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Retail Banking in the Age of Apponomics



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EXECUTIVE SUMMARY

The recent financial crisis has left consumers with a bitter taste in their mouths, and the loss of trust in their banking institutions is likely to linger for some time. If banks are to restore that faith—and restart their growth engines—they will have to find strategies that promise customers a renewed sense of support, community, adaptability, and convenience.

Banks have responded to this pressing need in a variety of ways, including large-scale distribution, product innovation, and community banking. We believe, however, that only by embracing the coming digitization of the financial services sector can banks win back their customers and begin growing again.

Digitization is changing everything. The Internet, high-speed broadband, and mobile connectivity let banks provide their customers with a much more engaging, highly personalized financial experience, and platforms such as social networking are adding a renewed sense of community as well. The result will be a new era in banking in which banks and their customers will work together to co-create value through innovative new products and services and more efficient operations.

RETAIL BANKING IN THE 21ST CENTURY

As the retail banking industry emerges from the recent crisis that overwhelmed much of the global financial services sector, it continues to face a number of important growth challenges. High unemployment, an ongoing low-interest-rate environment (despite concerns about potential inflation), heightened consumer protection laws focused on reducing fees and increasing transparency, and increased capital requirements as well as new regulatory oversight costs—together, these suggest continued stagnant top-line growth and declining profitability.

Consumer trends have made the situation even trickier: Globalization, cross-selling, and multitasking have increased the complexity of people's lives. The intensification of work, multiple roles at home and in the workplace, and rapid changes in how

people live have boosted the pressure of stress, burnout, and depression. And as consumers watched their financial assets evaporate rapidly in the wake of the recent crisis, thanks in part to the actions of narcissistic bankers driven by greed and egomania, that loss of security has led to a much stronger sense of uncertainty.

As a result, consumers have lost faith in any number of institutions, not least their banks. Gone are the days when people viewed banks as the most solid structures in town, both physically and financially, a perception that has been replaced by a deep feeling of distrust in how banks and bankers do business—indeed, in whether they are on the side of their customers at all. How can retail banks counter this perception and win back the hearts, minds, and wallets of their customers?

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WAYS TO PLAY

The key to retail banking success in the 21st century lies in resolving the three factors—complexity, uncertainty, and stress—that are at the heart of the problem. Banks can help reduce complexity by simplifying and increasing the transparency of their products and services, and by providing customers with more guidance and support in their efforts to understand those offerings. Stress can be countered by providing greater convenience and easier access to account information and transactions, more relevant product offerings, and better advice. And the uncertainty that many people feel in dealing with their banks—and indeed in all their financial activities—can be reduced by the continuous education of customers, helping to guide them through the rapid changes in their lives. Promoting a sense of community through opportunities for social bonding and networking, and giving customers a purpose in their banking activities, such as retirement

savings, can further reduce the sense of uncertainty.

How have banks responded strategically to customers' need to reduce complexity, uncertainty, and stress?

Distribution giants: Some banks have chosen to develop large branch networks with extended hours and a broad range of products and services. The strategic goal is to focus on convenience and easy access. Some Deutsche Bank and Barclays branches, for instance, offer a full set of customer services, ranging from personalized advisory services to lounges serving food and drink.

Product innovators: Others focus on product innovation, offering new features and packages of products. Examples include ING Direct and EasyCredit, both of which promote their products in terms of customer support, transparency, and simplicity.

Community banks: Community banks, which typically include cooperative banks and savings banks, focus on their deep roots in their local communities, strong relationships with local leaders,

traditional product offerings, and branch-oriented delivery of services.

Segment specialists: Offering specialized product sets and custom solutions to their customers, these banks compete through their deep client expertise and product knowledge. Their goal is to reduce complexity by focusing on customer support.

None of these four “ways to play,” however, fully addresses all of the customer concerns, and the inherent lack of trust, that are overtaking the retail banking sector. To effectively confront these changes, banks must completely rethink how they approach the customer experience, a move that will require transforming the bank from top to bottom. Banks must focus on four critical aspects of the customer solution as they try to assuage these concerns and restore the trust of their customers—support, community, adaptability, and convenience. If they can do so, they will be in a much better position to work with their customers to co-create value.

Depending on its chosen way to play, a bank must make sure it has the

capabilities to succeed in each of these four aspects. We believe that the effort to build these capabilities can be guided by a generic operating model framework (see Exhibit 1). Complexity can be reduced by focusing on support: listening more carefully to the voice of the customer, generating a customer mind-set and added skills on the part of employees, and simplifying processes. Uncertainty can be managed

through community and adaptability, by promoting internal change readiness and flexible resource planning, and through customer-facing solutions like self-service. And customer stress can be reduced if banks focus on convenience—improving customer sensing, encouraging employee empowerment, and even simplifying the physical layout of branches.

In meeting the concerns of customers, a distribution giant might choose to concentrate on the customer-sensing capability and singling out complexity, while a community bank might choose to focus on its physical and virtual layout, along with coaching and empowerment. In any case, every bank must determine the specific set of capabilities needed to drive its strategy and enable it to best meet the needs of its customers.

Exhibit 1
Levers to Address Current Consumer Concerns

STRATEGIC IMPLICATIONS

Consumer Concern	Customer Need	Lever				
		Improve customer understanding	Realign staff behavior & culture	Simplify organizational design	Increase process efficiency	Standardize IT infrastructure
Complexity	Support	Voice of the customer	Customer mind-set	Building skills	Singling out complexity	Convenience in handling
Uncertainty	Community	Customer-sensing capability	Coaching & empowerment	Cross-functional teaming	Customer-backed continuous improvement	One version of truth
	Adaptability	Customer demand & churn management	Change readiness	Flexible resource planning	Performance management & visual controls	Self-services
Stress	Convenience	Customer-sensing capability	Coaching & empowerment	Physical & virtual layout	Singling out complexity	Robustness & self-services

Source: Booz & Company analysis

THE DIGITIZATION STRATEGY

We believe that if retail banks are to regain the trust of their customers and return to a position of stability in a rapidly changing world, they must take full advantage of the power of digitization, a truly disruptive force that can completely change the rules of the game and that will ultimately become the way to play across the board in retail banking.

The world at large is swiftly digitizing, and as the barriers to entry into the digital experience fall, people across the globe are rapidly connecting with one another and with businesses of all kinds. New business models are being created and being abandoned with stunning speed. The effect on human behavior has been profound, not just in how people conduct their personal lives but in their relationships with the companies they do business with. Dozens of new communications channels are opening up, enabling people to converse not just with one another but with larger and larger social groups and communities. No longer do customers deal solely with their banks on financial matters; instead, the conversation

now extends to colleagues, friends, neighbors, and other customers. No longer do banks need to limit themselves to old media like newspapers and magazines to get their messages across. Communicating with customers has become an entirely open arena, and the possibilities are endless.

High-speed broadband connectivity enables the use of video in all kinds of new applications—not just video calls with advisors and call-center agents but also sophisticated virtual reality services such as virtual agents and even entire virtual branches. And ubiquitous mobile connections through camera-equipped smartphones allow for all manner of location-based services—pinpointing the nearest ATM, paying photographed bills, even picture-based authentication.

Digitization—this combination of the Internet, broadband, and mobility—is a requirement for every bank looking to thrive in the new world. Carefully planned for and managed, it can transform all four

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aspects of the customer solution—support, community, adaptability, and convenience—and empower banks to provide their customers with the best possible personal, social, and financial experience. The result will be a new kind of bank, one with which customers are fully engaged; this level of engagement will develop into a kind of partnership between banks and their customers, enabling them to co-create value.

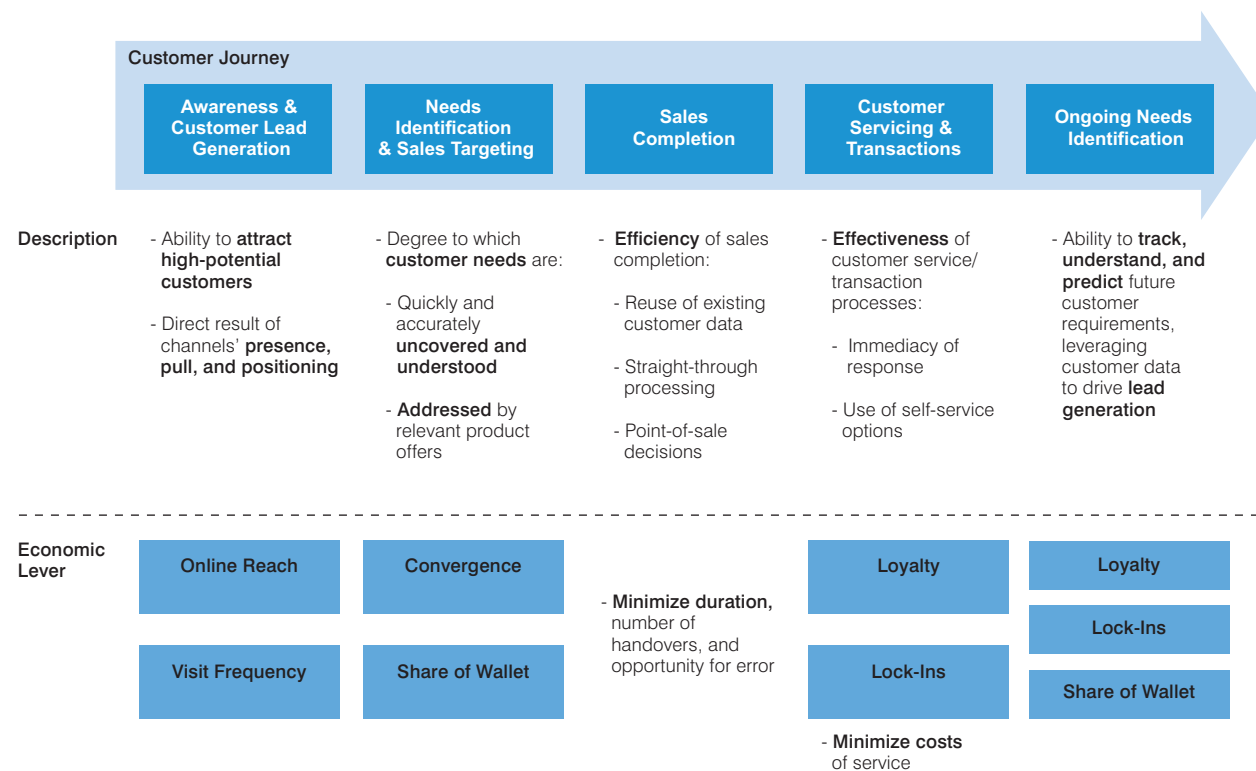
No bank has committed fully to digitization. Many have incorporated some elements of it into their business

models—for instance, some banks are experimenting with what they call virtual branches—but their efforts to create a digitized strategy are still immature and do not yet present a coherent digitized face to their customers. Yet there is no reason that banks can't begin now to launch a coherent digitized retail banking strategy.

On one level, building all the capabilities necessary to become fully digitized will not take a bank very far out of its comfort zone. Banks typically view their interactions with

customers along the overall customer journey, from generating leads to completing a sale to identifying future needs (see Exhibit 2). Digitization has the power to boost the capabilities needed at every step of this journey. It can improve marketing reach; accurately identify customer needs; improve conversion rates through tools such as virtual advisors, co-browsing, and social networking; and promote customer lock-in and loyalty through personalization and customization.

Exhibit 2
Benefits of Digitization Across the Entire Customer Journey



Source: Booz & Company analysis

THE BANKING EXPERIENCE

Recent research has shown that consumers' top priority in their online dealings with companies is to have a great customer experience. On one level, their needs are relatively simple: fast and simple navigation through company websites; the ability to chat and browse along with customer service representatives; consistent, clearly priced products; and a straightforward process for completing transactions. These needs suggest the importance of a simple, cleanly designed website that is very easy to use but also has the ability to generate marketing campaigns and product and service offerings that are personalized

for each customer. The benefits in terms of greater trust on the part of customers will be significant.

On another, somewhat more sophisticated level, customers are looking for such interactive features as access to greater information about more complex financial products, proactive assistance in understanding products, communities of experts able to provide further help and understanding, and ratings and reviews of specific products. Here, banks should take a page from the top e-commerce players as they pursue the goal of boosting support, community, adaptability,

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and convenience: A segmented, personalized portal site that offers advice and financial solutions could also integrate independent communities, including third-party advice or customer ratings and reviews, and even third-party marketplaces and app stores featuring products and services linked to financial needs.

In building the digitized bank of the future, it will be critical to devise a new strategy for satisfying customers—providing them with customized personal, financial, and social experiences—and to implement a different operating model that can continuously seek out new customer needs. The strategy must offer customers the best experience as they interact with the bank and conduct transactions, through the creation of a segmented menu of products and services tailored to each customer. And it must encourage an ongoing banking

relationship through an even more narrowly focused set of services—perhaps including the use of social media to increase communication and support—that customers can pick and choose among interactively. The operating model must promote innovation through partnerships with other, nonbank service providers and the rapid testing of new ideas through small, agile pilot programs. Finally, a dynamic, scalable technology platform must be built to support the entire effort (*see Exhibit 3*).

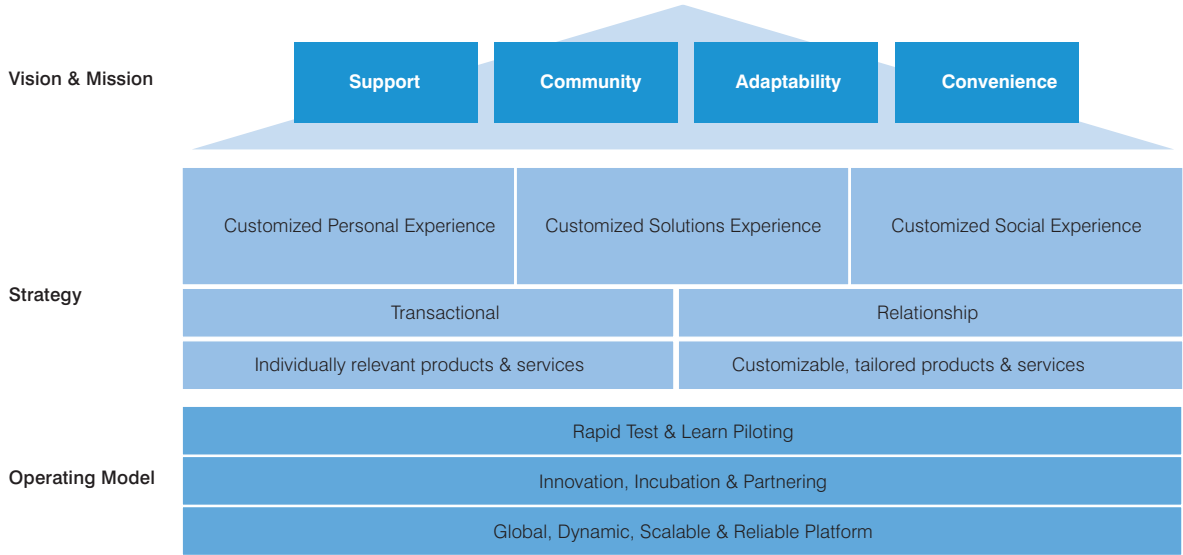
In short, banks must incorporate every opportunity that digitization has to offer into their operating models in order to achieve the four goals of support, community, adaptability, and convenience. Social networking, for instance, should be a critical feature of this effort. The operating framework discussed above will serve as a model for the capabilities needed to pursue a social

networking strategy and create additional value for banks and their customers alike.

Enabling customers to express themselves will promote community, while the ability to receive advice from other customers and independent third parties offers greater support. The opportunity to get a problem solved or to help solve the problems of others can further the goal of adaptability. And putting all these services together to make meaningful connections across the entire banking community offers a new level of convenience. Social networking will also become a powerful tool for banks themselves, improving their understanding of customers and changing their own culture to become more customer-focused. The overall effect will be to build better relations with customers, increasing loyalty and trust and making banks more efficient and innovative (*see Exhibit 4*).

Exhibit 3
A Strategy and Operating Model for the Digitized Bank

NEXT-GENERATION RETAIL BANK



Source: Booz & Company analysis

Exhibit 4
Social Networking in the World of Bank Digitization

STRATEGIC IMPLICATIONS OF PARADIGM CHANGE
(SOCIAL NETWORK STRATEGY VALUE-ADD)

CASE EXAMPLE:
Social Networks

VALUE TO CUSTOMERS		Lever					VALUE TO THE BANK	
Make meaningful connections based on shared interests	Customer lead	Improve customer understanding	Realign staff behavior & culture	Simplify organizational design	Increase process efficiency	Standardize infrastructure	Marketing spend efficiency (brand awareness, consideration)	
Express themselves	Support	Voice of the customer	Customer mind-set	Building skills	Singling out complexity	Conversion in hand	Traffic & conversion (unique visitors, visits, page views, leads)	
Receive exclusive rewards & recognition	Community	Customer-sensing capability	Coaching & empowerment	Cross-functional teaming	Customer-backed continuous improvement	One view of the customer	Customer lifetime value (retention, profitability)	
Get advice, validation & assurance about decisions	Adaptability	Customer demand & churn management	Change readiness	Flexible resource planning	Performance management & visual controls	Self-service	Operating expenses (support, sales, marketing)	
Solve a specific problem (their own or someone else's)	Convenience	Customer-sensing capability	Coaching & empowerment	Physical & virtual layout	Singling out complexity	Robustness & self-service	Customer insights to drive innovation (indirect R&D savings)	
May be addressed through social network strategies								

Source: Booz & Company analysis

THE ECONOMIC PAYOFF

This discussion of the digitized strategy has centered primarily on the benefits that accrue to customers in terms of support, community, adaptability, and convenience—all in the name of restoring consumers' trust in their banks. Yet digitization is by no means a one-sided coin; indeed, banks and their customers will evolve into a mutually beneficial partner-

ship that will create value. In this scenario, banks have much to gain as they pursue these various strategies.

Growth: Digitization offers banks a powerful way to boost online traffic by increasing their marketing reach and the frequency of visits to all of their communications platforms. And banks will be able to monetize that additional traffic more effectively through increased share of wallet and higher conversion rates. The increased traffic combined with the ability to better monetize that traffic will lead to improved top-line growth.

Efficiency: This, too, will increase. Lower-cost online channels will

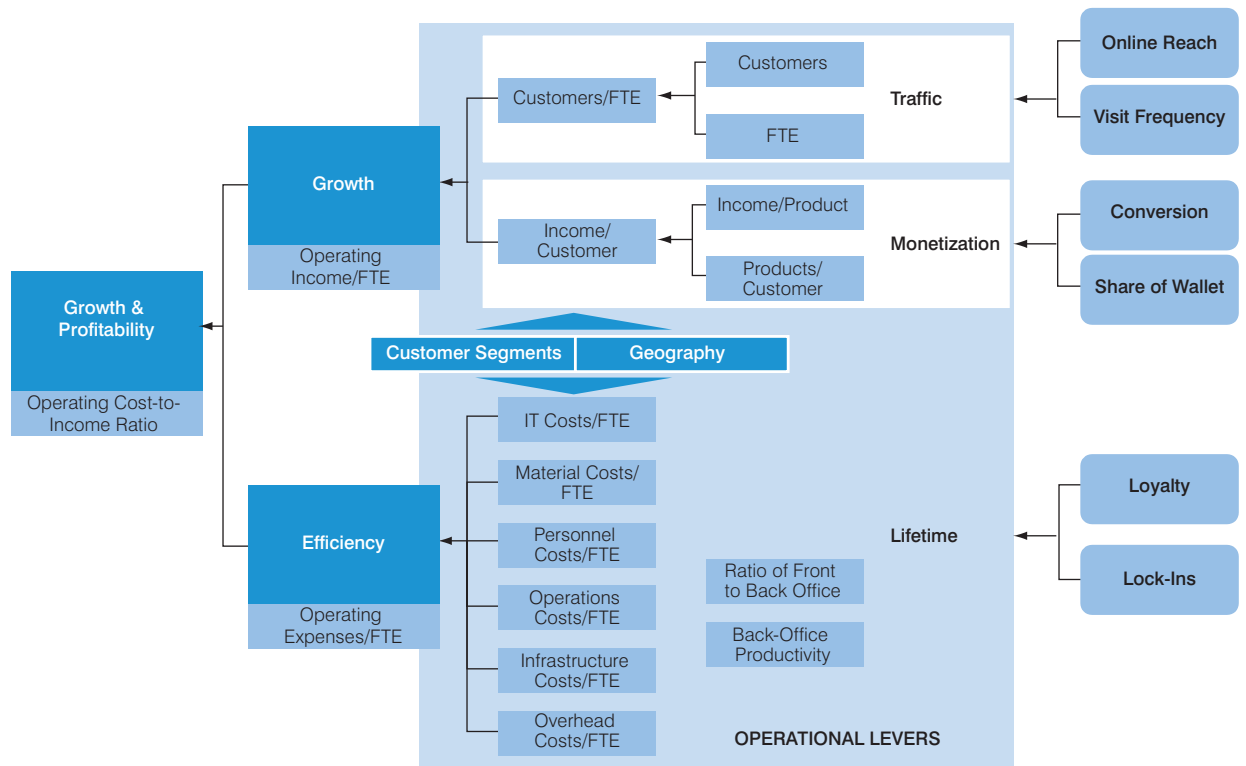
take over the roles of expensive offline channels. As conversion rates increase, the cost of converting each customer will go down, increasing the efficiency of marketing costs. Thanks to reduced churn, customers will provide banks with a higher lifetime value. R&D costs will decline as greater insights gleaned from customer communities and third-party tools drive product and service innovation. And overall operating expenses will decline through lower costs for customer care and overall personnel expenses.

Ultimately, the combination of higher revenue and lower costs will lead to significantly higher net income (*see Exhibit 5*).

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Exhibit 5
The Economic Value of Digitization

NEXT-GENERATION RETAIL BANK ECONOMIC FRAMEWORK



Source: Booz & Company analysis

KEY INITIATIVES

The increasing influence of digitization over consumer behavior and banking operations offers a real opportunity for banks to create a solid refuge in a confusing world and to create value in the process. As banks strive to capture these benefits, they need to start now to make progress on three separate fronts at once:

Channel management: Banks must establish seamless customer integration across both online and offline channels, achieve global scalability, and develop comprehensive mobility and portability capabilities. To bring additional expertise to their digitized strategies, banks should consider leveraging channel partners including partner-managed community elements and vertical portals.

Personalization of customer relationship management: Promoting support, community, adaptability, and convenience will require offering customers a highly personalized experience. This should include the ability to create their own dedicated “MyBank” that is tailored to their specific needs, provides a complete picture of their banking activities, and is linked to a powerful recommendation engine with state-of-the-art behavioral targeting algorithms. A CRM personalization initiative should also include an effort to increase marketing automation and establish segmented banks for target customers.

Innovation: No bank will succeed in the world of digitized finance without raising to a higher level its innovation capability, which has not been one of retail banking’s strengths. Banks need to think very creatively not just about new products and services to

offer customers, but also about ways to expand their business beyond the realm of traditional retail services. Banks could sell services such as financial advice (through online chat, for instance) on a stand-alone basis to customers and to the general public. And they could integrate third-party marketplaces into their offerings, charging fees to sell outside services, a feature that has already proven popular with consumers. Everything should be on the table.

Moreover, digitization itself will be a rich source of ideas for further innovation. The insights to be found on social media and other community sites offer a great opportunity to better understand the specific needs and concerns of consumers. And establishing “financial laboratories” that enable customers to configure their own financial products could produce all kinds of new offerings, some of which might even be sold externally.

If retail banks are to find new avenues of growth in the coming years, they must come to terms with the strong feelings that consumers currently harbor toward the banking sector. Creating a richer but less complex experience can provide customers with better support and convenience. That experience must take advantage of consumers’ willingness to use the many new tools of online communication and networking to promote a sense of community, and encourage their adaptability by offering entirely new ways to think about their financial lives. Only by achieving all these goals can banks fully regain the precious trust that is at the heart of a strong relationship between banks and their customers.

Resources

"The Rise of Social Apponomics," by Matt Anderson, Gregor Harter, Henning Hagen, and Stefan Plenge (Booz & Company, 2010). www.booz.com/media/uploads/The_Rise_of_Social_Apponomics.pdf

"The Rise of Generation C," by Roman Friedrich, Michael Peterson, Alex Koster, and Sebastian Blum (Booz & Company, 2010). www.booz.com/media/uploads/Rise_Of_Generation_C.pdf

"Web 2.0 Banking," by Johannes Bussmann, Paul Hyde, and Jörg Sandrock (Booz & Company, 2011). www.booz.com/media/uploads/BoozCo-Web-2.0-Banking.pdf

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