter with some disruptive solution any time now.

## 8.2 Construct from Theory

This section applies the vocabulary from the Theoretical Framework chapter, demonstrating how the theory explains the observations. First, the Entry Strategy (Staykova & Damsgaard, 2015) is covered, then the Minimum Viable Product (Ries, 2011), and thirdly the Digital Competitive Grid (Staykova & Damsgaard, 2021), which is covered in depth in the Theoretical Framework chapter in this research.

### 8.2.1 The Entry Strategy

***Timing of Entry*** - Timing is thought to be the most important factor in effective market entry. Estimating the best time to enter a market is important since it can have a major competitive advantage. The results from the interviews indicated that being a first mover in the Icelandic market would be important. The entry strategy framework also considers that the ability of a company to launch a product earlier than its competitors is viewed as a source of competitive advantage, as businesses may use entry timing as an additional dimension to differentiate themselves.

Signaling the market about possible entry can trigger a response from competitors. Still, the interviews' findings revealed that the incumbent banks did not react to Indó preannouncement of the upcoming entry to the market where they do not think Indó will provide a disruptive service or products. However, the theory suggests that new product preannouncements may relate positively to the level of customer switching costs incurred in adoption. The findings revealed that switching cost is high in the financial market in Iceland. Therefore the preannouncement of a new entrant to the market could make consumers aware and decrease their engagement with their old provider.

According to the Entry and Expansion strategy theory, the decision to enter the market also depends on changes in the economy and consumer perception, and the interviewees talked about this. How consumer preferences in Iceland are changing, and banks need to be aware of that when they are developing new products and solutions. Therefore, this change in consumer perception can easily affect the decision of a new entrant to enter the market.

***Order of Entry*** - Staykova and Damsgaard investigated whether the first-mover can gain substantial competitive advantage and if the advantage can be sustained over time when later entrants enter the market. Our findings highlight that if the first-mover would offer a disruptive solution and have a successful entry into the market, the competitive advantage is likely to be sustainable. N26 and Revolut were first-movers in the market as challenger banks, but their entry did not result in a substantial customer base. The theory also says that the first-mover advantage has a direct impact on the switching cost. High switching costs put late entrants at a disadvantage because they must invest more resources into attracting customers away from earlier entrants. This is in line with the findings where the switching cost in Iceland is high for financial services and might thus indicate putting later entrants at a disadvantage.

***Design of Entry*** - The design of entry can be connected to the timing of entry if there is pressure to become the first mover. Like the interviewees mentioned, it could be good to enter the market with a simplistic solution that is not thought thoroughly in terms of monetization and figure out the logistics of that later. The value from gaining a critical mass of users is so high. The theory suggests that some platforms may enter the market one-sided and transform into two-sided as they develop. Banks are most often one-sided, but that is changing, as we saw in the interviews. Banks want to become more of a financial marketplace in the future where customers can find different products and services through their banking app that is not necessarily provided by the bank but connects them to a third party. In those cases, the bank becomes a two or multi-sided platform that can leverage network effects in terms of indirect network effects.

### 8.2.2 Minimum Viable Product

The theory does not support the common notion that hard work, good timing, determination, and most importantly, good product or service alone can ensure success. Instead, the theory suggests the importance of incorporating consumer insight when launching a product. The interviews confirmed this, where it is necessary to maintain close contact with customers and develop products that they want and need. In its simplest form, the Lean startup approach is described as rapidly building and testing a product, and then based on customer feedback, quickly refine the promising concepts and ruthlessly change direction. This is precisely what our interviewees emphasized with their approach to launching in a new market, focusing on communications with the customers, and developing products they actually want and need.

### 8.2.3 Digital Platform Competitive Grid

The theory demonstrates that most platforms begin by competing in a single competitive area. As they evolve their offerings and services, they span across related and unrelated markets where they encounter different competitors. The interviews showed that the competitors outside the single competitive area of Lunar do not look at them as a threat. This could be impacted by the launch of Revolut and N26 in the Icelandic market as they are not part of the national financial infrastructure needed to compete with the Icelandic financial services. However, the incumbent banks in Iceland talked about how they are collaborating with third parties. That is their response to the increased competition from fintech companies that may be coming from unrelated markets. The theory suggests that digital platforms need to be flexible and quick to launch proactive measures against diverse competitors and respond to their competitive actions. It can be challenging for incumbents where they do not have the same cost structure as fintech companies and challenger banks have.

The Digital Platform Competitive Grid also includes seven competitive actions. One of the actions, market entry, is a competitive action that refers to decisions about the platform's strategic initiatives when entering a market. In the case of our interviewees, the incumbents in Iceland are not worried about a new market entrant entering the market, as they feel competent about their position in the market. Another action is Signaling; a competitive market signal conceptualized as announcements or previews of

potential actions intended to convey or gain information from competitors. Indó signaled the market, and there has not been any response from the incumbents.

## Summary of Findings

*This chapter presented the findings of the data collected from the interviews with nine specialists from the Icelandic financial market. The main findings were the importance of being a first mover in the market and gaining a critical mass of users before worrying about monetizing and earning a profit. The Icelandic financial market does not seem to be threatened by new entrants. Most of them believe the entry barriers are too high for foreign challenger banks to enter into the national infrastructure. Challenger banks like Revolut and N26 did not enter the national infrastructure and are therefore not a direct competition to the Icelandic banks. If someone entered the infrastructure, it would have to offer a disruptive and revolutionary product or service to the Icelandic consumer to succeed in the market.*

9

# Recommendations for Entry Strategy

Contents



## 9. Recommendations for Entry Strategy

*This chapter presents the entry strategy for Lunar into the Icelandic financial market. Based on the internal analysis of Lunar, the macro-environmental analysis of the Icelandic financial market, and the findings from the interviews with the financial specialists in Iceland. First, the incentives for Lunar to enter the Icelandic financial market are described. Second, what entry barriers are necessary to overcome. Lastly, the main entry strategy combining every aspect of the analysis and findings is presented.*

## 9.1 Incentives for Market Entry

Looking at the learnings drawn from the internal analysis of Lunar and the analysis of the Icelandic financial market, there are many incentives for Lunar to enter the market. First, the PESTEL analysis revealed that Iceland is a wealthy nation with high GDP per capita, which could indicate a profitable landscape. Although the market is small, with the country's population being only around 350.000, where we estimate that potential banking customers could be around 295.000 people (from the age of 16 and up), the Nordic consumer provides more economics than consumers from other European countries (See chapter 6 Case Description). After the financial crisis in 2008, distrust towards the three big banks arose and has remained relatively stable since then. The overall attitude toward banks is negative, especially in terms of high-interest rates and expensive service. With its transparent and customer-centric business model, challenger banks like Lunar could potentially attract those unhappy customers away from the incumbents. Both the interviews and the PESTEL analysis concluded that there is greater demand for sustainable and environmentally friendly goods and services. Lunar has social impact integrated into its business model where the goal is to improve financial health, not to invest in oil, gas, weapons, or countries violating human rights, and free charity donations. In addition to the greater demand for more sustainable products and services, the interviews found underserved market segments in Iceland, such as entrepreneurs and SMEs. Lunar has found this to be true elsewhere in the Nordics and has a unique service tailored to the needs of those customers (See chapter 6 Case Description). Currently, no challenger banks are operating in Iceland as part of the national infrastructure, which means they don't offer national payments or accounts. Therefore, they have not been able to gain a significant market share and directly challenge the national players. Lunar has the opportunity of becoming a first mover in the market. According to the PESTEL analysis, the Icelandic consumer could need some help with financial literacy, especially the younger generation, where there has been a significant rise in applications for financial assistance (See chapter 7 Icelandic financial market). All of which Lunar does have in addition to their sustainable and transparent business model.

## 9.2 Entry Barriers

Launching Lunar in Iceland has potential entry barriers. Key findings from the PESTEL analysis concluded that Iceland is a small and volatile market. Iceland also has its own currency, the krona, which has fluctuated significantly in terms of other currencies, and some may argue that it is quite unstable. The exchange rate risk associated with the krona has served as quite the entry barrier for other foreign companies to enter the market. Further, the government in Iceland has a so-called "banking tax," which is a special tax on financial companies with an operating license in the country, standing at 0.145 percent today. The banks have claimed that the special tax distorts their competitive position and gives other parties in the financial market who are not subject to the tax an unfair advantage.

Iceland is a technologically advanced nation with cutting-edge IT infrastructure in the financial sector. In Iceland, the banks have built the infrastructure that has centralized deposit and payment systems and central claim systems. Lunar has to enter the IT infrastructure to be competitive in the market. But integrating into the infrastructure is a costly and time-consuming process. Further, the banks in Iceland are well on their way on their digital journey where most of their services can be consumed digitally, and their digital products are mature, and customers are satisfied with them.

## 9.3 The Entry Strategy

***Timing of entry*** **-** As mentioned in the PESTEL analysis of the Icelandic financial market, there has not been much change or diversity in product and service offerings by the incumbents, which could present an opportunity for a new entrant. As found in the interviews, the consumer preferences in Iceland are changing. They want to choose companies that they do business with more based on personal values. Environmental issues and sustainability are big trends that consumers are passionate about, and Lunar can tick this box with its environmental and sustainable strategy. This can be a good indicator that the right time to enter the Icelandic market would be soon.

***Order of entry*** **-** Currently, no challenger bank is targeting Icelandic consumers. As mentioned above, European challenger banks like N26 and Revolut allow Icelandic consumers to open accounts but are not advertising or actively recruiting the Icelandic

consumer. Additionally, they are not part of the Icelandic financial infrastructure and therefore are not considered competitors in the market. Indó is a new Icelandic challenger bank that has announced that they will be entering the market, but there is still a chance to become a first mover. The authors would recommend Lunar to enter before Indó. There is an ability to obtain a substantial first-mover advantage if they can acquire a critical mass of customers, which can disadvantage a later entrant due to the market's high switching cost.

***Design of entry*** - Like Lunar has done when entering a new market, they have started with a soft launch where limited product offerings are presented (See chapter 6 Case Description). It would be recommended for the Icelandic market as well, where the focus would be on attracting as many customers as possible and then increasing product offerings over time. The findings from the interviews about banks becoming more of a financial marketplace indicate that Lunar would be a great fit where they are collaborating with diverse fintech companies to provide their customers with all kinds of banking products. Lunar should try to attract customers by encouraging them to try their products without switching from their bank. Once the customer is registered, Lunar can prompt him with products to try and get him to use Lunar as its primary banking app over time. The design of entry is very closely related to the minimum viable product of the Lean Startup method, which will be discussed in the next section of this chapter, where more in-depth recommendations are given about specific products to launch.

| Strategy | Recommendations |
|---|---|
| Timing of entry | Be a first mover in the market |
| Order of entry | Enter before Indó where there is an opportunity to gain a significant first-mover advantage |
| Design of entry | Lunar should focus on becoming a financial marketplace |

*Table 6 - Entry and Expansion Strategy Approach and Recommendations*

### 9.3.1 Products to Launch (MVP)

Currently, there are a lot of untapped markets that Lunar could enter and take market share. Understanding the needs of the potential customers and then releasing a minimum viable product would be ideal for Lunar. Then work closely with the customer to know how he perceives the product by analyzing behavioral data, asking questions, doing customer interviews, etc., to get a holistic view of the customer's needs. For launching in the Icelandic market, the authors would recommend that to begin with, Lunar should launch with their most standard products: deposit accounts with a focus on financial literacy with the personal finance tool and goal setting. Also, to differentiate themselves, they should include their environmental projects, like the Project Blue Ocean, investments where other players in the market are not currently providing that, and the subscription management tool currently unavailable anywhere in the market. As the interviewees indicated, Iceland can be a great pilot market for testing a new product and getting quick customer reviews. If Lunar were to launch in Iceland, it is suggested that they use Iceland to test new products in the Icelandic market and gather feedback before launching in other markets.

| **Strategy** | **Recommendation** |
|---|---|
| Minimum Viable Product | Lunar should launch with their most standard products, the deposit account, with a focus on financial literacy with the personal finance tool and goal setting. As well as their social conscious products like the Project Blue Ocean. Lastly, they should launch with their investment platform and subscription management tool. |

*Table 7 - Minimum Viable Product Approach and Recommendations*

### 9.3.2 Competitive Actions

Digital platforms encounter different competitors at various new markets they enter. These competitors possess different characteristics and capabilities in terms of the user base, portfolio functionalities, technology capabilities, financial resources, and more. That is why it's essential to make recommendations for a competitive approach in each of the four corners of the digital platform competitive grid (See chapter 4.4, Theoretical Framework).

***Innovate and Imitate - Native & Customer Focused*** - These are competing in the first competitive area that Lunar would enter, with similar characteristics, and with whom Lunar would engage in a head-to-head battle at multiple markets. When adopting this approach, Lunar should emphasize market entry, signaling, and functionality releases. Even though Indó has signaled their entrance to the market, they have not yet entered, which means that Lunar could be first in the market and gain a substantial market share. Lunar should signal the market and let them know about their plans to enter the market and try to enter before Indó does.

As mentioned earlier, the challenger banks available in Iceland, N26 and Revolut, are not part of the Icelandic infrastructure. The authors would recommend that Lunar would not take the same entry approach as they did but rather put in the work to integrate their system into the national infrastructure, meaning entering the IT banking system of RB (See chapter 7.2.4, The Icelandic Financial Market). That way, they can compete directly with these competitors, offering direct real-time transfers between banks and access to the claim pot that is considered a standard service for banks in Iceland. The authors recommend that Lunar focus mainly on this corner of the competitive grid when entering the Icelandic market.

***Disentangle and Contain - Native & Infrastructure Focused*** - These kinds of competitors are often the initial platform providers or offer underlying infrastructure where Lunar would be operating. These are the incumbent banks of Iceland, which have a very established market share and strong brand loyalty with their customers. The Disentangle and Contain approach emphasizes competitive actions such as capability building. Lunar should focus on launching with capabilities that differentiate them from these incumbent players. The recommended products and services that Lunar should launch are described earlier in this chapter. That should be their key competitive action against these players, as it may attract customers away from them and towards Lunar.

***Envelop and Spread - Non-native & Infrastructure Focused -*** The authors would not recommend Lunar to enter this corner until they have settled into the market. It should rather be part of their expansion strategy as it can be overwhelming competing in all four of the battlefronts simultaneously.

When the time comes, against non-native competitors, with a focus on infrastructure innovation, Lunar should embrace an Envelop and Spread approach and focus on competitive actions related to envelopment as part of its competitive repertoire. In the Icelandic financial market, the mobile payment provider Aur would be in this category. They were founded by a telecommunication company that is non-native to the financial industry. Relying on an existing infrastructure of the banks to develop their product which is peer-to-peer payments using telephone numbers. Currently, Lunar does not offer the same solution. Still, their shared account could be seen as a similar solution where it makes it easy for customers to share expenses, whether it's a budget account with a loved one, a food account with friends, or a travel account for the family. As Aur relies on the existing infrastructure, it should be easy for Lunar to imitate Aur solutions.

***Unite Supporters and Strengthen Core - Non-native & Customer Focused*** - The same applies to this corner of the grid. The authors do not recommend that Lunar focuses on this corner in their entry strategy but instead in their expansion strategy. When facing competitors that are non-native but customer-focused, Lunar should unite forces with those that are under similar threat and strengthen key competencies through capability building. For Lunar, these are competitors like Síminn Pay and Google with GooglePay and Apple with ApplePay. In other markets, Lunar has partnered with the "buy now pay later" giant Klarna (Danish Challenger Bank Lunar Takes on Klarna with Pay Later Product, 2020), which Lunar could also do in Iceland when the time comes to compete on this battlefront.

| Strategy | Recommendation |
|---|---|
| Native & Customer focused | Enter the national infrastructure |
| Native & Infrastructure focused | To compete with the players Lunar should differentiate themselves with innovative products |
| Non-native & Infrastructure focused | (part of Expansion strategy) Shared accounts |
| Non-native & Customer focused | (part of Expansion strategy) Buy now pay later collaboration with Klarna |

*Table 8 - Digital Platform Competitive Grid Approach and Recommendations*

### 9.3.3 The Expansion Strategy

The authors want to emphasize that the entry for Lunar into the Icelandic financial market should be an iterative process where they should not just enter with the above strategy and sit and hope for the best. It is important to look out for signals in the market and other competitive actions they should expect when entering the market. Then when the time is right, Lunar should proceed with their expansion strategy and compete in one additional corner at a time. As mentioned above, a part of the expansion strategy should be the Shared accounts as a competitive action against Aur and the Buy not pay later feature as a competitive action against SíminnPay. Also, Lunar should offer cross-border payments because of the demand in the market for that product offerings, as was evident in the findings. As well as products and services for small and medium enterprises (SMEs) and entrepreneurs.

Below is a table with an overview of Lunar's main competitors that were interviewed and which products are part of the entry strategy (color: blue), which are part of the expansion strategy (color: pink).

| *Corner of the Competitive grid* | *Native & Customer focused* | | *Infrastructure & Customer focused* | | | *Non-native & customer focused* | *Non-native & Infrastructure focused* |
|---|---|---|---|---|---|---|---|
| **Financial service** | **Lunar** | **Indó*** | **Arion** | **Íslands-banki** | **Lands-bankinn** | **Síminn Pay** | **Aur** |
| Investment | x | | | | | | |
| Spending overview (PFM) | x | | x | x | x | | |
| Goals | x | | x | | | | |
| Buy now pay later | x | | | | | x | |
| Charity | x | | | | | x | |
| Joint accounts | x | | | | | | x*** |
| Cross-boarder payment | x | | | | x | | |
| Subscription manager | x | | | | | | |
| Blue Ocean | x | | | | | | |
| SME and entrepreneurs | x | x** | | | | | |

*Table 9 – Comparison of the Digital Platforms of Lunar's Main Competitors*

**Indó has not announced which products they will launch with but this is according to research done online as well as from the interview with Haukur*

***Haukur from Indó mentioned in the interview that this would be on their plans.*

**** Aur has a similar product*

*Coloring: Blue is entry strategy and pink is the expansion strategy*

# 10

# Discussion

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## 10. Discussion

*This section interprets and places the findings of the thesis in an academic and practical context. The research question is answered by extrapolating and summarizing the key findings of the analysis. Further, the limitations of the theoretical and methodological approach of the thesis are explained and discussion on the contribution of the thesis to the field of entry strategies of Digital Platforms. Finally, recommendations for future research areas within the topic of Digital Platforms in the financial sector will be laid out.*

## 10.1 Research Findings

For Lunar to enter the Icelandic market, a successful entry strategy should consist of the following actions:

1. It's important to become a first mover in the market. There is still an opportunity to do so since there is currently no challenger bank operating in the national infrastructure.
2. They would have to enter with disruptive products or services that differentiate from the current players in the market to acquire customers.
3. Lunar should launch with products that feed into consumers' values. In recent years, consumer perception has been changing, resulting in a greater demand for sustainable and socially responsible products and services.

The overall business model of Lunar revolves around making a positive social impact, emphasizing financial health, responsible investments, and transparency. It separates Lunar from the key players in the Icelandic financial market and responds to the need for more sustainable banking.

Lunars key competitors in the Icelandic financial market are the three biggest banks and other fintech companies that are either native or non-native to the financial industry. The native players identified in the research are other European challenger banks, the Icelandic neobank Auður, and the possible entrant Indó. Non-native players are SíminnPay, Apple Pay, Google Pay, and Aur. Lunar has to take different competitive actions depending on each competitor. That includes entering the national infrastructure and differentiating themselves with innovative products.

The PESTEL analysis revealed that entry barriers are pretty high, and competitors in the market are not expecting competition, giving Lunar an advantage. Current key players in the market are expected to underestimate the potential entry of Lunar, where they think no foreign challenger bank wants to integrate into the national infrastructure. That is the case with N26 and Revolut entry strategies in Iceland.

## 10.2 Findings in Relation to Literature and Expectations

***Lunar as a digital platform -*** For this research, Lunar is defined as a digital platform, and the existing literature of digital platforms entry strategies and competition are reviewed. In the past, scholars approached entry strategies of banks more traditionally, and more conventional theories and concepts are applied, for example, the Five Forces Model of Michael Porter (Parker et al., 2016). Although Lunar does fit the digital platform description, some of the key features of platforms are not as obvious. Digital platforms are often characterized by network effects. However, network effects produced by banks are not as evident as network effects generated by other digital platforms, such as mobile payment apps. The authors argue that indirect network effects exist, in which the number of customers influences the attractiveness of Lunar to potential partners interested in joining the platform. In the literature review, a winner-take-all market is one of three possible scenarios that might emerge in the competition between platforms (Ruutu et al., 2017). In the case of banks, a winner-take-all scenario is not attainable. Although new entrants might enter the market and challenge incumbents and gain a substantial market share, the market is still very mature and too large for a winner-take-all scenario.

According to Munger (2015), the key value proposition of the platform business model is not about selling products but "selling reductions in the transaction costs." That is especially true for Lunar, a completely digital bank that assists customers with money management by connecting them with the appropriate financial service, thereby reducing their search cost.

The entry strategy framework argues that in industries with strong network effects, a first mover has the potential of significant first-mover advantage over its rivals if they manage to get a large installment base and constitutes a barrier to entry for followers (Staykova & Damsgaard, 2015). The findings of this research do not cover that as the network effects are not seen to affect the success of a new entrant. However, the authors argue that it's important to be a first mover in the market, giving Lunar the opportunity to lock in customers. The Icelandic financial market consists of high switching costs and brand loyalty which puts late entrants at a disadvantage. They will have to invest more

resources to attract more customers away from the earlier entrants, which aligns with the framework. The framework suggests that digital platforms should enter as one-sided platforms, then transform into two-sided and eventually into multi-sided platforms. Defining one-sided platform as the platform provider and just one group of users who are subject to strong same-side network effects. Again, same-side network effects are rarely present for banks, but it can be argued that there are opportunities in product offerings to create same-side network effects. Consider the shared accounts provided by Lunar. That creates a network effect in which, for example, if a group of friends wants to create a shared account, they must be Lunar customers.

The Lean Startup is a great how-to method that teaches startups and companies how to drive a startup and how to launch a new product or service (Ries, 2011). While Lunar entering the Icelandic market is not exactly a new product release, but rather a market entry where products that have already been launched in other markets and tested by consumers. But still, the authors feel that theory is helpful in launching in a new market, as it should take the same approach as if it were launching something completely unique.

## 10.3 Limitations & Future Research

Some potential limitations of this study should be highlighted. To begin with, challenger banks are a relatively recent phenomenon, and there is a lack of research on these banks' entry strategies in the field of digital platforms. Previous research on digital platform entry strategies has focused mostly on more visible digital platform companies such as social media platforms, mobile payment platforms, sharing economy platforms, etc. As a result, there is a scarcity of literature on banks as part of the digital platform literature, posing a limitation for this research. The results cannot be easily compared to previous research.

Furthermore, it is useful to determine consumer demand in the potential entry market for a service or a product as part of a successful entry strategy. The research did not provide the consumer's point of view because the authors thought it would necessitate more extensive research of the Icelandic consumer that there was no time to undertake.

Although, the interviewed specialists in the Icelandic financial market provided insights about their perspective of consumer preferences and needs in the market.

Lastly, representatives from each of the corners of the Digital Platform Competitive Grid were interviewed. However, foreign market players such as Apple, Google, N26, and Revolut were not interviewed because the authors did not receive responses from these companies to conduct interviews.

Future research would be value-adding to gather data on consumers about their perspectives, product demands, and attitude towards a new challenger bank entering the Icelandic market. It would be valuable information for Lunar to know what the Icelandic consumer attitude is towards their entry, what kind of products and services they want, to develop a successful entry strategy. As platforms and their dynamics are fast-paced, it is difficult to say what the future will hold. Thus our outlook shows only how the future might be based on our interviewees' beliefs and articles about future development. The authors believe that these insights might be of inspiration to researchers that want to include challenger banks as part of the digital platform research area.

# 11

# Conclusion

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## 11. Conclusion

This case study and action research has examined, through interviews and secondary sources, what entry strategy Lunar should implement if they were to enter the Icelandic financial market. Through an in-depth analysis of the Icelandic financial market and Lunar, and findings from interviewing nine financial specialists in Iceland, an entry strategy was developed. The strategy includes competitive actions against various native and non-native competitors and the minimum viable product Lunar should launch. In this research, Lunar is defined as a challenger bank that adopts a digital platform business model, where previous literature on platform entry strategies has not been conducted on challenger banks. This research is a contribution to that field of research.

The research question was presented: ***If the digital platform Lunar were to launch in Iceland, what entry strategy should they implement to succeed in the market as the first digital challenger bank?***

1. **Sub-Question:** *What are the most important macro environmental factors affecting the financial market in Iceland, and how does that impact Lunar's entry strategy?*

2. **Sub-Question:** *What should be Lunar's minimum viable product according to market opportunities?*

3. **Sub-Question:** *How is the competitive landscape both in terms of native and non-native players in the Icelandic financial market and what competitive actions should Lunar take for each player?*

To answer the research questions, the importance of being a first mover in the market and gaining a critical mass of users before worrying about monetizing and gaining a profit, was established. The Icelandic financial market does not seem to be threatened by new entrants where most of them believe the entry barriers are too high for foreign challenger banks to fully enter into the national infrastructure. Which brings us into the first sub-question: "*What are the most important macro environmental factors affecting the financial market in Iceland, and how does that impact Lunar's entry strategy?*" Iceland is a small, volatile, and homogeneous market. It has its own currency which can be unstable and serve as an entry barrier for foreign entrants. Some of the banks are government owned and the government also has a banking tax which can give banks a competitive disadvantage. Iceland has a very mature IT infrastructure for it's banks but foreign entrants need to integrate themselves into that infrastructure to be able to provide national payments and be competitive in the market. Finally, the Icelandic consumers are dissatisfied with their current banks. Even though the challenger banks Revolut and N26 are available to Icelandic consumers, they did not enter the national infrastructure and are therefore not a first-mover in the market. Indó has signalled their entry into the market and are expected to enter any time soon. This still gives Lunar time to enter and become a first mover in the market. If someone would enter the infrastructure it would have to offer a disruptive and revolutionary product or services to the Icelandic consumer if they were to succeed in the market. This brings us to the second sub-question of the research question: "*What should be Lunar's minimum viable product according to market opportunities?*". Lunar should focus on using its digital platform to become a financial marketplace. Lunar should launch with their most standard products, the deposit account, with a focus on financial literacy with the personal finance tool and goal setting. As well as their social conscious products, the Project Blue Ocean, the subscription manager, and the investment platform.

The third sub-question asks "*How is the competitive landscape both in terms of native and non-native players in the Icelandic financial market and what competitive actions should Lunar take for each player?*". The competitive landscape is mature and consists of many diverse players in each corner of the Digital Platform Competitive Grid. For competitors in the Native & Customer focused the authors recommend entering the national infrastructure of Iceland in order to compete in that corner. For Native & Infrastructure focused competitors, Lunar should differentiate themselves with innovative products. The authors recommend that Lunar starts to compete with the first two corners mentioned above when entering the market. For non-native & Infrastructure focused competitors, Lunar should launch with their shared accounts feature where that would be a direct competition to Aur that offer peer-to-peer payments. This should be part of their expansion strategy. In the last corner, non-native & customer focused where Síminn Pay, ApplePay and GooglePay, where Lunar should offer the product Buy now pay Later, where they are partnered with Klarna and join forces to compete against these players. Again, this should be part of Lunar's expansion strategy as it is not recommended to enter the market competing on all four battlefronts.

Even though the Icelandic financial market is mature and its players have put a lot of focus on their digital products, the authors argue that there is an opportunity for a disruptor in the market. The incumbents and other financial services in the market are too comfortable in their seats and are not stressed about a new entrant entering the market, like Vilhjálmur from Arion Banki said about a potential new entrant in the market: "*The Icelandic banks are offering a hell of a lot of good solutions, and Arion especially with the app, we have gained an advantage with the app and then it's a bit difficult to compete with it.*"

Lunar could be what the market needs, a leader and a disruptor, and become the first challenger bank in Iceland providing new innovative products that the consumers want and need. Like Steve Jobs famously said: "*Innovation distinguishes between a leader and a follower".*

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