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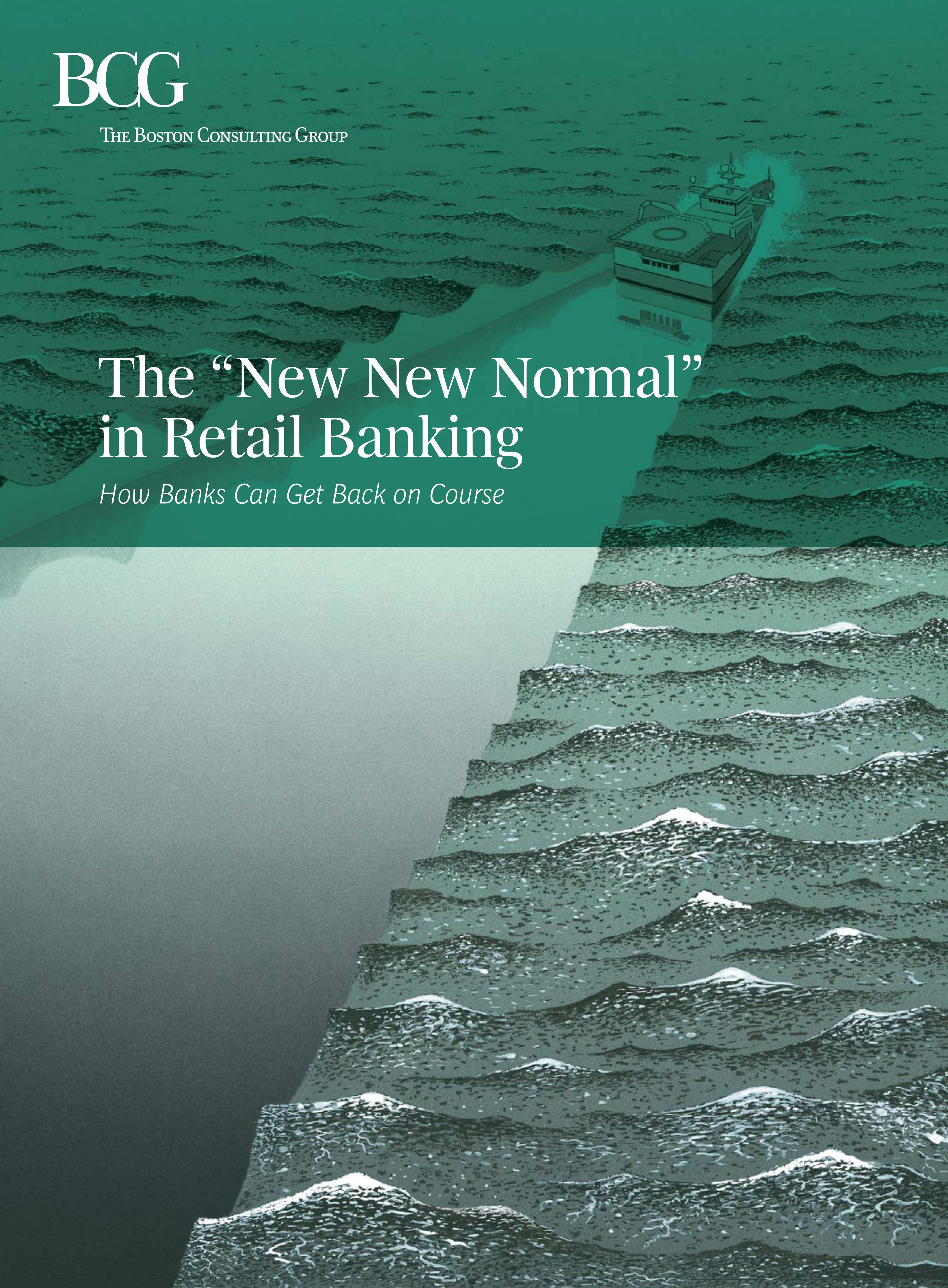
The "New New Normal" in Retail Banking

How Banks Can Get Back on Course



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AT A GLANCE

Becoming more customer-centric—while improving operational excellence—is critical to success in retail banking today. Being truly customer-centric is about being a trusted partner, knowing the customer's needs and preferences on the basis of activity history, and making access and interactions simple across multiple channels.

Holding the Main Banking Relationship with the Customer Is Crucial
Once considered "nice to have" but not necessarily profitable, the main banking relationship is now retail banking's sine qua non, providing the foundation for optimizing customer service through prompts, cross-selling, and numerous communications.

The Search for Profitability is Tilting Permanently Toward the Asset Side of the Balance Sheet
Deposit margins are being squeezed by low rates (except in some emerging markets), competition is increasing, and fees are under pressure from regulators. The winners will be those banks that generate sufficient margin on their assets to compete aggressively for funding, that treat their balance sheet as a closed-loop system, and that bring true rigor to risk management.

Although its overall health has improved since the dark days of the financial crisis, today's retail-banking industry is not yet out of the woods. In developed markets, revenue growth is stagnant (at best), and credit demand is weak—so repricing is a must. The cost of funds is still high, and margins on deposits remain low. In many developed markets, there is an ongoing war for deposits that shows few signs of cooling off as banks try to secure sufficient funding—putting a damper on sales of investment products.

There are further difficulties as well: in many markets, consumer trust in banks remains at its lowest ebb in decades; the cost of risk is still above historic levels; and loan losses have not yet fully abated. Moreover, taking refuge in emerging markets is not a cure-all, because achieving scale abroad is not realistic for most liquidity-starved, capital-constrained Western banks. (See the sidebar, "Navigating a Two-Speed World.")

NAVIGATING A TWO-SPEED WORLD

It is common knowledge that in terms of economic growth, different regions of the world are moving at different speeds. Major mature markets are expanding at a far slower pace than emerging markets—now typically referred to as rapidly developing economies (RDEs). What does this two-speed world mean for Western banks trying to gain a foothold in RDEs?

RDE banks have delivered higher total shareholder returns than banks in developed economies, their success driven by fundamentally healthier profitability and valuations. These banks generate sufficient liquidity domestically and have strong capital bases—even by the stringent standards of Basel III. Their price-to-book ratios are greater than 1, and their return on equity is greater than their cost of equity.

However, many RDE banks remain small. With the notable exception of several major Chinese institutions, few have made it into the ranks of the world's 30 largest banks. Moreover, although RDE banks are consolidating, there is still room for further concentration. The very real challenge is to create cross-border scale. Unfortunately, few, if any, developed-economy banks can participate in this process.

To be sure, banks in the more developed parts of Asia-Pacific, for example,

NAVIGATING A TWO-SPEED WORLD (CONTINUED)

are aggressively targeting regional growth. And with the ongoing rise of the middle class—whose bankability and overall consumption will increase dramatically in the coming years—the opportunity is significant. According to recent estimates, as much as 35 percent of global consumption will come from RDEs by 2020, up from 25 percent today, and this will translate into higher values per customer. Within the same time frame, banking assets in RDEs are expected to more than double. To capture these opportunities, many RDE banks have been refining and even developing new business models targeted at serving customers who are either new to banking or whose sophistication has increased along with their level of affluence. In doing so, some local and regional banks are now able to offer distinctive value-adding propositions that rival those deployed by global banks.

Still, achieving regional growth will not be easy for banks in RDEs. Stronger, more confident governments are raising regulatory barriers, and many operational challenges remain.

Ultimately, although the fundamentals of winning in retail banking remain fairly homogeneous worldwide, the market context of RDEs requires banks to focus more on local levers. Overall, Western banks attempting to gain a sustainable foothold in RDEs have their work cut out for them. Some first movers have pioneered innovative approaches, with SME and consumer banks leading the way.

At the same time, the news is not all bad at the aggregate level. Some industry fundamentals—such as impairments and costs—have improved and are now showing positive trajectories. (See Exhibit 1.) In essence, the "new new normal" in retail banking is not totally different from what we have seen over the past few years—but the bar for success is significantly higher, and the margin for error is much narrower. One overarching fact is that being truly customer-centric is no longer a choice—it's an imperative. Retail banks must focus on customer satisfaction, offer a fair-value exchange, and execute in a truly integrated multichannel mode. They must develop intelligent analytics, a more streamlined product range, and a much simpler industrialized operating model that is run by engaged and motivated people. These are just a few of the elements of a truly customer-centric bank.

Another key to current industry trends can be found in the shifting roles of products and channels. Distinct differences have evolved between the "old world" of the precrisis era and the "new world" of today. Consider the following dynamics:

- Holding the *main banking relationship* with customers was once considered "nice"—but not necessarily profitable. Today, it is retail banking's sine qua non, anchoring the relationship that provides the crucial foundation for optimizing customer service through prompts, cross-selling, and numerous communications. Best-practice banks have specific definitions of what constitutes a customer's

Exhibit 1 | Some Retail-Banking Fundamentals Show Positive Trends

	Trend, 2007–2011	Trend, 2012	Driver
Asset margins	↗	→	Widened from unsustainably narrow margins driven by repricing, asset margins are now stable
Liability margins	↘	→	Pressure has eased up somewhat from the depths of the crisis, but margins are still tight
Asset volumes	→	→	Supply pressure is beginning to ease, but (new) consumer-credit demand remains low
Liability volumes	→	↗	Liability volumes remain higher than precrisis levels as consumers continue to save more
Fees and commissions	↘	↘	Reduction in investment activity drives declines in fees and commissions; the trend is driven by a shift from investment products to deposits and less active trading
Impairments	↗	→	In some markets, loan impairment charges are dramatically better, and there are modest write-backs
Costs	↘	↘	Costs are going down, driven by efficiency programs initiated at the onset of the crisis
Capital	↗	↗	The capital base is stronger, driven by increases in the capital requirements of Basel III regulation
Return on equity	↘	→	Though impairments and cost reductions help return on equity, a return to precrisis levels would require signifiant growth, which would be hard to come by in the current environment

Source: BCG analysis.

main banking relationship. For some, the bank must hold the primary current account as well as a mortgage or a savings account. Other banks go further, perceiving only those people who have multiple active accounts and routinely use multiple channels as fully committed customers for whom the bank can provide the best value propositions in a truly customer-centric fashion. This is a high standard—one we endorse.

- *Savings accounts* could once be counted on to generate wide margins from long-standing customers, with funding an afterthought. Today, savings accounts are primarily a funding vehicle for the asset side of the balance sheet, with profit margins squeezed on both the front and back books.

- *Cards and loans* were often sold as standalone products or cross-sold to deposit and mortgage customers to solidify relationships—at thin (even negative) margins. Today, they are crucial sources of margin from customers with whom banks hold the main banking relationship.

- *Mortgages* were once a source of margin on the back book and a game of segments on the front book, characterized by minimal losses as housing prices escalated. Today, mortgages are more a game of microsegments on the front book, constrained by funding and a desire to manage aggregate risk—with wider margins across the book.

Overall, with deposit margins squeezed by low rates (except in some emerging markets), competition increasing, and fees under pressure from regulators, the search for profitability is tilting permanently toward the asset side of the balance sheet. The winners will be those banks that generate sufficient margin on their assets to compete for funding aggressively, that treat their balance sheet as a closed-loop system, and that bring true rigor to risk management.

As for channels, the key will be the ability to provide a truly integrated multichannel offering in a world where banks need to have more high-quality interactions with their customers than ever before.

- The *branch*—and the face-to-face contact it provides—remains the primary channel for acquiring and deepening relationships, as well as for interactions perceived by customers as complex and difficult to comprehend without guidance. The focus is on high-touch transactions and high-value customers. In overbanked markets, there is a significant opportunity to reduce or change branch density, and as more banks in these areas take action, we will likely see a weakening of the traditional tie between relationship managers and branches. More relationship managers will work remotely, presenting a management challenge for banks: recruiting and hiring people whose skill set fits the evolving role. We also expect to see a much greater variety of branch formats—such as transaction-only, advisory, "lite," full-service, and flagship—and greater variation in both hours of operation and staffing profiles. The goal is to have the right people in the right place at the right time.

- The *online channel* has evolved, becoming the primary convenience option that is focused on high-volume activity (such as balance and statement viewing, transfers of funds from one account to another, and simple research). Banks' online goals include putting forth customized offers and achieving one-click paperless sales, especially for preapproved consumer-credit and savings products.

The focus is on high-touch transactions and high-value customers.

- The *mobile channel* provides on-the-go support for simple services and sales, as well as updates, alerts, and prompts leading to one-click fulfilment. Having a strong mobile-banking offering has become a minimum requirement for competitiveness in the industry. Mobile payments are nascent but promising. Overall activity and transactions using the mobile channel are rising sharply.

- The *call center* is a key onboarding and retention channel and a vital conduit for leads and appointments. It represents the branch outside of branch hours and gives a live voice to digital channels.

- The *ATM channel* provides 24-7 brand presence on the street, as well as quick and efficient service, especially for cash transactions. Banks are increasingly deploying automated-deposit machines alongside their traditional ATMs.

As for return on equity, the industry's ROE is hovering around 8 to 11 percent in developed markets, a far cry from precrisis levels of around 19 to 25 percent. We believe that the ROE gap can be bridged through a combination of initiatives—including further cost and impairment measures in concert with reductions in the asset intensity of the P&L—leading to long-term ROE in the 16 to 23 percent range. (See Exhibit 2.)

In a broader sense, we also believe that in order to thrive in the new new-normal retail-banking environment, institutions will need to take concerted action on numerous fronts. We think of these actions as the nine keys to success in retail banking.

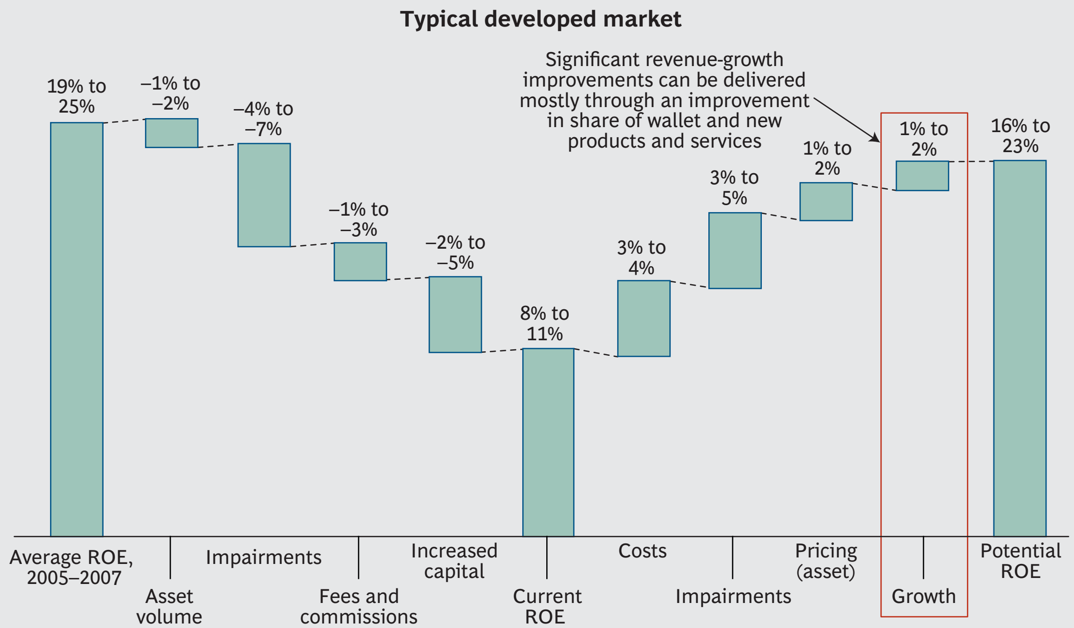
The Nine Keys to Success in Today's Retail-Banking Environment

If keeping the main banking relationship with the customer is critical to retail-banking success today, then becoming more customer-centric—in conjunction with improving operational excellence—is the key to maintaining that relationship.[1]

Being truly customer-centric, and knowing how to deepen customer relationships for the long haul, is about many things: being a trusted partner, understanding the customer's needs and preferences on the basis of activity history, and making access and interactions simple across multiple channels. It is also about achieving full transparency on prices and fees, clearly communicating customized offers, and explaining suitable alternatives. It is further about making the customer's best interests an integral part of the strategy, culture, and capabilities of the bank.

The following imperatives represent what we see as the keys to success in today's highly challenging retail-banking environment.

Exhibit 2 | The ROE Gap Can Be Bridged



Source: BCG analysis.

Turn marketing and communication around. Rather than just broadcasting messages through standardized advertising campaigns, retail banks should foster a dialogue centered on individual customers' personal financial needs, making explicit commitments and having "ready to go" products and services. Each retail bank should also strive to be perceived as a reliable partner, striking a sustainable balance between shareholder and customer interests and acting as a responsible corporate citizen—as opposed to placing a short-term focus on maximizing shareholder value and profits at the expense of long-term stability. Also, in many markets, retail banks must work harder to overcome the damage to consumer confidence that the 2008–2009 financial crisis wrought on the industry.

Orchestrate a multichannel service and sales strategy. The channel experience should serve natural customer pathways and make interactions across multiple channels simple—not disjointed or constrained by internal organizational boundaries that lead customers to dead ends. The key is for channels to support—not compete against—one another. Best-practice banks are making deliberate choices about the target channel for each interaction and are actively migrating certain activities to the most appropriate option for the customer—predicated on easy access and simple "apps."

Of course, it is no surprise that more transactions and interactions are moving to digital (online and mobile) channels. Yet the leverage of digital channels for sales depends greatly on the product. Banks that have a highly evolved online presence sell approximately 50 percent of new current accounts and unsecured consumer loans through this channel. That said, use of the mobile channel is still in its infancy; 2010 was the first year in which some banks conducted a nonnegligible number of mobile transactions. Mobile payments are on the rise, but the endgame is far from clear.[2]

The leverage of digital channels for sales depends greatly on the product.

Best-practice banks also optimize the cost of serving customers by dedicating the branch network and the time of its frontline staff to activities that create the most value: advising customers on sophisticated products and converting these conversations into sales. Indeed, a winning customer experience at branches is a matter of superb execution in a handful of critical service interactions—those "moments of truth" that determine whether a customer will buy a certain product or, at the other extreme, switch banks. Well-managed moments of truth create strong advocates. Banks should identify a small number of these decisive interactions—especially those related to high-value, low-volume transactions—and attack the root causes of dissatisfaction. The call center, for its part, is critical for advising customers, guiding them through difficulties they may encounter with digital channels; explaining products, services, and pricing; and serving as an interface with branches.

Obviously, all channels should be fully integrated so that each is aware of what has already occurred in the others and customers never need to repeat themselves or resubmit information. Banks want to be good at this, but very few actually are. Superior multichannel integration requires highly effective identification and conversion of customer leads that originate online. In a successful multichannel environment, the bank *always* supports natural consumer pathways and typical cross-channel interactions. Consumer credit and savings for existing customers can be powerfully enabled in the digital world through one-click sales. Checking-account features—such as extending an overdraft, making payments, and verifying balances—work equally well within or across multiple channels.

Mortgages are a different matter: applications can be downloaded and banks can follow up on incomplete applications with phone calls, Web chat, or e-mail—or, indeed, when the customer appears at a branch. But to successfully complete a mortgage, it is the integration of these actions across channels that separates the best from the rest. Overall, thorough integration allows for an easy service experience across the branch, the website, the call center (including online chat), and mobile channels.

Pricing structures should be fair, and fees should be transparent and based on the value of the relationship.

Dramatically simplify the front-book product range and retool pricing. Today more than ever before, retail banks need well-developed and relatively narrow product ranges by category, the details of which are communicated in simple language. The key is to enable both frontline and back-office colleagues to develop deep product knowledge, which helps the bank increase conversion rates. Some banks believe that customer choice should be maximized; we believe it needs to be *optimized*—with a manageable number of choices that allow customers to make active and informed decisions about the products that best suit their needs. Successful banks emphasize products that drive growth. They continually monitor and adjust products throughout their life cycles. Above all, a streamlined, simplified, and highly focused portfolio is mandatory for the products that are on display—in the store window, so to speak—in branches, digital channels, and through the call center.

Developing the most dynamic products depends largely on the accuracy of the bank's customer insight. Does your bank have specialized teams that develop product strategies for the most profitable segments and subsegments? Such strategies should involve highly targeted value propositions and proactive marketing activities. In our view, product development at its highest level should include the following: rigorous customer insight; qualitative and quantitative research; concept pilot testing, fine-tuning, and validation; business case development; clear internal and external communications; cross-functional involvement; and multiple go/no-go junctures. Pricing structures should be fair, and fees should be transparent and based on the value of the relationship—as opposed to being characterized by one-price-fits-all mandates and hidden charges.

At the same time, it is important to note that it may not be wise to kill off too many older products that are held by relatively few customers. For example, some observers might look at a bank's offerings and—noticing that, say, 15 percent of its products generate 50 percent of its revenues—recommend terminating many of the remaining products. Yet before taking such a step, the bank must identify the costs of keeping such products alive and weigh the costs against the value of terminating the products.

Reenergize sales force effectiveness. Now is the time to focus on sales force effectiveness. The stakes are high because the gulf between good and bad sales processes leads to vast differences in performance at a time when the competition for customer acquisition is intensifying. Good processes also reduce future "hindsight" risk.

In truth, although most banking executives think that they can recite the key elements of a sales-force-effectiveness program by heart, very few institutions execute consistently well across their networks. A solid program zeroes in on specific measures such as booking appointments electronically, capturing customer data early, creating more effective sales scripts, and carefully managing customers' early tenure. Banks that take these actions create a self-reinforcing sales and service culture. Such a culture includes a recruiting and talent model, clearly defined practices and norms for key roles, product training and certification, coaching programs, and performance recognition—as well as mystery shopping, customer polling, and surveys that capture the voices of customers and bank employees. This model is reinforced by targets and incentive schemes that focus on driving the frontline to meet customer needs. Winning banks also develop customer relationship management systems that facilitate workflow. Offer management systems identify the next logical product, and leads are embedded in processes at the teller counter and elsewhere.

In best-practice banks, a can-do sales culture permeates the air.

In best-practice banks, a can-do sales culture permeates the air. Sales and service colleagues are energized by the knowledge that they are providing value to customers, that each day's calendar is full of promising appointments, and that the more they do for customers the more they do for themselves. Meaningful leads come from tellers and other colleagues who have their own incentives to keep the river of customer knowledge flowing.

Indeed, banks can create a virtuous circle. Excellent customer service creates positive word-of-mouth referrals, which, along with clear marketing messages, drive consumer traffic to branches, to the website, and to the call center. This traffic drives leads, sales, cross-selling, and customer loyalty, which in turn feed back into more positive customer reviews and higher traffic.

Create customer intelligence and use it to drive the business better. To gain or maintain competitive advantage in the new environment, retail banks will have to adopt an even more disciplined approach to collecting data on customer behavior and sentiment across multiple interactions. They cannot rely mainly on information that is "siloed" around specific products or channels. Each bank needs to capture the information that matters so that when it is collated and synthesized, it generates sales and service prompts that are highly relevant to customers and builds trust in the institution.

Also, the IT and business sides of the bank need to collaborate more closely to make customer needs a driver of IT design choices, which in turn should mean an easy banking experience for the customer and flexibility for the bank. Above all, banks must harvest customer data carefully, store the information safely, keep it current, and share it effectively to enable the frontline to meet customer needs proactively, improve the overall customer experience, and deepen relationships.

Customer details should be used to define and deliver what is expected, allowing for "over-delivery" (through speed of execution or higher service levels) at key moments. The goal is to transform mere satisfaction into loyalty and advocacy—not simply to meet the expectations of the average customer with a standardized service level. Each bank needs to invest in the capabilities that demonstrate—to the customer—that it performs better than the competition.

Engrain customer satisfaction into the organization. The customer's perspective should be a key factor in organization design, hardwiring customer satisfaction into incentives and clearly defining customer segments. Governance should not be centered solely on financial performance and built around single products or channels. Overall, thinking and acting in the customer's best interests should become an integral and pervasive part of the bank's strategy, culture, and capabilities, supported by strong executive commitment and enabled by recruiting, training, and proactive oversight of career paths. Banks should avoid creating a silo-based organization populated by fragmented cultures in each product group and channel.

Radically change the end-to-end operating model. In the new environment, services that are "one and done," new products that function immediately, and quick cycle times are more necessary than ever before. And some banks will need to undergo fairly radical change to achieve a top-performance operating model.

A recent BCG benchmarking survey revealed stark differences among banks. For example, cycle times for opening new accounts varied from 5 minutes to 76 minutes. The best players focus on providing a "walk out working" experience: the customer leaves the bank with, for example, a debit card in hand or requested funds fully available. One institution has integrated the sale of a consumer line of credit into the account-opening process, lengthening the process by only two minutes.

Moreover, achieving strong end-to-end performance is not limited to simple products. Even for complex offerings such as mortgages, there are best-in-class performers that make decisions and provide credit much faster than competitors. The top performer in our survey conditionally approved conventional mortgages at the point of sale within 15 minutes of the time an application was submitted, compared with a median of four hours. Several large banks were still unable to provide same-day conditional approval. Among them, the median elapsed time from approval to availability of funds was 14 days, with times ranging from about 2 days for the best performers to almost 37 days.

Some banks will need to undergo fairly radical change to achieve a top-performance operating model.

For the best end-to-end performers, customer and account information is readily visible in sales and service systems, real-time updates are executed without delays or the necessity for end-of-day processing, and vital customer data are easily accessed—at the customer touch point. Moreover, such banks can rapidly check customer eligibility for preapproved credit and make immediate loan decisions facilitated by robust risk-based scoring models.

Our benchmarking also revealed a substantial range in performance for both new-product openings and postsales administration. The leading bank in the survey opened about 90,000 new current and savings accounts per operations full-time equivalent (FTE)—three times the number of the second-place bank and eight times the median in our sample—largely on the strength of highly optimized processes and IT support. In account administration (across all products), this bank handled roughly 18,000 products per operations FTE—twice the level of the median. Clearly, the trend toward straight-through processing is continuing: about 70 percent of our survey participants have invested strongly in it. Many institutions are developing business cases for automation that are built on the quality of the customer experience, as well as on the typical cost-based drivers.

Overall, in the new climate, banks will increasingly need processes that are designed and assessed for speed and simplicity. Errors and exceptions must be identified, measured, and reduced over time. Back-office operating models must balance scale benefits and the cost of complexity, differentiating between simple mass processing and complex tasks.

We have observed that, to the greatest extent possible, top performers use standardized processes across all locations, products, channels, and customer segments, achieving just the right balance of centralization and localization. Moreover, banks increasingly need to move beyond merely optimizing processes to *industrializing* them—reducing complexity to the bare minimum while increasing speed and reliability—in a way that sets the bank apart from its competitors.

Risk management has become an obvious top priority for all financial institutions.

Get (or stay) lean. Banks with a truly lean structure have managers with large spans of control and organizations with few layers—in both the branch network and the back office. In branches, for example, spans of control are typically 10 to 14 direct reports, although the exact range can depend on a number of factors, including the extent of support by central-management functions and the size of the branch. In the back office, spans of control are typically larger—15 to 20 on the team level and 8 to 12 at senior levels. These are best-practice spans for general processing activities; spans are often smaller for specialized activities and larger for more routine processing and call centers. In addition, management functions (such as sales control, product management, channel management, and operations management) need to be lean and focused strictly on activities that provide actual value. In our survey, the average share of FTEs in management functions was 11 percent, whereas the best performer had only slightly more than 6 percent.

Bolster risk management. Risk management has become an obvious top priority for all financial institutions. In the current climate, retail banks need to establish at least three lines of defense to enhance risk management: first, at the business unit level, establishing operational risk control in day-to-day transactions; second, with a broad-based initiative to define and monitor compliance with regulatory policies and determine the bank's overall risk-tolerance levels; and third, by establishing an internal audit function at the group level that independently verifies compliance with both internally and externally established policies.

Banks must also create a comprehensive governance model and a culture of true accountability and transparency regarding risk—not only at the top but far down into the organization. Processes and reporting on key risk areas must become more efficient and effective so that corrective action can be taken while it can still make a difference. Finally, banks must leverage their technology and quantitative tools to lower both costs and risk.

Getting on the Customer-Centric Track to Success

Banks that respond to these nine imperatives and strive to become truly customer-centric will not achieve their goals overnight, nor will they succeed without confronting major challenges. But retail banks can begin the process of adapting to the new new-normal environment by focusing on several immediate priorities:

- Seeking growth by building deep relationships; anticipating customer needs ahead of time, meeting those needs in real time, and foreseeing how to deliver what the customer will need in the future; concentrating on customer value to drive the customer experience; sharpening product positioning and pricing; and making the right offers to each customer by capturing and leveraging the right data

- Achieving sales and service at low unit cost through an attractive multichannel offering and pushing hard on operational excellence to drive income and lower costs

- Concentrating on funding and superior asset generation and working relentlessly on impairments and collections

- Being ever watchful for M&A opportunities—to address liquidity needs or to benefit from scale advantages through acquisitions

- Turning regulatory changes into an advantage: consumer protection and risk regulation will result in higher sales costs and higher barriers to entry

Retail banks that take the initiative now and address the many challenges (and opportunities) that await them will very likely find themselves ahead of the game in the years to come. Those that sit back and wait may find themselves falling behind—and in a position from which rebounding in a meaningful way will be very difficult.

NOTES

1. See *Customer-Centricity in Retail Banking*, BCG report, March 2012; and *Operational Excellence in Retail Banking*, BCG report, February 2012.
2. See "How Banks Can Take the Lead in Mobile Payments," BCG article, June 2012.

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