



Building the retail bank of the future

The most viable blueprint marries digital and physical assets, through a DigitalSM transformation, in order to catch up to customers and create new forms of value.

By Mike Baxter and Dirk Vater

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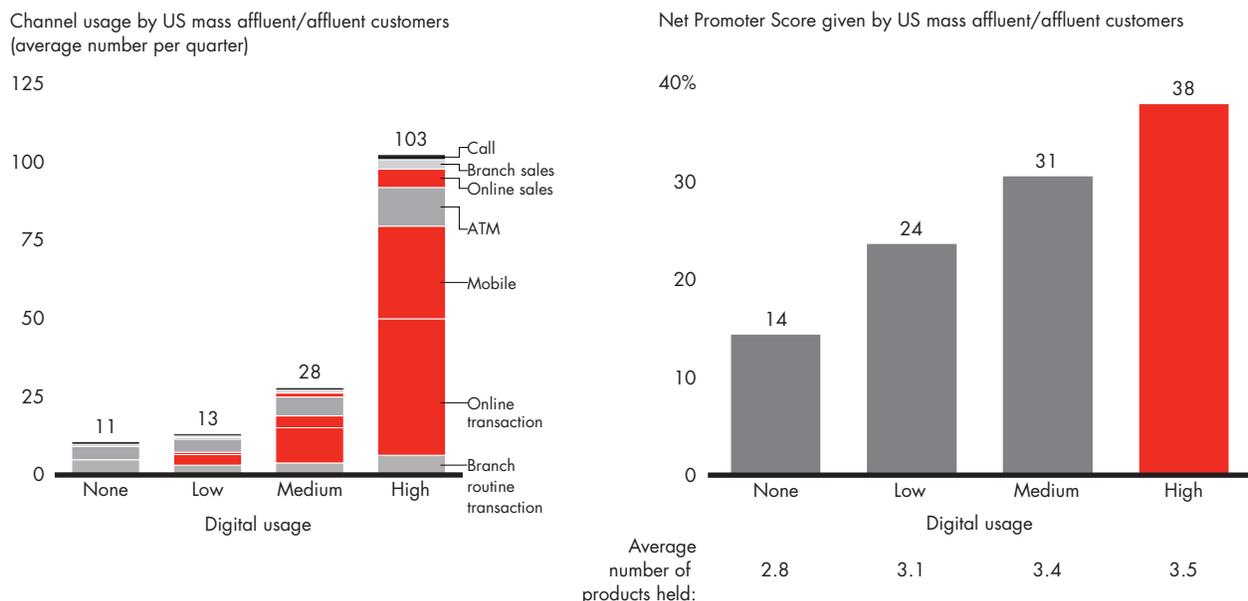
Retail banking has already become a digital business, spurred by the rapid spread of broadband access and affordable smart mobile devices. Globally, an average of more than half of consumers' banking interactions took place through online or mobile channels, with an even greater share in digitally advanced markets like the Nordic countries and Australia, according to Bain & Company's 2013 customer survey, executed through Research Now. Add the use of ATMs, which increasingly connect to the Internet, and the share of digital interactions exceeds 85% for the most advanced countries today and is heading to more than 95% in the near future.

Yet many banks are still in the early stages, with a long way to go. Fewer than half of consumers in developing countries and just over a third of those in developed countries used smartphones or tablets for their banking. That's not for lack of trying, as consumers expect to be able to use the channel of their choice when and where it suits them, as they already do in music retailing, consumer electronics, airlines and hotels (see the sidebar on page 2, "The customer's manifesto").

To date, many banks have focused their digital investments on improving their ability to do simple transactions through online or mobile channels, thereby reducing brick-and-mortar branch costs. They haven't devoted as much attention to making customers' banking lives more convenient, easy and engaging, by creating a differentiated customer experience featuring truly innovative, useful digital applications and a seamless integration of all channels. Customers often cite certain digital interactions as "wow" experiences that exceed their expectations—moments like remote deposit capture, remote bill pay or even well-delivered basic transactions through a mobile app. Winning in the digital realm, therefore, is critical for improving the overall customer experience.

Lagging banks should be concerned, because digital usage correlates closely with customers' loyalty (see Figure 1). Mobile banking users, for instance, give a higher Net Promoter ScoreSM (NPS[®]), a key measure of loyalty, than people who don't use mobile devices—on average, 25 points higher. And the payoff: Loyalty

Figure 1: High digital usage correlates closely with customers' loyalty (US example)



Note: Digital usage is defined as the number of transactions per quarter via smart mobile/tablet apps, online tools or chat/videoconference (1-9 is low, 10-29 is medium and ≥30 is high); affluent customer is defined as a household with >\$100,000 in investable assets (excludes mortgage and home equity)
 Source: Bain/Research Now Customer Loyalty in Retail Banking annual study, September 2013 (US, n=77,000)

The customer's manifesto

In virtually every country where Bain has surveyed consumers, they voice a similar set of needs and expectations. Their comments can be distilled to 10 bedrock priorities for banks to address:

1. You look out for me and recognize me as a valued customer.
2. I can easily find simple, clear product and service information.
3. Whenever it's convenient for me, I can easily get trusted advice or help by phone, video or in the branch.
4. I can apply for a product or service through one channel and seamlessly finish the transaction on another.
5. I can buy the same products at the same price, regardless of how or where I go.
6. I can access all my accounts on any device.
7. I can do most of my day-to-day banking through digital channels.
8. I can make purchases, payments and transfers quickly through my smartphone.
9. My interactions are efficient, secure and fast—"one and done" with minimal paper.
10. I can easily share feedback, including on social media platforms, and my bank will resolve the issue quickly.

has a powerful influence on a bank's economics, because customers who become promoters stay longer with their primary bank, buy more products, often cost less to serve and recommend the bank to other people.

Digital usage will increase over the next few years, according to our survey, but digital channels will not fully replace physical channels. Branches, for example, will not disappear, but their role will change: Branch networks in many countries are organizing around "hub" flagship branches that serve as showrooms for complex product sales and venues for providing expert advice. These hubs are surrounded by "spoke" branches with a smaller footprint and limited functionality, supplemented by video call center technology that links customers with experts in a flagship branch or a call center. In-person sales and service interactions continue to appeal to con-

sumers with more complex needs, while follow-up communications and ongoing relationship management can be done remotely through video calls or email.

Some leading banks have begun to marry digital and physical assets into a hybrid combination that customers now demand—what we call a *Digical*SM transformation. These banks are fundamentally transforming their core business—including offerings, channels, technology infrastructure and organization—funded by aggressively decommissioning legacy costs and systems.

The Digical transformation often starts with moving current functionalities online to make banking more convenient. The most forward-looking banks have gone farther to reinvent the customer experience and provide new ways to engage and add value to customers, some-

times partnering with technology start-ups to accelerate innovation and create new propositions.

This brief focuses on the Digital transformation. In a future brief, we will discuss the discipline of corporate venturing to support new propositions and, more broadly, explore the reinvention of the industry. Both briefs are informed by Bain's extensive work with banks worldwide; our annual global survey about loyalty in banking, which looks at customers' banking behaviors and their perceptions of their providers; and our Retail Bank of the Future benchmarking panel of 78 major banks around the world.

An increasingly credible threat: Digital attackers

The Digital transformation has grown more urgent, in part because new, low-cost digital-only entrants are taking market share in profitable niches by responding to customers' needs and banking behaviors. Anthemis Group, an investment and advisory firm for digital financial services companies, tracks 3,000 such companies worldwide. Many are uprooting the traditional value chain in ways similar to what has happened in industries like music, retailing, travel and photography. We cluster digital attackers in three groups, with different levels of business change and share taken:

- *Aggregators* redefine the interface between traditional banks and customers, putting pressure on banks' profit margins. Moneysupermarket, Mint and CHECK24 each plays to customers' desires for greater transparency around prices and product features, and may increasingly become the primary interface.
- *Innovators* use existing technology platforms, but they bring their own innovative sales or customer relationship management approaches. Companies such as Square and eToro can squeeze margins and also take revenues away from traditional banks, reducing banks' function to simply processing transactions.
- *Disruptors* such as Simple and Moven seek to redefine the rules of banking and replace incumbents by providing alternative products and services, often

offering a better experience for a targeted customer group. By freezing out incumbent banks, they take revenues and threaten banks' economics in market niches, cherry-picking the most attractive customers.

Paving the way for digital attackers is the fact that banks' classic barriers to entry—personal relationships between bank managers and customers, branch networks' scale economies and a reputation for security—have been crumbling. Even regulation in some countries, such as the UK, has grown more accommodating, as regulators who once frowned on new business models now want to promote competition in banking with new entrants.

Most bankers acknowledge that they have to change...at some point. They don't yet see the flames curling up around the foundations of their houses—flames that can quickly engulf entire structures. One reason may be that older, high-value customers in many markets are reluctant to change their bank, even if they've begun to adopt digital technologies along with everyone else. So bankers don't notice attrition among this segment, even though large portions of the segment's spending on investments, credit cards or home loans have been going to competitors with better propositions for years. Meanwhile, customers in their 20s—a prime age for switching banks—are increasingly considering digital capabilities when selecting their primary bank.

For traditional banks, the choice is clear: Invest in change now or die with your older customers.

Fortunately, there is enough evidence from Digital efforts to date that points to a specific path forward. Bain's research and work in the field show five specific imperatives that are essential for building a strong bank of the future.

1. Create a differentiated Digital customer experience where you can win.

Banks have long deployed technology to support and automate internal processes and to replicate functionalities online, mostly in the service of reducing costs. But now, truly customer-centered banks have also fused digital and physical assets to make customers' banking lives easier, more convenient and more engaging.

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Commonwealth Bank of Australia (CBA), for example, took a core banking product, mortgages, and innovated Digital capabilities to help customers buy their homes. Partnering with multiple listing database Domain.com.au, CBA developed a mobile app to search any house in Domain's database for visual and written details, which engage customers from the start of their home-buying experience. Customers can click through to get advice, then start the mortgage application online or book an appointment with a mortgage adviser in a nearby branch. After completing the application, a rapid "straight-through" decision process and e-alerts keep customers updated on their application status. The bank's mobile payments capability allows customers to transfer funds to the vendor on the go and manage their mortgage balance through any channel, including mobile, online and ATM. This easy, convenient and engaging experience has helped CBA to reinforce its leadership in Australia's mortgage market.

Among the innovations by Westpac, another bank in Australia, is the way it built its position in superannuation, the compulsory pension scheme, with its "BT Super for Life." Westpac allows customers to aggregate and manage all of their superannuation accounts in one place, whether that's through the Web, a mobile device or in the branch. Once they enter their personal information, the platform behind the product does the rest, including finding the customers' "Supers," moving them to target-date funds and then letting customers see and manage these accounts alongside their bank accounts online or through a mobile device. The low cost of this innovation stems from cutting out the investment adviser and has allowed Westpac to price the product at 75 basis points, roughly 40% less than the market average. Delivering a simpler, low-cost platform has also helped Westpac to achieve fast growth in the superannuation market and improve cross-selling performance.

In South Korea, Hana Bank has innovated around a core of "moving money." The Hana N mobile platform serves as a full-service bank in a smartphone, working seamlessly with Hana's branches. Customers can withdraw cash from ATMs via their smartphones, parents can send money to their children via their mobiles, and N money includes near-field payments technology that can be used

to pay at many stores. Hana's online platform offers integrated money management and monitoring. Wrapped into the platform are engaging location-based offers and coupons, as well as the ability to borrow for larger purchases while in the store.

These end-to-end experiences create platforms for adding value in new ways. Other banks are replicating the approach and applying it to customers' needs such as buying a car or managing cash flow.

Developing exceptional experiences requires collaboration by marketing, product groups, IT, branches, and digital and compliance staff, along with the CEO's sponsorship. This can be done, however, without changing the organizational structure. We worked with a leading global bank to help create different customer experiences, such as onboarding new customers in payments by assembling a cross-functional "SWAT team" with access to resources across the bank's functions. One executive likened the process to a "wind tunnel," because the rapid pace of idea generation, design and development honed a more streamlined banking experience.

2. Build out omnichannel distribution, one market at a time.

Achieving the goal of "anything, anytime, anywhere" banking has major implications for the role of the branch. With teller-assisted transactions declining at an annual rate of 10% to 15% for many banks, migrating to lower-cost, automated formats is essential. Moreover, innovations in smart ATMs and video teller machines have made self-service easier and more engaging.

Optimizing the footprint is one aspect of how the branch network will evolve for an omnichannel world. To start, many existing branches in the Americas and Europe will close. Among our benchmark banks in these regions, 75% to 80% plan to reshape or close their networks, with some banks shrinking as much as 30% of their networks over time. This will be expensive for banks that have been slow to move. For a US bank with 1,000 leased branches, we estimate that closing 30% of its network might cost up to \$120 million.

To raise the overall effectiveness of the network, leading banks also are developing new branch formats that consist of lighter but sturdier alternatives to the traditional branch. As noted earlier, the most common new model consists of hub-and-spoke configurations of advisory offices, light-retail consumer shops and self-service kiosks arrayed around the full-service flagship store. All of the new formats incorporate digital technologies to enhance the customer experience and provide self-service capabilities that customers increasingly expect. Some spoke formats have removed bank tellers altogether.

An advantage of the hub-and-spoke model is that it can be built in one local market (a city neighborhood or rural district) and then optimized while rolling out more broadly. Forward-thinking banks have been using sophisticated modeling techniques, geodemographic data and geomapping software to dramatically improve decisions about the network. First, they identify key local markets, building a picture of potential revenues and profits to determine where branches can be most profitable. Then they identify which factors have the greatest influence on branch performance—being close to a shopping center or train station, for instance. Finally, they apply behavioral science to lay out and design the store.

In aggregate, the branch network will undergo substantial change. While many banks are cutting the number of branch tellers and assistant managers, between 50% and 75% are expanding specialist and relationship adviser roles. They're also plowing money into technology to promote a more seamless experience across channels; depending on the technology, 40% to 60% are adding in-branch tablets, video teller machines, smart ATMs and the like.

In a few places like Singapore, more versatile ATMs make customers' lives easier by allowing them to buy airline tickets or pay parking fines. Experiments with other branch features abound: Raiffeisen's flagship branch in Zurich, for example, offers a robotic retrieval system for round-the-clock access to safe-deposit boxes. And some banks have launched branches that resemble lounges or cafes, either to complement a strong direct bank presence or to encourage high-value relationships.

Achieving the goal of “anything, anytime, anywhere” banking has major implications for the role of the branch: fewer tellers and managers, more specialists and advisers, plus technology such as video teller machines and tablets, to promote a more seamless experience across channels.

As branches evolve, customers expect them to dovetail seamlessly with digital channels for an omnichannel experience. Customers will increasingly expect transactions on their smartphones or tablets to flow directly to the branch and interactions with the bank to be easy and engaging, whether online or in person. Call centers, for instance, will evolve into contact centers integrating video chats, co-browsing and other digital functionalities. Banks are responding to this demand for omnichannel interactions, though they still have a long way to go (*see Figure 2*).

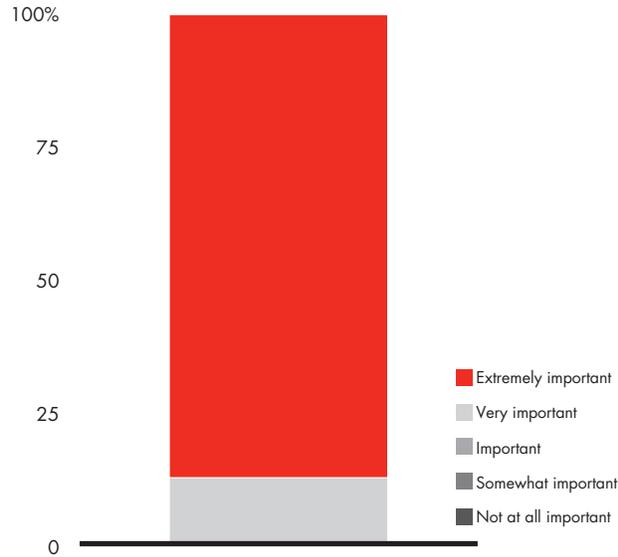
The challenge grows more complex as banks roll out more and more specialized mobile apps, such as small business apps that offer payment or foreign currency exchange services and meet needs that are different from those of consumers. With more diverse needs come more coordination across channels. But from the customer's perspective, seamless channel connection is nonnegotiable.

3. Overhaul the technology platform to simplify customers' lives.

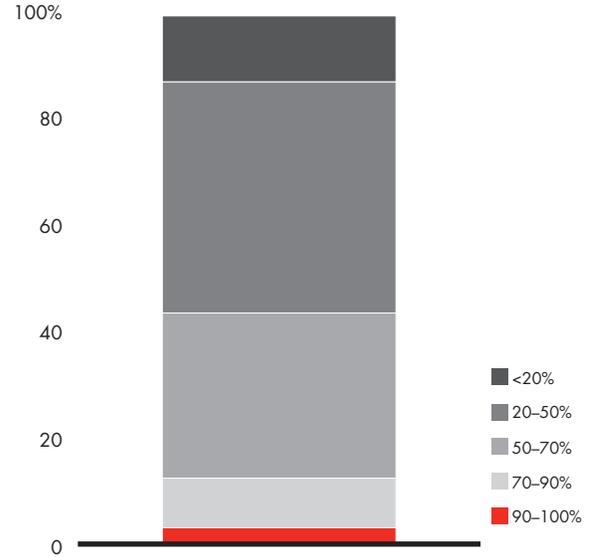
To deliver a differentiated, seamless experience to customers, most banks will need to make substantial improvements to their IT infrastructure. CBA's effort to build digital innovations around home buying and other experiences, for instance, was premised on its long-term commitment to investing in customer record migration and integration—infrastructure that allows a single view of

Figure 2: While banks view an omnichannel approach as important, most are in early stages of developing one

Response to "How important is it for you to create a seamless omnichannel experience for your customers?"



Response to "How much progress have you made in creating a seamless omnichannel experience for your customers?"



Source: Bain Retail Bank of the Future Benchmarking survey, 2013

the customer from any channel—and the reconstruction of its core IT platform for one-and-done processing.

Joined-up IT capabilities are becoming a competitive advantage for many banks that invest in technology. Fragmented infrastructure remains a pervasive problem for the retail banks on our benchmarking panel. Standard services might be available online and through mobile, but for even slightly more complex transactions like sending funds abroad or prepaying a mortgage, customers still have to go to a branch. For fully half of our benchmark banks, less than 40% of their processes are “one and done,” so customers have to endure a slow, clunky, multistage experience.

The Digital transformation entails a few essential characteristics of IT infrastructure:

- Joined-up customer data that creates a holistic data file for each customer

- A single view of the customer so frontline employees can see the entirety of a customer’s relationship
- Technology that supports one-and-done processes and a real-time processing engine, rather than batch processing, to speed up outcomes for customers

Building these kinds of capabilities usually involves a multiyear roadmap of changes to systems and infrastructure that’s expensive and hard to deliver. A few banks have chosen to replace their core and single-view systems all at once, but most are staging the transition. Others are exploring outsourcing and cloud-based capabilities to achieve their IT goals at a lower cost; roughly one-quarter of our benchmark banks have used the cloud, and 60% plan to expand their use of cloud computing in the future. Whichever path a bank chooses, an IT migration plan should closely align with the bank’s vision for the customer experience and the omnichannel delivery of sales and services. Of our benchmark banks,

however, only 60% report having a migration plan with clear budgets and allocated investments.

4. Fund the transformation by leaning out the legacy.

Funding the investment for this massive change poses a major challenge to management. Banks on our benchmarking panel are freeing up funds by simplifying their products, processes and organizations. They're also planning to reduce costs by migrating basic transactions online. Other levers to reduce cost include process automation; branch format redesign to reduce staff, as well as bad and avoidable volumes; and streamlined sales processes. The most commonly applied method uses lean techniques.

In addition, banks plan to free up money in legacy infrastructure, systems and projects that don't directly accelerate the Digital transformation. At one European bank, the new CEO inherited a portfolio of 150 projects that were under way, with highly varying relevance to his vision for the future enterprise. Having screened these thoroughly against his new vision, he stopped or redirected over half of the portfolio, freeing up €120 million of annual run rate that could be reinvested elsewhere.

However, about half of our benchmark banks have yet to fully understand the cost of digital change for their business. Having a budget and a plan for building omnichannel capabilities would seem a prerequisite for the transformation, yet about 41% of our benchmark banks do not even have a budget. Moreover, investing in omnichannel requires discipline to avoid dropping cost benefits to the bottom line in the service of quarterly earnings. Establishing a "change fund" on the balance sheet will ensure that a bank has sufficient money to accomplish the change over a number of years. Several banks have established a ring-fenced venture fund for investments in technologies and innovations as one way of protecting funds from the quarterly earnings pressure.

5. Organize to speed up innovation and change.

The broad-scale change implied by the Digital transformation raises major challenges for banking organizations as well. The behavior endemic at many traditional banks—

strong departments that narrowly focus on improvements within their domain—works at cross purposes with an omnichannel approach. Walls between departments and functions will have to come down. Technology investments will deliver just a fraction of the potential benefits unless banks understand and act on the implications for staff capabilities and behavior (*see Figure 3*).

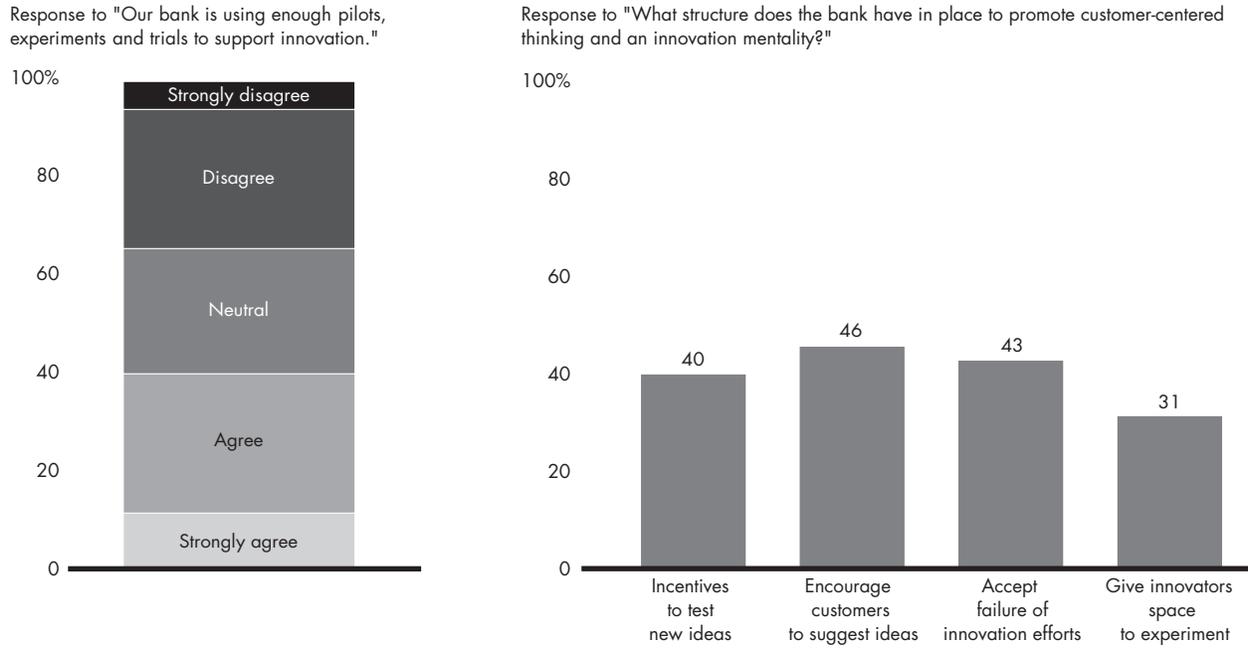
Today, 70% of the banks on our benchmarking panel organize "digital" as a standalone department, often a powerful function in its own right that reports to the head of retail. While this may have served in the early days to protect innovation projects outside of the core business, ultimately the standalone structure can hinder the kind of integration required for an omnichannel experience. It's a question of when and how to reintegrate, not whether to do so.

Indeed, many other aspects of the organization, from culture to the mix of skills to incentives, will have to change as well. Asked whether they exhibit common innovation requirements, such as incentives to test new ideas, freedom to experiment and tolerance of failure, fewer than half of our benchmark banks said they do. On the front line, the important skills are shifting away from administrative services like taking deposits and handling cash, to performing sales activities, giving product advice and providing information services in retail-type outlets. Frontline positions will demand stronger generalist and interpersonal skills than today's delineated roles of teller or specialist lender require.

Incentives also need to catch up. Currently, compensation for branch managers weights sales heavily, and digital channels are effectively seen as competitors to the branch network, creating an inherent conflict in the organization. Moreover, while there's a big opportunity for branch staff to steer customers to digital channels, most pay models do not reward that behavior. Banks will struggle until they address the organizational barriers and tensions impeding the Digital transformation.

Finally, the relatively insular and slow culture of traditional banks needs an accelerant to keep pace with digital innovations. Large pharmaceutical firms learned this lesson two decades ago and responded by identifying, partnering

Figure 3: Many banks lack the behaviors and organizational support that are required to innovate



Source: Bain Retail Bank of the Future Benchmarking survey, 2013

with and sometimes acquiring external firms to complement their in-house R&D shops. Forward-looking banks have already benefited from external partners that have expertise in key elements of the customer experience, security and verification, mobile apps, one-and-done processes and other activities.

Some institutions have set up venture units and innovation labs that are separate from the core business, with freedom to explore external deals and relationships. BBVA, for instance, has formed a network of investments. In the US, BBVA Compass acquired Simple and invested resources in a strategic alliance with SmartyPig. BBVA also has global investments in companies such as 500 Startups, a seed accelerator active across 40 countries, and Ribbit Capital, a venture capital fund active in ten countries. The appeal is clear: Landing the right skills and mindset for digi-

tal innovation may require access to nontraditional leaders with nontraditional organization structures, even if that provokes a clash of cultures.

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It may seem that banks are besieged from several quarters. Their customers' expectations for anything, anytime, anywhere banking currently outrun their capabilities. Their branch networks are no longer fit for purpose, but it will be expensive to fix. And digital attackers have momentum in building a base of customers, especially among young adults, as well as attracting talent.

But even traditional banks can regain their edge and once again compete effectively. If they're willing to rebuild their business around customers' priorities through the smart use of digital technologies, they can emerge even stronger from the Digital transformation currently under way.

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