MOVING AWAY FROM ONE-SIZE-FITS-ALL IN DAILY BANKING

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Daily banking has always been the glue that cements a customer's relationship with his or her bank. But a combination of regulatory changes, rising customer expectations, new competition, and technological advancements is weakening that glue and threatening banks' profitability. We estimate that a retail bank puts 15% to 25% of its revenue at risk if the institution fails to enhance its daily banking proposition by adding innovative new features, improving customer experiences, making better use of data, and commanding higher prices that reflect the added value enabled by the Payments Service Directive 2 (PSD2), also known as open banking.

As daunting as those stakes sound, retail banks can seize the initiative by drawing on best practices established by other B2C service providers during the past two decades. Inspired by data-driven insights and attuned to the power of behavioral science, companies in large, global industries—as varied as telecommunications and media, transportation, and even personal care—have creatively and profitably transformed their approach to pricing and product propositions in response to similarly rapid changes in their markets.

Their current approach has three elements:

- Replace traditional gut-feel and cost-plus approaches with more lucrative ones anchored in customer value.
- Shift away from one-size-fits-all in favor of more sophisticated solutions that tap into the power of bundling and differentiation.
- Rely on insights mined from transaction histories and consumer research in order to understand customers better and serve them in more creative and flexible ways.

The time has come for retail banking to follow the lead of successful B2C service providers in other sectors. The potential for improvement can be as high as 10% to 15% of current daily banking revenue, which can be achieved through a mix of higher customer acquisition volumes, higher revenue, and higher profits. With so much at stake, revamping the daily banking proposition should be top of mind for every retail bank CEO.

Daily Banking: Challenges and Opportunities

The challenges in retail banking today are numerous, relatively new, and urgent. Low interest rates have put pressure on traditional earning models. Low growth has intensified competition for market share among incumbents, direct banks, and financial-technology companies, which also pose an emerging threat. Regulation is altering the landscape as well, particularly in the European Union, where a cap on interchange fees has reduced the income from daily banking fees. PSD2, for example, creates such potential risks as disintermediation and enhanced price transparency, but it generates opportunities as well. (See the sidebar "Viewing PSD2 as an Opportunity, Not a Threat.")

The challenges shouldn't overshadow the numerous opportunities. Banks are realizing that customer relationships formed on the basis of daily banking contribute more than just deposits. They also provide a rich supply of data that can serve as a source for value creation. Such data yields insights that can help boost profits by improving risk assessment, uncovering ideas for more cross-selling, and developing personalized value-added services (VAS). Just like other B2C service providers, banks can use this data to make customer relationships stickier. They can understand customers better, predict behaviors, and make a bank's offerings more intuitive—an especially important factor because so much of today's consumer banking activity is online and self-service.

Another substantial and lucrative opportunity involves redesigning the daily banking proposition itself, in which banks choose one of several ways to leave behind their one-size-fits-all past and strive for the right combination of bundling and differentiation for the future. (See the exhibit.) These

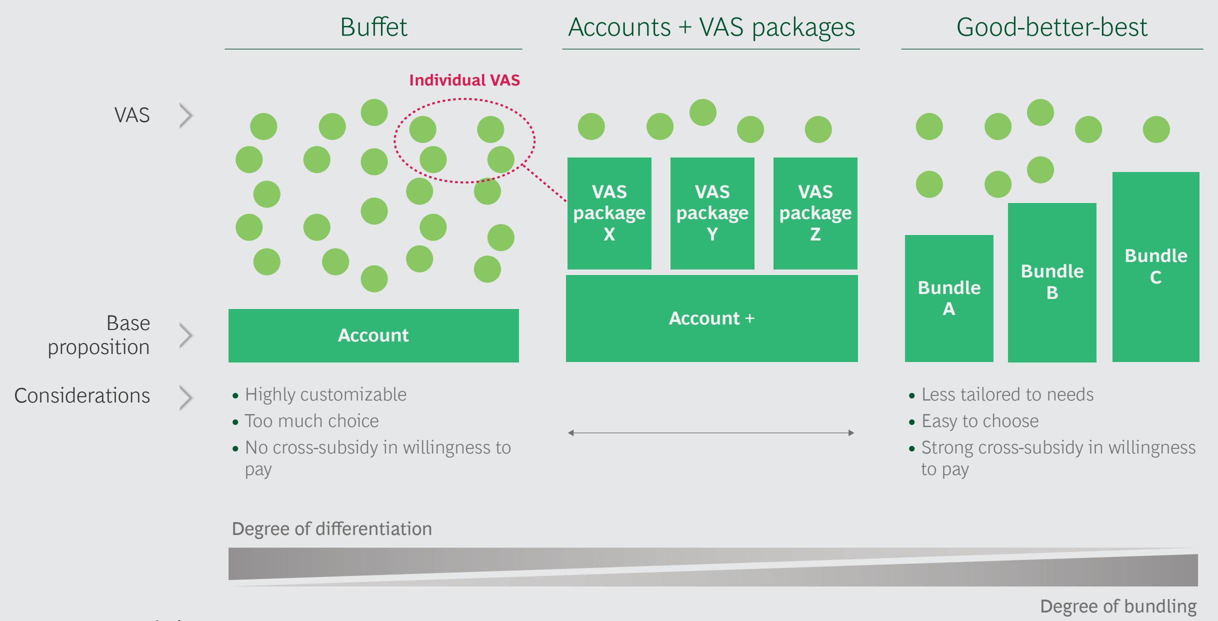
VIEWING PSD2 AS AN OPPORTUNITY, NOT A THREAT

The Payments Service Directive 2 (PSD2), or open banking, offers several opportunities. How well banks can capitalize on them will depend on customers' willingness to share their data as well as their interest and willingness to pay for new PSD2-enabled services.

According to BCG proprietary research, banks may pursue several opportunities for daily banking propositions:

- Respect customer data as a valuable resource. Customers are ready to share financial transaction data—but with two conditions: they want real value in the form of better and more personalized service or lower rates, and they want assurance that their data is in safe hands.
- Create new value propositions. Customers are interested in value propositions enabled by PSD2. The most popular are built around personalized savings, loyalty offers from third parties, and account aggregation.
- Tap into willingness to pay. Customers are willing to pay for new value-added services. A recent study launched in five EU countries shows that customers are willing to pay for features that go beyond the basic account. A bank has even more potential to increase revenue if it can combine such features into the daily banking proposition through more attractive product bundling.

Different Proposition Archetypes Offer Different Benefits for Tapping into Value Perceptions



Source: BCG analysis.
Note: VAS = value-added services.

alternatives also emphasize that improvement requires attention to all three elements of the daily banking proposition—features, price structure, and price levels—rather than a narrow focus on only price levels. The temptation to rely solely on price changes is deceptively dangerous, as one leading universal bank learned when it implemented across-the-board price increases in line with competitors' moves. The changes led to declines in both market share and revenue. When that bank subsequently changed the content of its bundles and the prices in tandem, its revenues grew by a double-digit percentage.

Each approach has distinct advantages and disadvantages that a bank must weigh carefully:

- **Buffet.** This approach takes differentiation to its extreme by maximizing choice and allowing customers to select their own features. Some banks now have as many as a few dozen distinct features on their buffet menus, each of which may have a strong appeal for one specific type of customer. But using this high degree of customization can have an unintended downside. Collectively, the sheer number of features—never mind their associated price levels—can overwhelm even the most sophisticated and discerning consumer. Customers are also prone to cherry-pick only items with prices that are equal to or lower than the ones that they are willing to pay.

- **Good-Better-Best.** At the other end of the continuum, this type of bundling approach makes intuitive sense in part because the communication is very straightforward. This alternative boosts revenues by tapping into a customer's willingness to pay for various features. But it can be suboptimal when customers feel forced to make too many compromises when choosing a bundle or when the bank loses out on potential revenue because of limited opportunities for differentiation.

- **Accounts Plus VAS Packages.** This middle approach has a great deal in common with the offerings of B2C service providers in other industries. It includes a beefed-up basic account, a few VAS packages, and a small menu of features available à la carte. This alternative maintains the structural advantages of bundling but offers a more finely tuned level of differentiation to make the most of the advantages of the buffet approach. Triple-play bundles in telecommunications, for example, usually allow customization through additional premium services, higher monthly data allotments, or increased internet speed.

Some banks have already realized significant financial impact by working within these three structural archetypes. One bank that had focused on growing aggressively through the use of a zero-fee daily banking account, for example, could no longer ignore the fact that its growth came at the expense of profitability. How could the bank go from “free” to “fee” to restore its profitability but without stalling its growth and compromising the no-fee promise it had made to customers?

Answering that question required an approach that went beyond intuition, experience, and basic cost-plus calculations. The bank shifted from a very simple proposition—one free account and a zero-fee promise—to three propositions. Two of those propositions were also zero-fee, allowing the bank to stay true to its original promise, but they offered less value to the customer. The third proposition was a new, higher-value package with a fee, paid add-ons, and favorable conditions for investments and lending. Implementing that solution helped the bank to not only boost profitability but also increase its market share by two percentage points.

How Banks Can Become Better B2C Service Providers

Banks can achieve such improvements by pursuing a dedicated process to understand what motivates customers, what features they need, what perceived value those features provide, and—most important—how to translate those insights into a proposition that makes financial sense for both the customers and the bank itself. This approach, which represents a break from traditional practices, is the juncture at which companies in other service sectors—including telecommunications and media, and transportation—often redesign their propositions to reflect evolving customer needs and a rapidly changing competitive and technological environment.

To create winning propositions in daily banking, the best banks take three steps, which they then integrate into a holistic solution: they outline their solutions at a high level, gain a more thorough understanding of their customers, and quantify their customers’ value perceptions.

1. Outline the solution. The process of redesigning the proposition starts with a clear articulation of an institution’s broader strategic objectives: How does the bank want to balance higher margins with higher growth? What customer segments does the bank want to prioritize? To what extent should the daily banking solution drive profit on its own as opposed to boosting profit by stimulating the cross-selling of other banking products? These questions are part of an overarching framework for thinking through and developing a pricing approach.

When outlining a solution, a bank needs to consider not only its business objectives but also its operating constraints. Regulation, for example, can restrict what features a bank can charge for, how it can communicate prices or price changes, and whether price levels are capped. Constraints on IT can determine the extent to which a bank can implement and scale up an attractive idea. Finally, the new daily banking proposition—and the resulting price positioning—must be in harmony with the bank’s branding objectives and be easy to communicate to customers.

2. Understand customers thoroughly. The better banks understand their customers, the better they can transform themselves into helpful and valuable life partners rather than one-size-fits-all transaction partners. To gain that understanding, banks need to ask themselves several questions: What do customers want, and what do they dislike, in the daily banking relationship? How, and on what occasions, do customers choose a partner for their daily banking relationship—for example, what services and features entice a customer to select a service provider? Branding also plays a significant role here, because some customers may refuse to consider certain brands or be unwilling to switch away from their current service provider. This relates to the purchase pathway, as the customer decides whether, where, and in what form to establish or continue a daily banking relationship.

After a relationship is established, several other design questions about growth and retention come into play: How can a bank use its pricing and proposition to nudge a customer toward a particular option, a set of desired behaviors, or both? What new services trigger customers' interest and willingness to pay? What cross-selling and upselling potential exists?

Banks have found the greatest success by answering these questions with a mix of qualitative techniques, such as BCG's Mind-Discovery, and quantitative techniques, such as data mining, in order to uncover different segments with common needs and behaviors. Customers' transaction histories, when properly analyzed, hold significant clues to their forward-looking behavior. Using today's machine-learning technologies, a bank can even forecast the future needs of its customers—such as a mortgage, a new investment strategy, and retirement planning—and proactively offer customized solutions on the basis of better risk assessments.

Banks can incorporate these insights into their daily banking propositions in several ways. They can offer favorable prices on other products, such as a better rate on consumer loans, if customers share their transaction data. They can reduce prices or waive fees on daily banking if cross-selling efforts prove to be successful. Banks can also offer bundles that target certain segments, such as families, homeowners, or frequent travelers. One European zero-fee bank, for example, performed a cluster analysis on its transaction data and discovered a segment of frequent international travelers in its customer base. The bank used this insight to create a paid add-on bundle with a capped number of free transactions outside the Eurozone as well as other travel-related benefits. This shows what a bank can do once it understands customers' needs and preferences at a segment-specific level. But the most lucrative opportunities emerge when a bank can discern the worth, in monetary terms, of the services and features that address those needs.

3. Quantify customers' value perceptions. Measuring the value that customers attach to different features is at the heart of creating a better daily banking proposition. This has several dimensions, including the prominence or visibility of the feature and a customer's desire for it. The quantification will be specific to each bank and segment.

Quantifying value perceptions, and how they change, has a lot of applications. It allows a bank to measure the perceived value of a price change by revealing how much more attractive (or unattractive) a proposition becomes if the bank cuts (or raises) its price. Those changes in perceived value are more pronounced in a primary fee component, such as a monthly fee, than in less visible price components, such as the price for an extra credit card or a supplemental fee for paper statements.

The bank can also measure the impact of changes in the price structure on perceived value. How does the attractiveness of the proposition change, for example, if a bank changes its policy from unlimited, free ATM withdrawals to only five free withdrawals per month and then €3 per transaction?

A bank can measure how adding benefits to the daily banking proposition can change its perceived value as well. What is the impact on the perceived value of adding a credit card or changing the cardholder's status from silver to gold? Understanding the impact on perceived value through various changes to the daily banking proposition enables the bank to optimize its bundles.

What's more, banks still have a tendency to underestimate customers' willingness to pay for the vast array of low-interest, low-frequency fees they may encounter. A bank may have more than 100 such features, including card replacements, paper statements, and card blockages. Many banks leave a considerable amount of money on the table by charging nothing for these services or charging fees that are far below the levels that customers would find acceptable. One alternative is to create à la carte prices for some fees to establish reference prices and then include certain features in segment-specific bundles.

A combination of research techniques—for example, conjoint measurement together with a direct-question approach, such as the van Westendorp method—enable a bank to accurately quantify customer value perceptions. These techniques have been used widely in other B2C services industries to generate the insights needed to refine pricing and portfolios, create desirable and profitable bundles, and launch new services.

The results of a conjoint analysis for one bank, for instance, revealed the value that customers attach to making free cash withdrawals from ATMs worldwide. This allowed the bank to replace the feature, which had become highly unprofitable, with an equally appealing but more profitable one that customers valued at least equally—and perhaps even more.

Designing and Implementing the Transformation

Once banks have integrated the three steps into a holistic solution, they need to focus on implementation.

The extent and pace of the transformation depend on whether the changes are tactical and are applied to the existing proposition, or whether they are fundamental and strategic, requiring time as well as investments in IT, analytical capabilities, and consumer research. Such investments cover skills in deep market-research techniques (focus groups and conjoint analysis), advanced analytical methods (data mining and machine learning), and tools for optimization modeling.

The tactical changes—a rich source of quick wins—include price changes or basic structural changes derived from simpler quantitative research (such as van Westendorp), competitor analysis, and a deeper analysis of existing transaction data. One US bank, for instance, simulated the way its own customers' transaction behaviors might change under competitors' plan structures. When the bank discovered that, under the modeling, its competitors' plans would extract revenues that were from 30% to 60% higher than its own, it used these insights to recalibrate its price structure and levels.

Tactical changes can also include a recalibration of existing propositions on the basis of a new and better understanding of customer value perceptions. One European bank used conjoint research to discover that its current proposition lacked sufficient value differentiation across the good-better-best levels. To address this, it lowered both the price and the value of the good bundle to meet current market levels but increased the fees for some additional features. It also improved the content in its best offer in order to increase the perceived value and justify a higher price.

The greatest impact will come from a full strategic overhaul of the daily banking proposition, relying on all of the steps described above. This requires a bank to make significant changes in the structure and content of its service bundles, including the use of innovative VAS, such as new PSD2-enabled features. Supporting these changes is a new strategic focus because the bank thinks and acts more like a B2C service provider and less like a traditional provider of a one-size-fits-all product. It also thinks in terms of value-based pricing instead of cost-plus pricing.

Revamping the daily banking proposition lays the groundwork for a bank to overhaul other areas of its business that have tradeoffs between price and service coverage. But the process begins when the bank truly understands the needs and value perceptions of its customers and offers them a choice among propositions. This leads to greater customer satisfaction and drives better financial performance. B2C service providers have known about these approaches and outcomes for years and have acted accordingly. Banks now need to do the same.

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