

GLOBAL RETAIL BANKING 2017

ACCELERATING BIONIC TRANSFORMATION



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CONTENTS

- 3 INTRODUCTION**
 - Key Findings
 - The Bionic Transformation

- 7 THE STATE OF RETAIL BANKING**
 - Top Performers Are Pulling Ahead
 - Fintechs Are Unlikely Disruptors in the Short Term
 - Regulations Can Be Opportunities

- 12 RESHAPING DISTRIBUTION FOR SUPERIOR EFFICIENCY AND SERVICE**
 - The Case for Bionic Distribution
 - Three Steps to an Optimized Branch Network

- 16 PERSONALIZING VALUE TO SUPPORT GROWTH**
 - Refine the Value Proposition
 - Three Steps Toward Value-Based Pricing

- 19 ADOPTING A JOURNEY MINDSET**
 - Weak Integration Impairs Customer Service
 - Four Ways to Design Winning Customer Journeys

- 22 CONCLUSION**

- 23 FOR FURTHER READING**

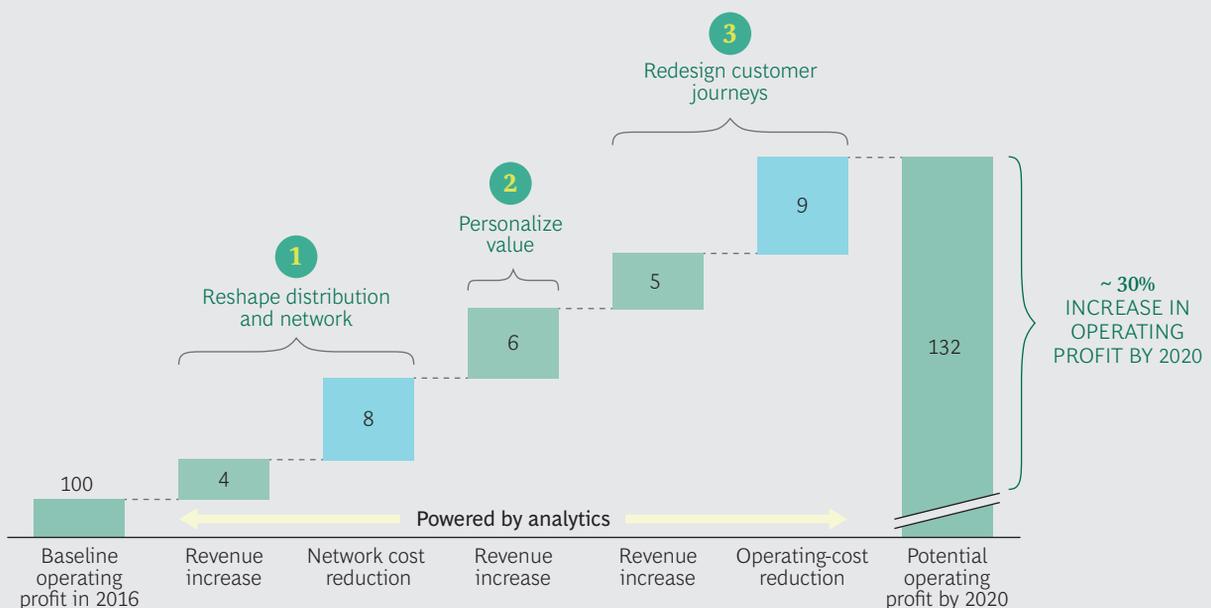
- 24 NOTE TO THE READER**

INTRODUCTION

FOR RETAIL BANKS NAVIGATING a still-challenging business environment, business as usual no longer works. Despite a concerted effort to stabilize performance following the financial crisis, long cycle times, inconsistent channel experiences, and generic customer propositions remain pervasive. Unless retail banks make deeper, bolder changes, profitability and competitiveness will suffer.

To improve performance, banks need to fuse digital functionality and personalized, human interaction. Since 2015, when BCG identified how customer, competitor, and market forces were pushing banks to harness the best of digital and physical environments, the need for bionic transformation has intensified. (See *The Bionic Bank*, BCG Focus, March 2015.) This year's study provides further evidence of that imperative. Leading banks will diffuse bionic capabilities beyond their front end to encompass the whole value chain. Data from our Retail Banking Excellence (REBEX) benchmarking, Banking Pools database, Fintech Control Tower, and our latest Retail Banking Customer Survey, combined with insights from client work, suggests that by accelerating bionic transformation in this way, retail banks can generate a 30% increase in net profit by 2020. (See Exhibit 1.)

EXHIBIT 1 | Bionic Transformation Can Increase Net Operating Profit by 30%



Source: BCG analysis.

Note: Increases from the baseline represent percentages in the middle of the expected range.

Key Findings

Retail banking remains an essential part of the financial services industry, accounting for 45% of all banking revenues. But while the sector has recovered from the financial crisis, the growth picture globally is mixed. Banks are seeing a return to precrisis levels of revenue growth, but economic, demographic, competitive, and technological changes will continue to exert downward pressure through the end of the decade. As a result, retail banks will need to get creative to sustain profitability.

Fueled by rising discretionary incomes, robust GDP growth, and a larger population of banking customers, retail banks in emerging markets, including Asia-Pacific, Latin America, the Middle East, Africa, and Eastern Europe, will continue to experience strong growth and are expected to account for 75% of the industry's CAGR over the next several years, according to our forecasts. It is a different story in Europe and North America, however. While banks in these markets will still account for half of retail banking revenue globally, growth through 2020 will remain tepid as banks struggle to shake off the constraints posed by historically low interest rates, sluggish GDP gains, and cautious spending appetites.

Across regions, the data shows a widening gap between top banks and the rest of the field. Since 2015, top-quartile banks have extended their already sizable 53% net operating profit lead over the median performer by an additional 3 percentage points.¹ Still, the data reveals that even the top performers are not transforming fast enough. Compared with the median bank, top-quartile institutions generate 56% higher net profit per customer and serve 38% more customers per full-time employee (FTE). Most of that performance differential comes from traditional cost-saving moves, such as trimming head count and closing branches, measures that have translated to a cost-income ratio (CIR) that is 8 percentage points lower than that of the median bank. But those advantages still aren't enough to sustain margin growth. Nor are they sufficient to close the service expectation gap with an increasingly mobile and digitally savvy customer base.

Customers have made it clear that they want choice in how to engage with their bank and that they expect service to be consistent, streamlined, and engaging no matter what channel they use. While 43% of survey respondents indicated a preference for digital-only experiences, the same percentage said they want a mix of physical and virtual interactions—a hybrid banking experience in which digital tools and capabilities combine with human input and advice at the moments that matter. More than half of all customers surveyed in China, Colombia, Italy, Russia, Spain, the United Arab Emirates, and the United States said they prefer this type of hybrid banking relationship. Only in the Netherlands—whose payments landscape is one of the most cashless in Europe—did respondents overwhelmingly embrace all-digital banking. No matter their favorite channel, banking customers indicated that they want advisors to have relevant data at their fingertips and digital processes that support a convenient, responsive, and customized experience. To enable that kind of experience, banks must go bionic.

The Bionic Transformation

A bionic transformation consists of three interrelated elements. First is the blending of digital and personal interactions to create a more responsive and cost-effective distribution model. Second is the articulation of a value proposition that combines human judgment with data power. And third is the adoption of a customer journey mindset with end-to-end processes that are supported with robotics and machine learning to reduce process intensity and improve customer satisfaction.

- **Reshaping Distribution for Superior Efficiency and Service.** To enhance the quality of customer relationships, banks must seamlessly combine human interaction with digital and self-serve functionality. One of the most important challenges in the move toward bionic distribution is reforming the branch network, which accounts for roughly 30% of total operating costs. Instead of a uniform branch model, banks need to create multiple branch formats, embedded within a well-rounded multichannel experience. They can use data and customer behavior analyses to determine which types of services customers prefer to access in person at a physical branch and which they prefer to use over online channels. They must also continually optimize coverage. Data-enabled location models allow banks to forecast expected changes in customer behavior, product mix, and profitability in order to optimize their footprint, serve more customers per branch, and achieve higher margins. Finally, relationship managers and salespeople must be equipped with the right digital and analytical tools. Customer relationship management systems, next-best-action tools, and other digital enablers can improve the quality and quantity of customer interactions. Our research shows that banks that move to this type of bionic network can see revenue gains of 5% to 15%, network cost reductions of 15% to 35%, and increases in customer satisfaction of 10% to 15%.
- **Personalizing Value to Support Growth.** Our research confirms that customers expect great, simple products at a fair price from a bank that knows and understands them. But accustomed to the ease and immediacy of digital channels, they also expect a high degree of personalization, differentiation, and localization from their retail banking partners across channels. To meet that demand, banks need to ratchet up product and service innovation and enrich the quality of banking interactions. In the near term, more effective value-based pricing practices could allow banks to add as much as 15% in revenue over 6 to 12 months, while improving customer impact—revenue that goes directly to the bottom line and can help fund the rest of the bank’s strategic agenda. Instituting such practices starts with understanding what customers value most and aligning product and service components accordingly. It also requires factoring in price elasticity and sensitivity in order to differentiate pricing where appropriate, and improving price realization.
- **Adopting a Journey Mindset.** While retail banks have made significant progress deploying sleek front ends in the form of user-friendly apps, websites, and mobile interfaces, they have made less progress integrating them with the rest of their opera-

tions. This means that banks are not getting the growth they need. For instance, while 80% of all customer touchpoints are digital, banks are struggling to convert that traffic into increased sales and efficiency. Compared with traditional banks, all-digital banks support twice as many new-account openings per operations FTE and serve 155% more customers per operations FTE.

To truly be customer led, retail banks need to approach process design in a fundamentally different way. They need to identify the customer journeys that matter most and redesign them end to end, leveraging artificial intelligence, robotics, and other service enablers to improve both speed and decision making. Our data shows that retail banks that digitalize their most important customer journeys can see a 5% to 20% boost in revenue from improved service, increased relationship manager (RM) capacity, and enhanced data-enabled offerings. They also reduce costs 10% to 25% through improved cycle times, automation, and faster and more-accurate decision making.

Banks that apply this way of thinking to their distribution network, value proposition, and end-to-end processes have the potential to significantly increase their operating profits.

NOTE

1. Throughout the report, median refers to the 50th-percentile bank.

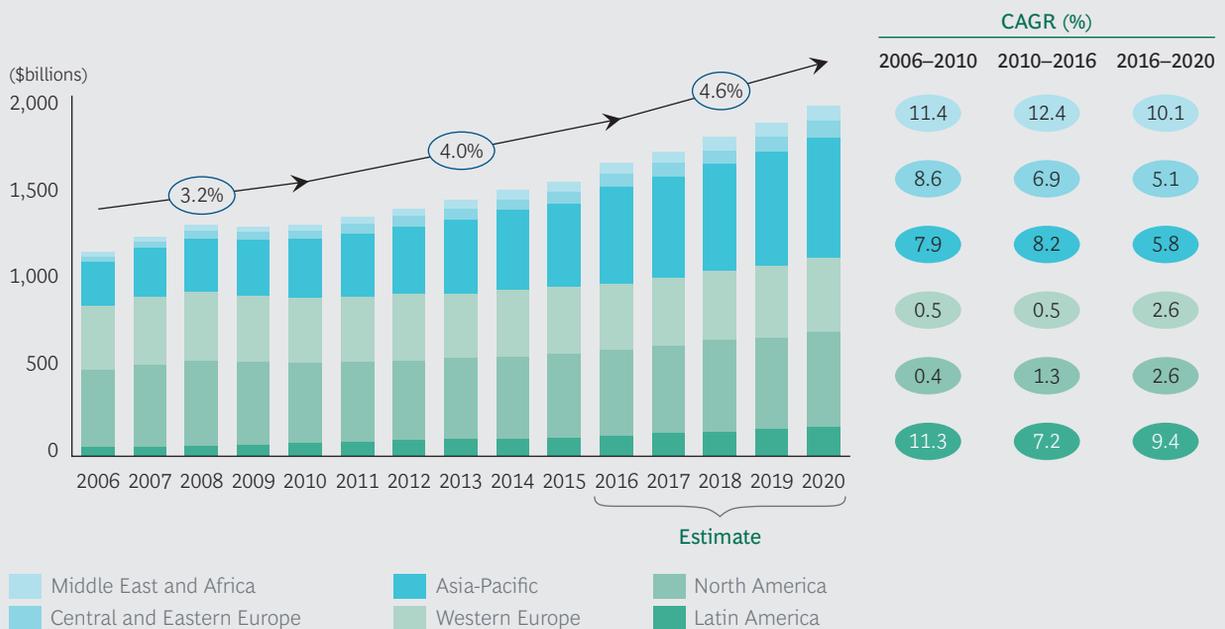
THE STATE OF RETAIL BANKING

THE GOOD NEWS IS that a stabilizing macroeconomic environment has put global retail banking revenue on track to grow at a compound annual growth rate (CAGR) of 4.6% between 2016 and 2020. That rate is nearly two percentage points higher than before the crisis. (See Exhibit 2.) But while that is encouraging, a closer look at

regional performance reveals a more nuanced growth picture, with emerging markets and developed markets running at different speeds. As they have for most of the decade, for instance, many retail banks in emerging markets continue to notch gains that are at or near double-digit territory, while banks in more established markets

EXHIBIT 2 | Global Revenue Growth Is Expected to Beat Precrisis Rates by the Decade's End

GLOBAL RETAIL BANKING REVENUE (\$BILLIONS)



Sources: BCG Banking Pools database; BCG analysis.

Note: Estimated retail banking revenue is for approximately 2,100 banks and is based on region-level financial and macroeconomic data.

cling to small but steady improvement in the low single digits. We expect this pattern to play out through the rest of the decade.

Looking toward 2020, our forecasts show that North America and Western Europe are likely to witness the biggest leaps in performance. Both regions experienced acute pressure following the crisis from deteriorating interest rates and tightening regulation. However, as economies recover and rates begin to move upward, we expect bank revenue growth in both regions to reach approximately 2.5% by 2020.

Compare that with the Middle East, Africa, and Latin America, where retail banks should see a four-year CAGR of 9% to 10% by 2020, and Asia-Pacific, where banks are expected to turn in average growth of 6%. That strong performance nevertheless marks a slight cooling from the super highs of the precrisis era, suggesting that emerging markets are settling into a more normal—though still robust—growth pattern.

In terms of products, savings are expected to account for 30% of global revenue growth over the next several years, compared with 20% from 2010 to 2015. Driving that growth are a relatively strong interest rate environ-

ment and large volumes of new savings from fast-growing regions such as Eastern Europe and Asia-Pacific. In countries such as India, for instance, government efforts to bring more people into the formal banking system have proved enormously successful. In more-mature markets, by contrast, loans and investment products will likely account for a larger share of growth. Factors there include a higher use of loans for housing and consumption purposes and an aging population.

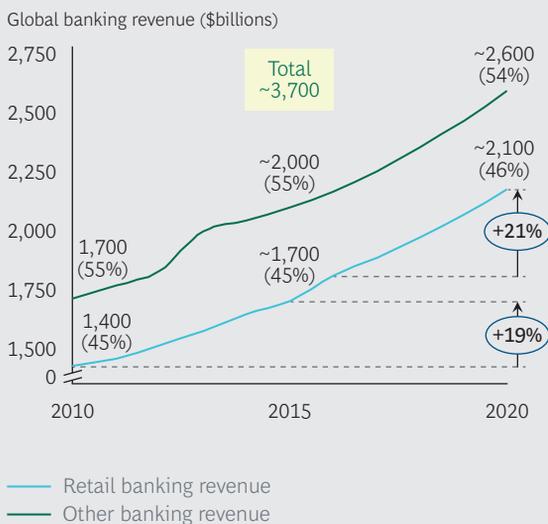
Looking at the retail banking industry overall, we expect that market, demographic, and economic changes will continue to exert downward pressure on long-term growth through the end of the decade.

Top Performers Are Pulling Ahead

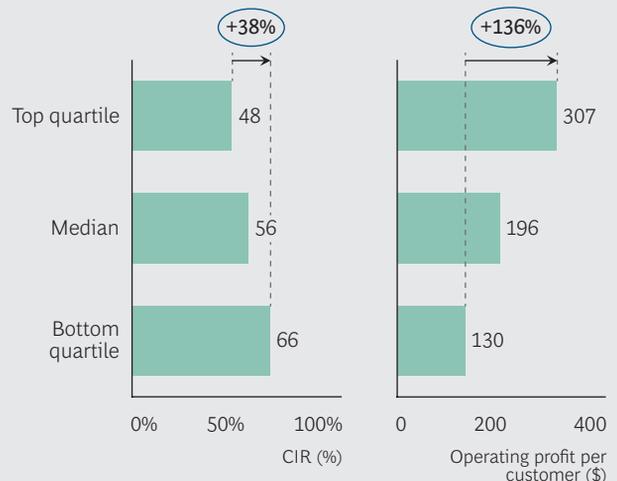
Retail banking revenue continues to account for nearly half (45%) of total banking revenue. But the gap between top-performing banks and the rest of the field is widening. (See Exhibit 3.) Our REBEX benchmarking shows that the CIR for top-quartile banks is 38% lower than for the bottom-quartile players, and operating profit per customer is more than 136% higher.

EXHIBIT 3 | Retail Banking Remains a Critical Market

NEARLY HALF OF TOTAL BANKING REVENUE IS FROM RETAIL BANKING...



... BUT THE GAP BETWEEN THE HIGH AND LOW PERFORMERS IS WIDENING



Sources: BCG Banking Pools database; BCG Retail Banking Excellence (REBEX) benchmarking. Note: CIR = cost-income ratio.

Most of that differential comes from traditional cost-saving moves, such as trimming head count and closing branches. Cost and sales efficiency gains are especially pronounced. The CIR of top-quartile players is 8 percentage points lower than that of the median bank. The top-quartile banks also serve roughly 800 customers per FTE, compared with roughly 600 for the median, a difference of 38%. That translates to sharply higher operating profit. Compared with the median, top-quartile players generate 56% more profit—3 percentage points more than in 2015. In addition, whereas bottom-quartile banks average \$400 in operating cost per customer, top banks spend only \$231, a difference of 73%. Top-quartile banks generate \$695 per customer, compared with \$441 for bottom-quartile banks, a difference of 58%.

The takeaway from these findings is that banks in every quartile have a significant opportunity to improve customer service and overall efficiency. Technology will be a critical catalyst in this effort, which is why banks need to accelerate bionic transformation.

Fintechs Are Unlikely Disruptors in the Short Term

How is the competitive landscape evolving in this improving but still uncertain macroeconomic environment? According to our Fintech Control Tower data, there are roughly 10,500 active fintech companies today, compared with 4,400 in 2010. That growth, combined with the advanced digital capabilities of these young and dynamic companies, has prompted some industry watchers to wonder if fintechs pose a direct threat to established retail banking players. We think that is unlikely in the near term.

There is no doubt that sleek payments platforms, powerful analytics engines, and other market-shaping innovations have the potential to add enormous value. Yet the fintech market remains highly fragmented, and although funding has ballooned since 2010, from \$18 billion to \$107 billion, that spending is spread across thousands of fintechs globally. Countries such as China may be the exception—there, digital banking models are attracting high levels of funding.

Another factor is trust. It may be surprising, but although customers may not always like the quality of the service they receive from banks, they continue to trust their banking partners. That is critical: 20% of survey respondents mentioned trustworthiness as the most important reason to join a bank. In addition, in every country but China, more than 60% of customers remain reluctant to share their personal financial information with anyone other than their bank. (See Exhibit 4.) To gain scale, fintechs need to change those perceptions—and that takes time. In addition, the fintech market is still in the early stages, with lots of startups pursuing niche propositions. That makes the space exciting and dynamic, but it also means that fintechs have not yet reached disruptor status, especially in developed markets. As the sector evolves, the equivalents of Uber and Amazon may emerge, but that will also likely take time.

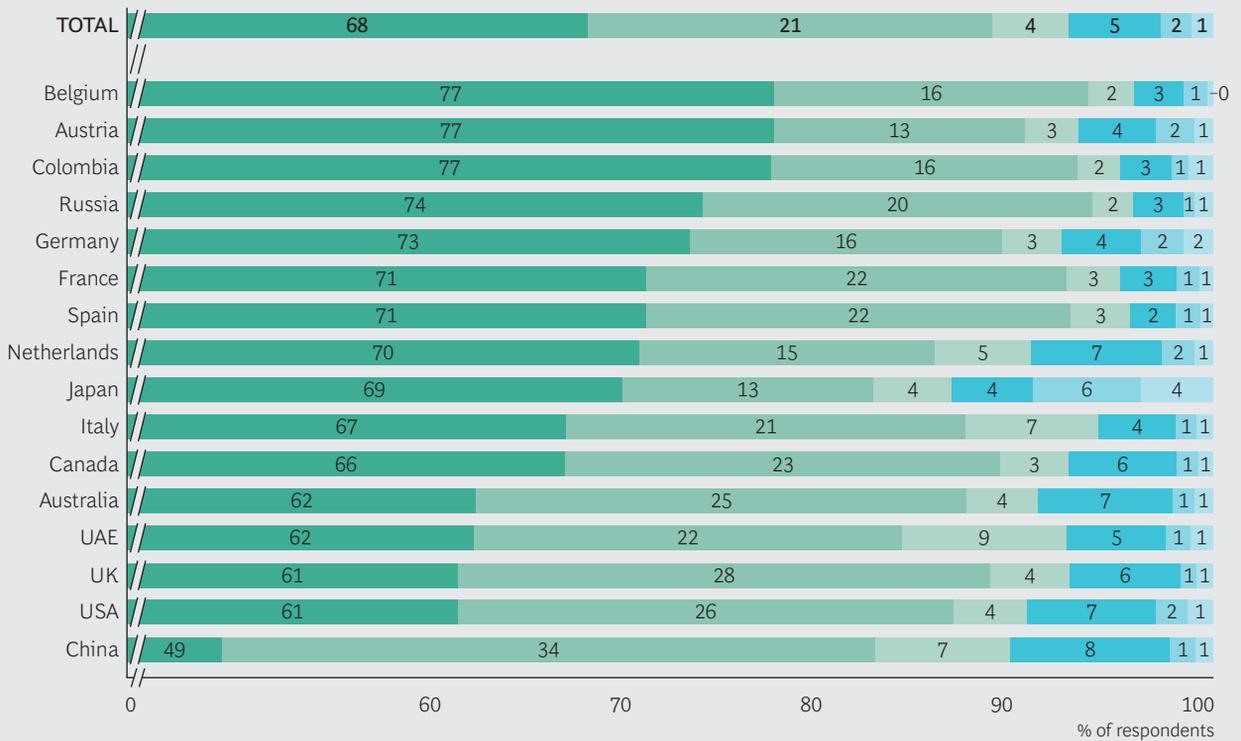
Banks in every quartile have a significant opportunity to improve customer service.

Therefore, for all the angst over the disruptive impact of fintechs, these companies are unlikely to endanger established retail banks in the immediate future. Our modeling suggests that the most probable competitive landscape scenario by 2020 is an ecosystem where incumbent banks still dominate but digital attackers gain share in some spaces. Far and away the greater threat comes from within retail banking's own ranks—from incumbents that blend fintech innovations into their business and operating models. To avoid being left behind, retail banks need to determine where fintech innovations can deliver the greatest top- and bottom-line impact and develop a cohesive strategy for befriending their fintech foes. Looking ahead, banks need to be at the heart of the evolving financial services ecosystem, not at the periphery.

Regulations Can Be Opportunities

The pace of regulatory activity has, if anything, picked up in the postcrisis period. Since

EXHIBIT 4 | Most Customers Are Reluctant to Share Financial Information Beyond Their Bank



“Are you happy to share personal financial information?”

- Not with anyone other than my bank
- Happy to share anonymous basic information digitally
- Yes—With a finance planning service but would prefer not to
- Yes—With a finance planning service and would be comfortable doing so
- Yes—I have also shared my internet banking log-in with a non-bank service but would prefer not to
- Yes—I have also shared my internet banking log-in with a nonbank service and was comfortable doing so

Source: BCG Retail Banking Customer Survey of 42,000 respondents in 16 countries conducted from December 2016 to January 2017.

Note: Because of rounding, percentages may not add up to the total shown.

2011, the number of individual regulatory changes that banks must track on a global scale has more than tripled, to an average of 200 revisions per day. Most of these actions are by individual jurisdictions, rather than globally coordinated initiatives. Given the need to stay on top of all those elements and implement changes efficiently across the organization, regulatory management is likely to remain a significant focus for retail banks through 2020 and beyond. (See *Global Risk 2017: Staying the Course in Banking*, BCG report, March 2017.)

Yet while the regulatory environment certainly raises compliance challenges, new regulations, such as the Payment Services Directive II (PSD2) in Europe, also present significant opportunities. PSD2 requires banks to enable

third-party access to customer account information through more open and standardized application programming interfaces (APIs). While some banks worry that this will make existing bank relationships easier for competitors to poach, we believe the directive represents a significant opportunity for established players to enrich their core business offerings, improve cross-selling, and turn a deeper store of customer and market data into new income-generating activities. That prospect is spurring retail banks in North America and beyond to consider their own API-driven open-banking business models, even without the regulatory push.

In our view, banks that take advantage of PSD2-enabled opportunities, such as aggregation platforms, marketplaces, mash-up ser-

vices, and comparison tools, will be in a stronger position to capture additional market share, fuel sustainable growth, and remain at the center of the primary customer-bank relationship. By the same token, banks that fail to seize on the opportunities that PSD2 provides run the risk of becoming “dumb pipes,” disintermediated by third parties and other banks to the point that their offering is commoditized, their brand becomes less relevant, and they compete merely on price and operational excellence.

Capitalizing on PSD2, however, will require most banks to augment their data capabilities and develop a tightly aligned customer-centric digital strategy. Advancing that agenda will take a mindset shift, partnerships, and better, faster bionic transformation.

RESHAPING DISTRIBUTION FOR SUPERIOR EFFICIENCY AND SERVICE

A BIONIC TRANSFORMATION CONSISTS OF three interrelated elements: the combining of human and digital capabilities to reshape the distribution model, personalization of the value proposition, and the adoption of a customer journey mindset. This report discusses each in turn, beginning with the distribution model.

Most banks manage wide-ranging distribution networks that include a mix of branches, ATMs, call centers, social media, web chat, and video interactions. Those touchpoints, though varied, should work together to create a smooth, consistent, and rewarding experience and serve as natural customer pathways. A consumer might see an intriguing offer on social media, for instance, research the offer on the bank's website, sign onto a web chat for help in filling out an application, and telephone the call center to monitor the status. Each of those interactions should feel seamlessly integrated. Yet too many banks view their digital and physical channels as separate entities serving discrete customer segments. That's slowing responsiveness and preventing banks from achieving the customer satisfaction and cost performance they need.

Our 2017 survey found that 43% of customers want purely digital interactions, compared with 28% in 2015. But hybrid customers, who are looking for seamless multichannel experiences, are also on the rise: 43%, compared with

37% in 2015. Channel usage varies considerably by country. Hybrid customers dominate in many places, especially in emerging markets such as China and Russia. Across much of Europe and Japan, hybrid customers represent around 35% to 40% of the market. The exception is the Netherlands, where 76% of respondents consider themselves to be primarily digital-banking customers. (See Exhibit 5.)

Behind those numbers are a few simple facts: customers expect their financial services partners to exhibit the same dexterity with the physical and the digital environment that they do, and they want banks to provide a more personalized experience, with sleek, efficient service tailored to the relative complexity of the offering. Simply put, customers want excellent, individualized service no matter when, where, and how they bank.

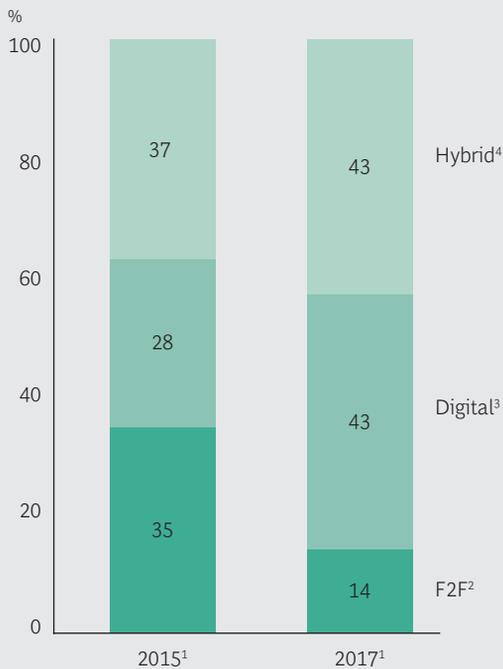
Shifting to a bionic distribution model will enable banks to serve all their customers—whether they are digital, face-to-face, or hybrid—and deliver superior customer outcomes at appropriate cost. While the model encompasses many elements, our data shows that branch optimization often provides the greatest near-term opportunity.

The Case for Bionic Distribution

Traditional branch traffic is slipping. Digital channels now make up 80% of all touch-

EXHIBIT 5 | Customers Increasingly Use Digital and Hybrid Channels

THE NUMBER OF DIGITAL AND HYBRID CUSTOMERS HAS INCREASED SIGNIFICANTLY SINCE 2015



HYBRID CUSTOMERS DOMINATE IN MANY MARKETS



Source: BCG Retail Banking Customer Survey of 42,000 respondents in 16 countries conducted from December 2016 to January 2017.

¹Average across all countries included in the consumer surveys in 2015 and 2017.

²Face-to-face (F2F) customers are those who do most of their banking through branches and seldom carry out digital transactions (once a year or less).

³Digital customers are those who carry out digital transactions frequently (at least every two to three months) and seldom visit branches (once a year or less).

⁴Hybrid customers are those who conduct online transactions and visit branches frequently (at least every two to three months).

points, compared with 60% in 2014. Banks have responded by closing branches and doubling down on measures to increase operational efficiency. While those efforts have been effective to a degree—branch costs as a share of total operating expenditures have fallen from 32% in 2014 to 29% in 2016—trimming the branch network alone will not get banks where they need to be.

There are two reasons for this:

- Human relationships remain the most important means of new-business generation.** Around the world, 98% of all mortgage deals and 74% of new current accounts still involve some human interaction, although that varies considerably by market. Nearly two-thirds of customers prefer human contact for quote assistance, a critical stage of the selling

process, and 43% still visit a branch on a regular basis for basic inquiries and to check account balances. All-digital banks seem to struggle to enter the mortgage market—this product represents only 9% of their business volume, compared with 36% for traditional players. The data underscores the fact that in-person interactions remain an essential sales enabler, especially for the complex products that typically are at the core of the primary banking relationship.

- Digital channels do not generate significant revenue yet.** There is no question that digital is becoming the preferred channel for routine banking activities. Yet many of those interactions do not generate revenue. Banks that maintain traditional branch networks have margins that are more than 70 basis

points higher than all-digital players, according to our REBEX data.

Amid rapidly increasing digital servicing and cost pressure, many banks struggle to maintain distribution reach while reducing distribution cost. Most banks have reduced their branch footprint in recent years, yet much more can be done. Given these shifts, we believe that banks are arriving at a tipping point. The best will revamp distribution into a multiformat network, in which a particular type of branch addresses specific customer needs, and the nature of those needs in turn will define where branches of each type are located. Banks that move to this type of bionic network model can see revenue gains of 5% to 15%, reductions in network cost of 15% to 35%, and increases in customer satisfaction of 10% to 15%.

Three Steps to an Optimized Branch Network

Here are three ways that banks can employ data, analytics, and agile work practices to improve their branch network and deliver stronger, more sustainable growth.

Adopt a bionic model in branches. Instead of a uniform branch model, banks must create multiple branch formats, embedded within a well-rounded omnichannel experience, using data and customer behavior analyses to determine which types of services customers prefer to use and engage with over online channels and which they prefer to access at a physical branch. The result extends the traditional hub and spoke model to a range of differentiated branch formats. Under that redesign, some branches will become full-service entities, others will provide specialist support, such as investment advice, and the remainder will become self-service branches with remote advisors.

Moving to this type of network model requires understanding the needs, priorities, and behaviors of various customer segments and then using those insights to reconfigure service delivery across channels. One major European banking group used this approach to achieve branch network cost savings with-

out affecting customer satisfaction. Although the bank had already reduced its branch footprint and considered itself lean, it saw an opportunity to improve service and efficiency. Drawing from sales and service data, the bank devised a range of formats, including counterless branches, full-service branches, and specialized advisory centers. The redesign unlocked 10% in additional cost savings.

Banks must create multiple branch formats to deliver an omnichannel experience.

Use data and analytics to optimize coverage. Branch planning used to be a real estate question: how many branches to establish in which locations. Decisions to close branches were often heavily based on internal performance criteria. Data-enabled location models that incorporate internal, geospatial, and ethnographic information allow banks to forecast expected changes in customer behavior, product mix, and profitability in order to refine their footprint, serve more customers per branch, and achieve higher margins. By blending internal and external data, and using advanced analytics, banks can achieve better cost and revenue performance.

A large Australian bank used advanced location models to explore which markets and locations were likely to have the greatest demand for different types of services. Those insights informed where to open or close branches, which to refurbish, and which to redesign. The effort allowed the bank to trim its branch footprint by 25% to 30% (for an expected \$100 million in net savings) while still increasing overall volume. And this is just a start. Whereas footprint optimization used to be a one-off effort, banks can now use advanced location models to continually reevaluate their networks.

Use digital functionality to enable the sales force. To serve clients effectively, RMs must be equipped with the right digital and analytical tools. Customer relationship management systems and dashboards

supported by advanced analytics can improve the quality and quantity of customer interactions. Digital tools can also help serve clients in need of human intervention. For instance, a bank may find that some customers begin the mortgage application online but abandon it partway through. Banks can use that information to trigger a “live chat” or “schedule an appointment”

notification, so customers can engage with human advisors to complete the process. Looking at the multichannel environment in a more strategic light can allow banks to understand where digital functionality and human engagement can make the biggest difference in driving sales and supporting the customer relationship.

PERSONALIZING VALUE TO SUPPORT GROWTH

RETAIL BANKING CUSTOMERS CONTINUE to expect great products at a fair price from banks that know and understand them. But while that fundamental expectation hasn't changed, banks now have the ability to make that value proposition bionic—by using digital tools and capabilities to personalize, differentiate, and localize their products and services to a much finer degree than ever before.

Refine the Value Proposition

If banks want to retain their position as the primary financial services provider for customers, they need to refine their value proposition. To do so, they need to make better use of data and analytics to understand customer expectations, quantify the perceived value of various product and service components, and adapt features, bundles, and pricing to match customers' needs and preferences.

Pricing is by nature at the heart of the value assessment. Our REBEX analysis concluded that more-effective pricing practices could allow banks to add as much as 15% in incremental revenue by 2020 while improving customer impact—revenue that would go directly to the bottom line. As important, pricing that is perceived as transparent, personalized, and fair is essential to attracting customers and keeping them satisfied. Our survey data found that pricing continues to play a major role in purchasing decisions.

(See Exhibit 6.) But it also shows that pricing is not the only determinant and that although rates and fees are very important to some customers, they are a lot less important to others. Banks need to take price sensitivity into account when designing and personalizing their pricing proposition.

Three Steps Toward Value-Based Pricing

Shifting to value-based pricing is one of the fastest and most concrete ways to redefine customer value and fund a bank's strategic agenda. For that to happen, there are three things that banks can do.

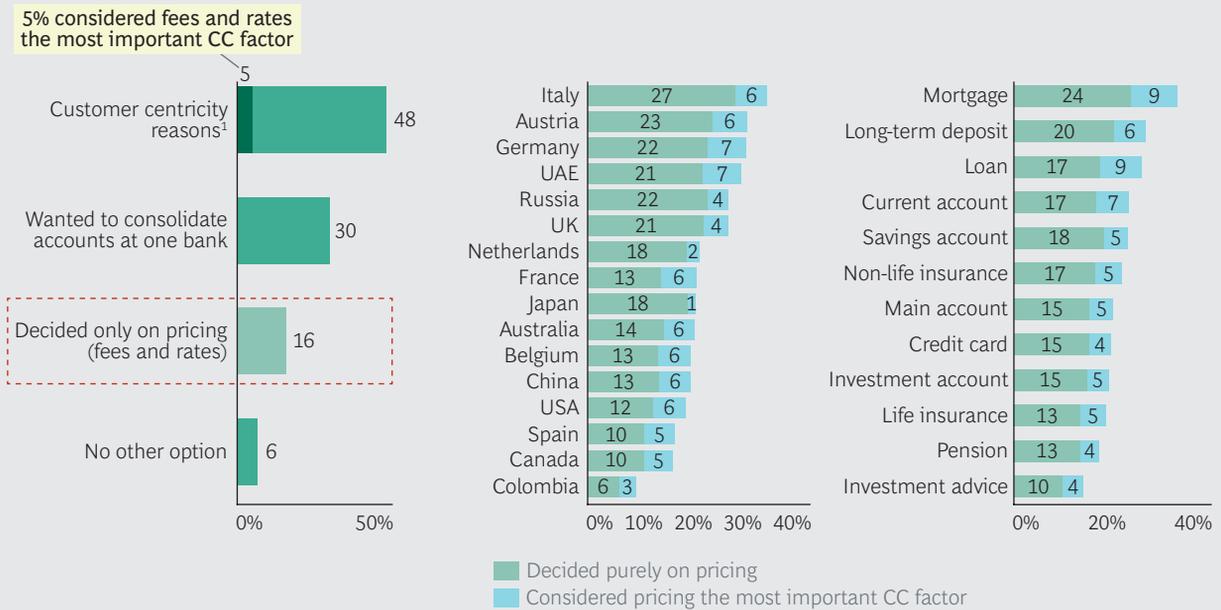
Understand what customers value most.

Banks have an opportunity to grow income by understanding what customers care about, giving customers greater choice, and aligning product bundles and pricing accordingly. Many banking bundles are complex—some include more than 50 features. But not every feature holds the same value, nor is pricing always transparent. Customers may be paying for services they don't care about, such as account maintenance and paper statements, while others that they do value, such as card provisioning, are free. Shifting to value-based pricing can make a huge difference. One European bank increased daily banking revenue by almost 15% by tailoring bundle pricing to customers' preferences. The bank

EXHIBIT 6 | Pricing Continues to Influence Purchasing Decisions

“WHY DID YOU CHOOSE TO GIVE YOUR BANK MORE BUSINESS?”

% OF RESPONDENTS WHO BASED DECISIONS ON PRICING²



Source: BCG Retail Banking Customer Survey of 42,000 respondents in 16 countries conducted from December 2016 to January 2017.

¹“I liked one or more of the following attributes: the bank’s service, products, rates (fees, interest), interaction (branches, telephone, internet, mobile), its image & advertising.”

²Averaged across products for per country view; averaged across countries for per product view.

used purchasing histories and surveys to determine what features should be included in various bundles and adjusted the mix to suit the needs and priorities of different client segments. Top banks are also taking a closer look at their sales makeup and seeking to make value-added services, such as investment accounts and advisory activities, a bigger part of their overall portfolio. Banks that have adopted this approach have attracted significant customer interest. High-performing banks are increasing the share of fee income from value-added services, such as investment accounts, which represents 12% of total revenue for top-quartile banks, compared with 2% for the median bank.

Factor in price elasticity and sensitivity.

While banks often differentiate pricing by cost and risk, they may not account for customers’ tolerance for pricing changes. There are two issues to consider. One is elasticity. Banks can use pricing grids and market data to gauge the impact of pricing changes on sales volume. This can be especially useful in countries where individualized pricing is not allowed and for products

that have transparent pricing information, such as mortgages and loans. A large European bank compared historical price and monthly volume data to quantify the price elasticity curve of its mortgage products. The model allowed the bank to see how monthly volumes and margins would change in response to subtle shifts in pricing. Using that data, the bank identified areas in the price grid (based on loan-to-value and maturity) where it could lower prices and other areas where it could raise prices to attract different customer groups. Those steps led to an increase of 10 percentage points in the margins on new mortgage production. The other issue is sensitivity. In some markets, banks can use historical customer data, such as previously accepted prices and promotion responses, and targeted client research to understand sensitivity to price changes in order to personalize pricing at the level of segments and individuals.

Fix price realization across the business.

Inconsistent discounting practices, limited monitoring, and infrequent updates to long-standing practices affect price realiza-

tion. (In some cases, for instance, adult customers may still be paying the same low introductory fees they were offered as students 10, 20, or 30 years earlier.) These unrecovered costs can add up, especially when compounded across the bank. Stemming that leakage can deliver a swift revenue boost. Gains of 5% to 15% are not uncommon, especially in investments, mortgages, and loans, where discount discrepancies are

common. What's more, fixing pricing realization generally requires very little near-term investment. What it does require is an effort to renegotiate the terms and conditions of existing customer contracts, together with better sales force practices. Because discounting habits are often engrained, changing the sales culture takes significant training, coaching, and oversight, along with the right tools and metrics.

ADOPTING A JOURNEY MINDSET

BANKING SERVICES AND PRODUCTS are a means to an end—the means to open a business, to finance an education, to buy a pair of shoes, to retire, and so on. Yet despite a desire to be customer led, many banks institute processes that feel anything but. Customers can spend hours searching for information on how to find the best mortgage, for instance, and more hours completing paperwork, making appointments to review that paperwork, and waiting for decisions to come in—when at the end of the day they really just want to buy a home. By reimagining the customer’s end-to-end journey—streamlining steps, injecting guidance at key moments, fast-tracking responses—banks not only make customer centricity their way of doing business but also dramatically improve their financial performance. Most banks are not doing this yet, and it is holding them back.

Weak Integration Impairs Customer Service

The reality is that while retail banks have made significant progress deploying sleek front ends—user-friendly apps, websites, and mobile interfaces—they have made significantly less progress integrating them with the rest of the bank. (See Exhibit 7.) That is hurting the customer experience. Our data found that 25% of all customer churn is caused by friction and process errors. Not even banks

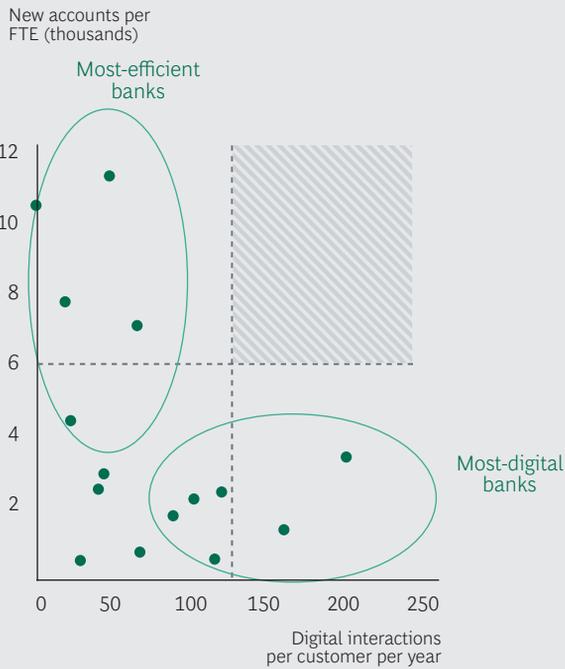
with above-average front-end digitalization achieve high levels of back-office efficiency, according to our benchmark. This comes even as top and median players look to become leaner and more productive by trimming middle- and back-office head count. Poor automation and process cohesion leave remaining employees to do more without the benefit of high-performing systems, which decreases efficiency, as measured by number of customers per operations FTE.

As a result, customers perceive many common services, such as loan processing and account onboarding, to take longer than they actually do. Loan cycle times average 39 minutes for the median bank, for instance, but 80% of customers surveyed said the process felt much slower. We also found that while front-end digitalization provides more selling opportunities for traditional banks, most still struggle to convert that traffic into sales.

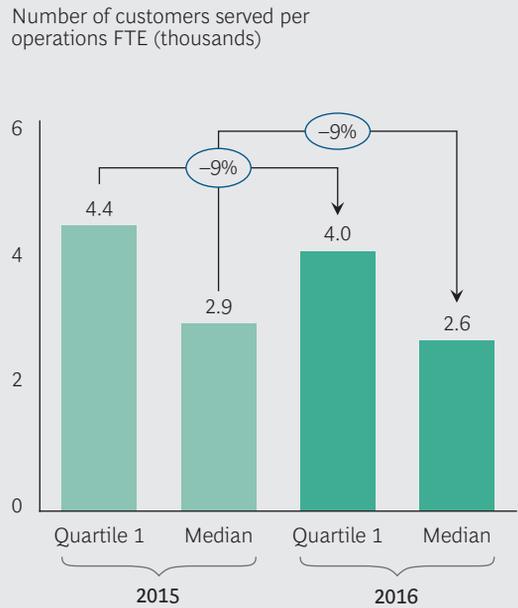
Not surprisingly, our REBEX data found that digital banks—online banks with modern IT architecture and highly automated end-to-end processes—are far more efficient than their traditional peers. They support twice as many new account openings per operations FTE as the median bank does and serve 155% more customers per operations FTE. In addition, their cost per customer is about one-third that of the median (\$108 versus \$329), and they have 30% more customer engage-

EXHIBIT 7 | Banks Struggle to Integrate End-to-End Processes

NO CORRELATION BETWEEN DIGITAL INTERACTIONS AND OPERATIONAL EFFICIENCY



NO IMPROVEMENT IN CUSTOMERS PER OPERATIONS FTE



Source: BCG Retail Banking Excellence (REBEX) benchmarking.

ment, as measured by the number of customer interactions.

We believe that designing end-to-end customer journeys that harness the best of digital and human tools and capabilities is the best and most sustainable way for banks to deliver value. Our experiences with clients in all regions shows that retail banks that optimize core customer journeys can see a 5% to 20% boost in revenue from improved service, increased RM capacity, and new data-enabled offerings. They also reduce costs by 10% to 25% from shorter cycle times and faster and more-accurate decision making.

Four Ways to Design Winning Customer Journeys

Customer journeys include how the customer first engages with the bank, researches offerings, initiates a request, selects a particular product or service, sets up the relationship, and uses the offering. Synchronizing the various stages of the journey and the elements that support them can significantly improve the quality of the customer experience.

Reimagining customer journeys end to end with a mix of digital and human capabilities is the key to becoming bionic at scale: doing so enhances the customer experience and radically reduces operating costs. Reimagining just a few journeys can often make a profound difference.

To reap the benefits, here is what banks need to do:

Prioritize the customer journeys that matter most. Typical retail banks have 20 to 30 customer journeys, each of which begins with a particular customer need, such as, “Help me with the funds to purchase my home,” “Help me define a plan to meet my retirement goals,” or “Resolve transactions that I do not recognize.” These journeys are supported by hundreds of processes and thousands of tasks. To a customer, however, they should feel seamlessly integrated.

Banks should begin by focusing on a few journeys. Customer transaction histories, call center logs, online footprint data, and pain point identification can shine a light on

which journeys, when thoroughly redesigned, stand to deliver the greatest impact. As banks roll out the first new journeys, they can leverage the skills and lessons from that effort to broaden the transformation. One large Australian bank focused on four journeys in the first year of a three-year transformation program. Even that small subset is making a difference. The bank is already seeing a dramatic reduction in cycle times, increased customer satisfaction and revenue, and lower costs.

Apply design thinking practices. The best journey redesigns do not simply tweak existing processes; they rewrite the playbook from the customer's point of view. Thinking about the banking experience in this way requires challenging norms and staying alert to the practices of experience leaders in other industries and markets. The result can be a profoundly different way of engaging customers. For example, a regional US bank used ethnographic research—studying how customers interact with the bank in day-to-day settings—to better understand customers' needs, wants, and preferences. The design team observed customers as they navigated their banking routines, which allowed them to see what interactions were appealing and which were not. The team married this “outside-in” perspective with “inside-out” business realities to define the baseline and improve the customer experience. The bank estimates that the changes could deliver \$60 million per year in combined cost savings and revenue gains.

Redesign journeys end to end. With those insights in hand, cross-functional teams—comprising product managers, designers, user experience experts, programmers, and others—can use agile development techniques, including rapid prototyping exercises, to improve the speed, quality, and efficiency of a journey. Continual ideation and testing are key. Teams should put prototypes into the field to elicit customer feedback and continually refine, iterate, and release journey elements until they meet agreed-upon performance targets. Back-office functionality must be redesigned concurrently for an end-to-end experience. One large bank that used this approach to redesign credit lending cut in half the amount of time required for

clients to go from application to funding. Automated and streamlined processes sharply reduced the amount of paperwork—saving the bank 30% in costs and increasing customer satisfaction. In addition, by employing dynamic queuing and other digital processes on the back end, the bank reduced the number of exceptions that required manual handling. Another bank reduced lead times by 47% and rework by 34% across newly designed journeys, saving the bank \$200 million over four years.

Use artificial intelligence to support the transformation. Banks can augment existing capabilities by employing robotics and machine-based learning systems that can sense the environment, provide information, and execute and adapt automatically. These technologies can automate routine, rules-based tasks and help banks discern key patterns in structured and unstructured data. For example, banks can use an AI-based pre-approval process to offer consumer loans in real time. They can also improve sales force effectiveness by providing evidence-backed next-best-action guidance based on customer behavior, social media, and other data. A top US credit card issuer, for example, partnered with third parties to employ new machine learning models capable of churning through 10,000 transactions per second from multiple channels to detect existing and potential fraud triggers. The combined speed and depth helped the issuer improve fraud detection rates by more than 40%, for an increase in savings of \$125 million.

CONCLUSION

RETAIL BANKS HAVE MADE good progress in stabilizing their financial performance in the postcrisis era. But macroeconomic, competitor, and customer imperatives require that they go further. Instead of surface-level fixes that address only certain aspects of the business and operating model, banks need to take an integrated approach. To get there, they must become bionic, combining digital functionality for speed and convenience with thoughtful, caring human interaction at crucial moments in the customer journey.

The starting point for each bank will depend on its business strategy, market position, and capabilities. But all banks must consider how they can reshape their distribution models, improve their value propositions, and develop end-to-end customer-centric journeys to increase growth and customer satisfaction. This report outlines what it means to go bionic in each of these three areas, with attention paid to concrete steps that have been shown to deliver a strong impact within a relatively short period.

In reconfiguring their distribution models, for instance, banks that invest in designing multiple branch formats within the context of a well-rounded multichannel experience will have a significant competitive advantage. Likewise, when it comes to personalizing value—something customers increasingly demand—banks need to double down on prod-

uct and service innovation and enrich their banking interactions. In the near term, value-based pricing practices can give banks an immediate boost, allowing them to generate 15% more revenue over 6 to 12 months while improving customer impact. Finally, banks must also approach process design in a fundamentally different way—by focusing on the customer journeys that matter most, reimagining them in bold new ways that leverage artificial intelligence, robotics, and other service enablers, and integrating the new processes across the bank. To seize the opportunity and set the right priorities, banks should also look externally to gauge how their performance stacks up against that of relevant peers.

Banks that apply this way of thinking to their distribution network, their value proposition, and their end-to-end processes have the potential to increase operating profits by as much as 30% by 2020.

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