The digital challenge to retail banks

Financial institutions that successfully apply digital technologies will embrace deep strategic, operational and organizational changes.

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Something big is stirring in retail banking. Across the world, financial institutions are rolling out a broad array of initiatives that place bold bets on new digital technologies, which they expect will fundamentally change how they attract and retain customers.

Most banks are investing heavily in apps for smartphones and digital tablets that make it easy for customers to conduct a wide range of banking activities while on the go. Some are developing interactive tools that help customers analyze their spending habits and strengthen their money management skills. Still others are mobilizing the power of social networks to draw "fans" to feature-rich Facebook pages that build their brands and entice consumers to share personal information.

Each of these initiatives marks a major effort to harness fast-moving digital technologies, unrestricted mobile access and vibrant social media to banks' interactions with their customers. But to a large degree the digital pioneers—as well as banks that have yet to cross the digital Rubicon—are also in a battle for survival as they race to keep up with consumers' rapid embrace of wireless interconnectivity.

The challenge is global and gaining momentum as banks try to come to terms with technologies that have transformed sector after sector. Venerable companies like Kodak, the photography pioneer, and Blockbuster, the once preeminent purveyor of video rentals, failed to step up to the digital challenge, spelling doom for their business models as they succumbed to nimble newcomers in faster, lower-cost digital imaging and online video streaming. Innovators like Amazon.com and Apple's iTunes applied new digital technologies to revolutionize the publishing and music industries, sweeping away long-entrenched incumbents. Closer to home, banks are feeling the hot breath of competition from PayPal, Google Wallet and others whose mobile payments technology threatens to displace banks in consumers' daily transactions.

The stakes could hardly be higher (see the sidebar "Five common misconceptions"). The winners will be able to shrink their physical footprints, eliminating at least 30% of their branches and massively reducing costs at a time when margins continue to contract across the banking industry. Meanwhile, they will be able to expand product variety and customization, accelerate service delivery, tap new pools of revenue and deepen customer relationships that boost retention and profitability.

Technology by itself will not deliver a competitive advantage; what banks do with it to develop a unique, personalized customer experience will matter most of all. Success will take much more than a string of initiatives that tack high-tech gadgetry and cool apps onto a traditional banking infrastructure and mindset. Indeed, technology for its own sake is a costly distraction, which adds complexity, muddies decision making and impedes the organization's ability to adapt. Failure to take a disciplined approach will divert attention from the pressing need to break through the conventional walls of retail banking—both literal and cultural—and engage customers seamlessly across all channels, on their own terms.

Bain & Company's in-depth interviews with more than 20 senior executives from 15 financial service institutions around the world revealed that, for a variety of deep-rooted institutional and cultural reasons, seizing the digital opportunity in banking will be especially challenging. Focused more on processing transactions than innovating around the customer experience, retail bankers have been slow to weave new customer-facing technologies into the core of their operations. They have been even more hesitant to take full advantage of the technology's potential by redesigning their product and service offerings, aligning their pricing and channel strategies, and rethinking how they hire, train and deploy their frontline employees. Lacking a clear strategic rationale, their digital initiatives end up producing only marginal enhancements that drive up IT spending rather than give the bank a competitive advantage.

Using digital technology to build a boundaryless bank will require a deft touch. Customers' need to save, spend and transfer money in a secure environment remains unchanged, but their behaviors are changing radically. Their interactions with their bank will effortlessly bridge the online and offline world. Before they set foot in a branch, customers are increasingly comfortable using the Internet to seek advice and gather product and service information. They expect to be able to choose the channel

Five common misconceptions

Myth #1: You have plenty of time to figure this out. Speed to market will be a critical success factor for banks seeking to embrace digital technologies. Innovation cycles have accelerated almost exponentially in recent decades.

Myth #2: It's all about the "apps." Offering easy customer access and cool functionality for smartphones, tablets and other mobile devices can be a powerful attraction. But unless it is integrated with a complete digital strategy, applications won't do much to enhance your business. Increasingly, apps are basic table stakes.

Myth #3: We don't need to invest in digital capabilities because retail bank customers do not change banks. Automatic paycheck deposit and long-term commitments, such as mortgage and home equity loans, have typically made depositors hostage to their banks. But the demographic shift to digitally literate younger customers, along with a revolution in consumer behavior, powered by social media, to look for a better deal, has increased customers' propensity to defect.

Myth #4: Adding digital capabilities is a job best delegated to the specialists in the IT department. Technology is a powerful enabler, but only banks that embrace far-reaching strategic and cultural changes led from the top of the organization will successfully meet the digital challenge.

Myth #5: Being a digital banking pioneer is not worth the risk, when a bank can quickly copy at lower cost what a competitor has done. There are huge first-mover advantages for a bank that puts its digital strategy in gear ahead of its rivals. It is the accumulated learning from trial and error and the patient implementation of cultural and organizational changes that spell the difference between the leaders and the laggards. Banks that are forced to play catch-up risk falling farther and farther behind the frontrunners.

most convenient for them—whether that's a branch office, browsing the bank's website or using a video-enhanced call center—and they will insist that all channels work together harmoniously. They expect all of the companies they do business with—and particularly their banks—to know them as individuals, anticipate their needs and actively involve them in coming up with tailored solutions. They do not hesitate to use social media to let other consumers know how they were treated.

Strategic imperatives: Empowering the digital customer

Retail banking leaders will need to adjust to this paradigm shift by tackling four strategic requirements.

Integrate your distribution channels. Leading digitally ready banks provide a seamless experience that lets customers decide how and when they interact with the bank. The contours of a bank that synchronizes all of its channels can be seen in the example of TD Bank, the pioneering North American retail bank.

Describing itself as "America's most convenient bank," TD Bank presents a friendly and always-ready-to-serve face at every point of customer contact. Branches are open for extended hours, seven days a week and staffed with dedicated relationship managers. The bank's full complement of online, mobile and interactive tools offers a common accessible and intuitive interface that simplifies money management and facilitates sales of basic banking products. TD Bank trains call center service representatives to be problem solvers for customers. Supported by state-of-the-art data systems, they are evaluated by their ability to achieve first-call issue resolution and earn favorable customer feedback—not by how quickly they can get the customer off the phone.

How banks manage customer data is at the heart of an integrated channel strategy. Industry leaders, like Citibank Asia, never need to ask a customer for the same information twice. Stored in sophisticated customer relationship management systems that span all channels, data that a customer shares at each touchpoint—whether it's acquired through a visit to a full-service branch, an online product search or contact with a call center—travels with the customer and is retrievable wherever the customer comes into contact with the bank. The more personal cross-channel tapestry of individual customer information enables the bank to size up his or her needs more quickly and deliver a tailored customer experience. (For a glimpse of how a digitally capable bank can mobilize around customer needs, see the sidebar "The Lees buy their dream home.")

Putting customers at the center of an integrated omnichannel strategy enables the bank to convert each channel from a mere dispenser of services or product information into a revenue-enhancing force multiplier. Using new digital capabilities to enable customers to choose the channel that provides them with the most value and convenience, banks are augmenting their websites or introducing mobile applications that encourage purchases for common products like credit cards or savings accounts. For example, Finansbank, an innovative Turkish retail bank, enables its customers to use smartphones to check their personal loan credit limit before making a major purchase, by sending a secure SMS message to the bank's database. Recognizing the caller's mobile number and PIN, the system automatically confirms the customer's account balance.

A fully integrated channel strategy makes the bank a companion that customers can call on whenever, wherever and however they choose. Integrated channel management vastly enhances the bank's ability to refine its marketing approach. Organizing campaigns across channels instead of diluting them within channel silos gets a bigger bang out of tight marketing budgets. They allow the bank to align its mass media, targeted online campaigns and in-branch advertising, to surround customers with information that captures their increasingly short attention spans.

How banks price products and services across their integrated online and offline channels needs to be transparent and uniform. Banks have commonly promoted bargain-priced "online-only specials" for basic credit cards and low-cost current accounts as an inducement for customers to purchase common financial products over the Internet. But banks that continue to practice multitier pricing without convincingly demonstrating that the price at each channel presents a distinct value proposition—for example, when charging a higher price for supplemental services provided by a financial adviser—risk alienating customers when they discover different prices for the same products. As high-end retailers and big-box consumer electronics chains have learned, customers expect the same deal whether they encounter it on a website or on the showroom floor. Banks, too, need to present customers with the same price for the same product, whether they are at a smart ATM, seated at a loan officer's desk or using a digital tablet.

In the transparent new omnichannel world, skillful management of pricing is a critical success factor. Presenting a one-price approach across all channels runs considerable risks of alienating customers when they sign on to low-cost digital outlets and discover better deals. But reflexively matching online competitors' low-ball prices squeezes profit margins. Because pricing is such a sensitive feature in the relationship between a bank and its customers, the leaders are beefing up their capacity to evaluate how customers respond to pricing.

Redesign your network. Torn between a desire to take advantage of the new efficiencies digital technologies can achieve and to satisfy customers' assumptions that their bank will be available to assist them whenever and wherever it suits their convenience, banks face a big job of managing expectations. Many banks have been too quick to capitalize on digital technologies as a way to strip costs out of their operations. Steering their technology-enabled customers to websites, mobile apps and ATMs, they are shuttering full-service branches and replacing them with automated kiosks. But while the savings from taking a self-service approach can be enticing, the longer-term costs of abandoning customers to their own high-tech devices are unacceptably high.

The Lees buy their dream home

It is the autumn of 2015, and the Lees, expecting the arrival of their second child, face a dilemma that has confronted young families for generations. Their current apartment is too small and their budget is tight. But the couple has new online and offline banking options for finding and financing an affordable new home, which were unimaginable just a few years earlier.

Using an app that he downloaded from his bank's website to his digital tablet, Mr. Lee enters the price range of the homes he and his wife think they can afford, their space requirements and where they would like to live. Based on an initial consultation via Skype with a personal financial adviser at their bank, the couple provided data that prequalified them for a home mortgage and opened a deposit account online to set aside the money the adviser recommended they would need for a down payment.

Pinged on his way to work by his smartphone's near-field communication technology a few weeks later, Mr. Lee sees that the alert he had set on the online tool confirms that a nearby house that meets his criteria is listed for sale by a real estate agency affiliated with his bank. Arriving at his office, Mr. Lee contacts his bank adviser via video chat. She presents a range of options about various loan terms and updates the Lees' information in the bank's central database. The real estate agent emails Mr. Lee more information about the property and schedules a tour. Meanwhile, the bank adviser gets to work developing pro forma financial estimates for the property the Lees will be viewing.

Following their house visit, the Lees stop by the bank branch, where the service concierge escorts them to their adviser's office. The adviser pulls up the data the Lees had provided and integrates it with the electronic worksheets she had prepared and stored. Using one of the branch's video conference rooms, the adviser introduces the Lees to a bank mortgage specialist, who works at a central office across town, to answer the Lees' more detailed questions and provide expert advice.

At home later in the evening, Mr. Lee checks mortgage comparison sites to confirm that the terms and closing costs his bank has offered matches or beats terms available at other lenders. Ms. Lee browses home buying forums to inquire about other people's experiences and consults her Facebook friends for their opinions.

Learning that the seller accepted their bid, the Lees contact their bank adviser via email to initiate the formal application process. She has the Lees fill out an online form that authorizes the bank to get the tax information and credit scores it will need to complete the loan approval. The Lees log in over the subsequent days to track their loan's progress. Returning to the bank branch to close the purchase via video conference, the Lees are delighted with the convenience and transparency of the mortgage process and are eager to tell their family and friends about their excellent home buying adventure.

Leading banks are capturing both the new technologies' potential cost savings and growth opportunities by reshaping their networks in ways that profitably meet—and exceed—customers' expectations. A recent Bain & Company analysis of key retail banking touchpoints in the US also found that mobile transactions have the greatest likelihood of delighting customers. In a forthcoming report featuring key findings from its 2012 survey, Bain will report that mobile usage to conduct banking transactions in the US has increased dramatically over just the past year in every age, income and asset segment. For example, 36% of customers whose annual household income exceeds $100,000 reported using a smartphone or tablet to conduct a banking transaction within the previous three months—up from just 24% in 2011. Ultimately, most routine banking, including the self-service purchase of common low-cost products like simple credit cards and no-frills deposit accounts, will migrate online to the bank's website. Rapid customer uptake of digital technologies presents a major opportunity for banks to create wow experiences that enable them simultaneously to reduce costs while deepening customer loyalty.

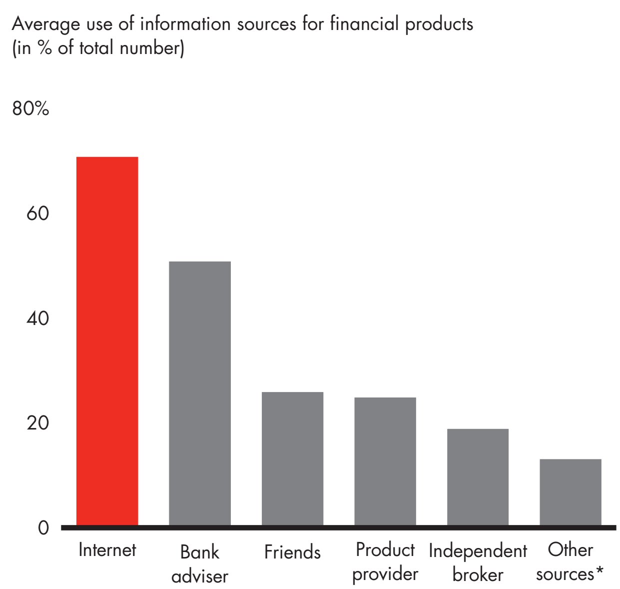
Branches are more important than ever as product showrooms and as places where customers seek expert financial advice. Instead of hollowing out their branch network, the leaders are converting it into a lighter, but sturdier, hub-and-spoke system. At the center of the retail network that Citibank is building in Asia, for example, are flagship stores in high-traffic prime commercial locations that offer a full complement of products and advisory services. Removing counters and teller windows, they are providing service amenities like free Wi-Fi access, videoconference lounges and dazzling merchandizing displays that entice customers to linger and explore. The principal function of the flagships and other full-service hubs is to serve customers' more complex financial needs, like retirement and investment planning or residential and business financing. As more banks aim to increase the convenience of a trip to a full-service branch while improving operating efficiencies, they may want to look beyond their industry to offer amenities like those available through OpenTable or similar reservation sites, which would enable a customer to see when a specific financial adviser is available and schedule a consultation.

At the networks' periphery, smaller satellite branches—some with on-site staff and others that are fully automated—field customers' high-volume routine transactions and assist them with the purchase of simpler products like auto loans. Analyzing the network configurations of leading banks in Germany, Bain found that most could easily close up to one-third of their branch offices while improving customer service.

What will set the leaders' networks apart from the competition is the investment they make in hiring, training and developing highly qualified financial advisers and multitalented customer service representatives. Value-added advice and peerless customer service, not mere convenience, will be the hard currency of the digitally powered bank. In the bidding for customer attention, banks are no longer consumers' leading source of information about financial products. A Bain analysis has found that more than 70% of consumers began their search on the Internet compared with about half who consulted their bank adviser (see Figure 1).

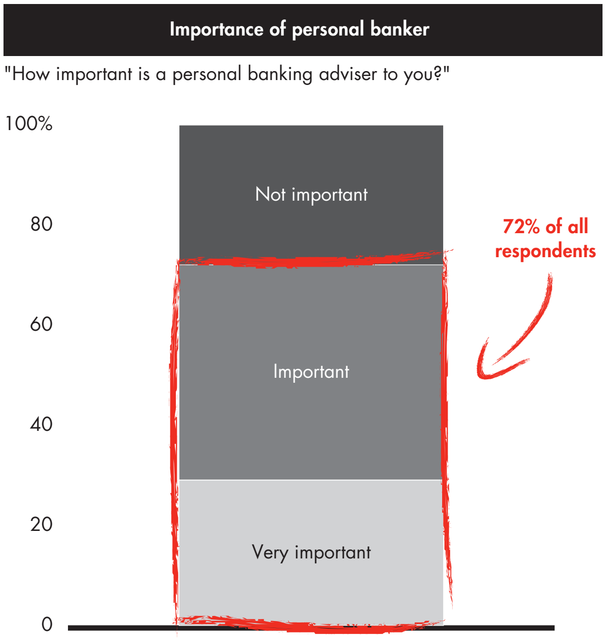
Increasingly, banks will need to win the battle against other banks and nonbanks to convert those better-informed online shoppers into customers. The quality of the advice they offer and the ability of their advisers and service representatives to help customers choose the products and services that are best tailored to their needs will determine which banks will best earn customer loyalty and win a greater share of total customer spending on financial services. Our analysis found that nearly three-quarters of customers describe the advice they received from their personal banker as "important" or "very important" to the financial decisions they make (see Figure 2).

Figure 1: Customers use the Internet as their number-one source of information about financial products and services



* Includes magazine/newspaper articles, broadcast media, display advertisements and advertising circulars
Source: Bain Retail Banking Study, 2012

Figure 2: Personal bankers remain customers' leading source of financial advice



Sources: Bain analysis

What will it take to build a great advisory capability to serve a more knowledgeable and self-reliant customer base? Hired for their formal expertise and communications skills, financial advisers are trained to master the intricacies of the bank's financial product line and how it can be custom-tailored to meet individual client needs. To get the greatest value out of these higher-skilled and better-compensated employees, banks will need to use technology to make their expertise available at all nodes of the network and across a wide range of media. Working in teams from the flagship stores, full-service outlets and off-site video call centers, the advisers will be able to serve customers wherever, however and whenever customers decide to contact them. Banks will need to move swiftly to redesign their networks and redirect personnel costs to strengthen their adviser teams.

Upgrade your service and operations platforms. The integrated online and offline digital bank needs a new organizational and technical spine to deliver a seamless service experience that's focused on customers and adapted to their varied needs across all media and channels.

Getting the organization right is the first crucial step. Today, most banks remain organized as they evolved over time in the brick-and-mortar world—around the geographic footprint and operational requirements of their branches. As online and mobile banking options emerged, they built parallel organizations, binding their information technology organizations to the online channels they support. Breaking down the structural walls between the online and offline modalities frees banks to begin the shift from organizing themselves by channel, product and geography to mobilizing around customer segments.

Nimbler, more focused banks are better able to standardize their product offerings and processes in both the online and offline channels. To support this more streamlined configuration that puts the customer experience at the core requires a redesigned IT architecture. But while IT has a central role in supporting the program, leading banks put the customer-serving units in charge of defining its scope and business objectives. Citi has embarked on an ambitious multibillion dollar IT program, called "Project Rainbow," to upgrade its customer insights by creating a single global IT platform for its retail bank by 2013. The new system will give Citi a comprehensive 360-degree view of its customers, irrespective of the products they purchase or their points of contact with the bank.

Serving all distribution channels, the new business-led IT organization gathers all customer information online and makes it available through a single customer relationship management system to frontline employees and advisers, wherever the bank touches them. Integrated decision-making rules that cut across all channels and are backed up by clear accountability for their fast and efficient implementation are crucial to ensuring that the voice of the customer is heard at each stage of the online and offline customer journey.

Having made customer relationship management a core strategic competency, Commonwealth Bank of Australia (CBA) has refocused its IT spending to developing customer-focused content. As a result, CBA is reaping dividends across four dimensions. First, it has boosted the efficiency of its workforce by dramatically increasing customers' ability to serve themselves.

CBA has consolidated its IT operations from 23 data centers to just two over the past five years. Second, the increased traffic the new system generates helps CBA generate new sales by improving its value proposition and highlighting new product offerings. Third, it has lifted sales of additional products to existing customers by making it easier to identify individual customer needs and tailor offerings accordingly. Finally, CBA has boosted customer loyalty across all of its most attractive retail and commercial segments by delighting customers with the system's ease of use and functionality. The bank has increased the number of feature enhancements that improve the customer experience from 1,200 changes per month to some 3,000 changes per month today.

Fortify your brand and reinforce your franchise. As digital technologies and changing customer behaviors shift the competitive landscape, banks need to anticipate that potential rivals can encroach from any direction. Wireless telecom giants like Verizon, nimble online payment systems like PayPal, Internet powerhouses like Google—along with a host of innovative start-ups in developed and emerging markets—are drawing up battle plans to take on traditional banks by offering greater speed, convenience and lower cost.

With barriers of entry crumbling, leading banks are sharpening their market intelligence to scan for emerging competitive threats. The leaders are scrutinizing each link of their value chain to assess potential vulnerabilities and erect defenses to reinforce their higher-profit-margin businesses and their grip on their most valuable customers. The leaders take proactive measures to know their customers better than any potential rival can. They tailor offers that anticipate customer needs and play to the bank's strengths. They innovate to increase customer convenience and invest in building a stronger brand that earns customer trust. By earning their customers' loyalty, they reap several mutually reinforcing benefits: Loyal customers are more likely to recommend their bank to colleagues and friends, earning the bank new customers through referrals. And they buy more of the bank's products and services, making them less likely to defect to a competitor and more profitable customers.

Mandates for change: Adopting a digital mindset

Unless it becomes a top priority, pushed urgently by bank senior management, a digital strategy will easily lose momentum. Banks will need to develop competence in four major areas where they have traditionally lacked them in the past.

Become transparent. Online media are creating a vast new public forum with enormous commercial potential—and risks—for banks. They have opened a channel into the private lives of consumers who are willing to share and store more personal data about themselves. They have also become a global sounding board for consumer opinion, as customers use social media to broadcast their likes and grievances to large audiences at digital speed.

Banks have mostly remained on the sidelines of this widening two-way torrent of communication. Institutionally, they have prized discretion, nurturing a culture that reveals little about themselves and virtually nothing about their customers. Their reflexes for sharing information are not up to the fast pace of the online world their customers inhabit.

Becoming more transparent is a double-edged challenge. Banks are sitting on a treasure trove of data, reaching deep into their customers' financial and personal lives—from routine purchase preferences to individual specifics on financial goals on major lifetime events like home buying, retirement, children and education. Banks need to learn how to tap into the data, opinions and behaviors their customers are willing to share and put those insights to work in ways that respect customers' expectations of privacy and trust.

At the same time, banks need to open themselves up to customers' insistence for access to information about their products, operating processes and values. In Turkey, for example, banks have registered more than one million "fans" on their Facebook sites, putting themselves on display for all to see. Recognizing that they ultimately have little control over the flow of discussions and opinions consumers exchange about them via social media, banks will need to be able to adapt their communications strategies to be candid, responsive and honest.

Adapt the business model. The economics of digital technology can be compelling. Online businesses are ruthlessly efficient users of capital and can scale up easily to deliver a high return on investment despite low operating margins. Introducing new digital technology leads to lower transaction costs that get passed along to customers.

As customers shift to the new digital formats, revenue and profit pools will shift with them. It is a difficult journey that is fraught with uncertainties. Management will need to commit to big investments in the new capabilities. Meanwhile, it will need to be prepared to watch the organization's competitive position deteriorate over the medium term, as declining prices result in decreasing profit margins and new digital offerings cannibalize traditional ones. Bain's experience has shown that there is no one solution that works for all banks to counter this risk. But bank leaders who aim to guide their organization smoothly from the traditional branch-centric business model to the new omnichannel one must be prepared to wage cultural war against the status quo.

Execute swiftly. Innovation cycles have shortened from years to months, but adapting product offerings, distribution channels and back-office operations to technology's quickening pace runs counter to banks' deliberative culture. Getting into sync with the digital challenge will test banks' capacity to identify cutting-edge opportunities early and speed them to market. With limited resources to invest in new technologies, banks will need to hone the disciplines for making small bets on a portfolio of promising ones, test and refine them quickly, team up with innovation partners and fully commit to the ones that show the best potential.

Focus on the customer. The digital challenge is turning banks' traditional top-down approach to managing customer relationships on its head. Preoccupied with setting policies, developing products and arranging operations that meet regulators' requirements and best suit their internal needs, banks have long been indifferent to what their customers really want. To attract and retain customers in the digitally networked economy, bankers are beginning to understand that it is customers who will define—and feel free to alter—the terms of the relationship.

The leaders are seizing the initiative by sharpening their customer intelligence and segmentation skills, using the increasing volume of information customers share to map their financial journeys in detail and discover distinctive ways to help them. They are doing this by forging true partnerships with the customers they most want to serve by using short surveys to solicit their input following a transaction. They apply a reliable metric like Net Promoter® score (NPS®) that enables them to differentiate between experiences that win promoters from those that create detractors. They cycle the insights they glean through feedback loops that foster continuous frontline learning and improvement and make the voice of the customer an integral part of the product and service development process.

How ready is your bank to surmount the digital challenge? To find out, please use our self-assessment tool at **www.bain.com/digitalchallenge** to size up the progress you are making on the four strategic imperatives and evaluate how you are adapting to the mandates for change.

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