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# The rise of the digital bank

**As European consumers move online, retail banks will have to follow.  
The problem is that most banks aren't ready.**

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Across Europe, retail banks have digitized only 20 to 40 percent of their processes; 90 percent of European banks invest less than 0.5 percent of their total spending on digital. As a result, most have relatively shallow digital offerings focused on enabling basic customer transactions.

Neither customers nor digital upstarts are likely to wait for retail banks to catch up. Recent analysis shows that over the next five years, more than two-thirds of banking customers in Europe are likely to be “self-directed” and highly adapted to the online world. In fact, these same consumers already take great advantage of digital technologies in other industries—booking flights and holidays, buying books and music, and increasingly shopping for groceries and other goods via digital channels. Once a credible digital-banking proposition exists, customer adoption will be breathtakingly fast and digital laggards will be left exposed.

We estimate that digital transformation will put upward of 30 percent of the revenues of a typical European bank in play, particularly in high-turnover products such as personal loans and payments. We also estimate that banks can remove 20 to 25 percent of their cost base by leveraging this digital shift to transform how they process and service. Put together, the economics of a digital bank will give it a vast competitive edge over a traditional incumbent. It's fair to say that getting digital banking right is a do-or-die challenge.

So why are European banks not aggressively moving in this direction? One of the reasons for the slower transformation in banking is that bank executives have tended to view digital transformation too narrowly, often as stand-alone front-end features such as mobile apps or online product-comparison charts. Commonly lost in the mix are the accompanying changes to frontline tools, internal processes, data assets, and staff capabilities

## Takeaways

European banks that don't adjust to the needs and wants of today's digital customer put their very survival at risk, but a narrow understanding of digital transformation is preventing them from taking essential actions.

Most of the potential value in digital banking comes from the impact on the cost base, particularly in the areas of automation of servicing and fulfillment processes and migration of front-end activity to digital channels.

Digital transformation is a major process, but costs can be contained by maximizing the use of existing technology. However, no amount of technology will help European banks if they don't address the people issues driven by digital.

needed to stitch everything together into a coherent front-to-back proposition. Although the journey may begin “digitally” on an online form or payment calculator, it does not remain so for long, as anyone who has taken on a mortgage can attest. Instead, the onerous documentation requirements and significant manual intervention that characterize the typical bank's mortgage process soon emerge. This can seem jarring to customers accustomed to more seamless interactions with nonbanking services.

Some banks point to security and risk concerns as justification for their slow approach, but this is a contrast to other industries. The airline industry, arguably beset by even stronger risk concerns, has automated just about every aspect of its customer experience in the last ten years, boosting customer service without compromising safety. Banks can do the same. What's more, the effort is likely to pay for itself—and then some.

## Where exactly is the value in digital banking?

Our modeling indicates that European retail banks that pursue a full digital transformation, pulling all improvement levers, can realize improvements in earnings before interest, taxes, depreciation, and amortization of more than 40 percent over the next five years. Almost two-thirds of this potential value comes from the impact of digital on the cost base and loss provisions rather than from revenue uplift, which is why a focus beyond front-end investments is critical.

While the cost-saving opportunity for banks comes in many forms and touches every area

of the bank, there are two areas that are especially significant and represent the bulk of the value: automation of servicing and fulfillment processes and migration of front-end activity to digital channels. On automation, European banks can realize 40 to 90 percent cost reductions in a range of internal processes through careful deployment of work-flow tools and self-servicing capabilities for customers and staff. On front-end transformation, beyond diverting existing branch activity into digital channels, digital tools can also be used to augment frontline servicing (for example, with iPad forms rather than paper forms, or videoconference access to specialists to maximize their utilization)—easily doubling staff productivity and enhancing the customer experience.

The potential for revenue uplift is not quite so concentrated. Rather, European banks need to pursue a broader range of opportunities, including improved customer targeting via digital marketing and microsegmentation, more dynamic, tailored pricing and product bundling, third-party integration (for example, with Facebook), product white-labeling, appropriate distribution via aggregators, and, of course, establishment of distinctive mobile and online sales offerings. In the near term, we expect shorter-tenure, high-turnover products like credit cards, loans, and payments to see the most digital transformation. In fact, these are the areas most under attack from new digital entrants. Looking further ahead, bank accounts and mortgages, which together drive more than 50 percent of many banks' revenues and usually provide “sticky” annuity streams, will be brought into the fray. Given this development, European banks will need to carefully watch the evolution of their

digital share and the success rate of digital products in the front book. The future replacement rate of these annuity streams will be increasingly dependent on digital capabilities. In essence, it's about securing the future and not being lulled into a false sense of security based on the back book.

### **How to go digital without going crazy**

Going digital doesn't have to mean millions in new investment dollars or convulsive upheaval in IT. Sizable investment will no doubt be necessary in some areas, but in general, many of the elements banks need to exploit this opportunity may already be in place. Banks just need to leverage them better and invest in these targeted ways.

#### **Maximize the use of existing technology.**

Many banks have widely deployed imaging and work-flow systems, online servicing, capacity-management software, interactive-voice-response systems, and other connectivity and work-management technologies. But they're not using them widely or well enough. One European bank, for instance, installed a new high-resolution-imaging platform but never fully enforced its use. Customer-service representatives continued to send documentation by fax, and the poor image quality led to significant inefficiency in downstream processing. Addressing this problem requires systematic evaluation of existing capabilities, their usage rates, and barriers to adoption.

**Apply lightweight technology interventions.** Banks can generate significant performance gains with surprisingly small targeted investments. Examples include wider deploy-

ment of tools like e-forms and work-flow systems, which can be implemented relatively rapidly, sometimes without deep integration into complex legacy architectures. The relationship managers and underwriters at one bank, for instance, got together with IT to design a stripped-down and user-friendly online loan application. The form automatically adapts to input data and guides underwriters on which risk processes to follow. Another European bank sped up mortgage decisions by tweaking its existing application to follow standard rules, such as minimum down-payment thresholds and rating data, which allowed applications to be scored and routed faster, with less manual intervention.

**Place a few selective big bets.** There will be places where you need to pursue more sweeping transformation investments. However, instead of trying to automate every aspect of a given process or product, home in on the few that drive the most capacity consumption and give the greatest return. Do not build a gleaming digital empire for the sake of it. One European bank that went through a systematic mapping of its processes for automation potential found fewer than ten processes that represented the bulk of full-time-employee capacity. In these targeted areas, the bank embarked on more radical investments, retiring old platforms, deploying new digital solutions, and reinventing the way the process works.

### **Address the people dynamics**

No amount of technology will help if you don't address the people issues driven by digital. Success requires more than rethink-

ing technology; it requires rethinking the organizational model, too, especially when it comes to skills, structure, incentives, and performance management. The following steps can help.

#### Set the right structure and incentives.

There's more than one way to organize around digital. Some European banks appoint a head of digital with profit-and-loss responsibility. Others use a center-of-excellence (COE) model to develop offerings that the rest of the business can take and deploy. Either model can work, but you must make concerted efforts to realign incentives to ensure collaboration. For instance, creating a COE but not giving the business digital targets often leads to a lot of technology being successfully built, but with limited drive and pull for adoption. In extreme cases, the wrong functionality is built—it's exciting to demonstrate to senior leaders and wins awards externally but ultimately creates no bottom-line impact.

**Increase the focus on business outcomes, not digital activity.** Too often, banks manage the progress of their digital transformations by tracking activity metrics, such as the number of app downloads and log-in rates. Such metrics are inadequate proxies for business value. Banks must set clear aspirations for value outcomes, looking at productivity, servicing-unit costs, and lead-conversion rates, and link these explicitly to digital investments. Only then will the collective focus be on shaping the right actions to fully capture the value available.

#### Formulate and implement a people vision.

Finally, you need a vision for the role of employees in the new digital reality. This takes two forms: expectations of how they spend their time and how they work alongside the new technologies, and clarity on what technology competencies they need to develop. Digital transformation will clearly diminish the importance of some roles, which is why many employees will view it as a threat and be resistant to the change that digital brings. However, it also shifts the focus of many workers' time toward higher-value tasks, creating exciting new opportunities for development. For example, relationship managers will spend less time capturing customer details and more time giving valuable advice. Additionally, deeper awareness of the technical capabilities available and how they can affect processes will be a prerequisite to effectively manage in this new world. Business leaders need to be conversant in how technology can be leveraged to address commercial challenges. You cannot rely on bringing in new talent from digitally savvy industries to transform your bank. New talent provides an important stimulus, but digital needs to become a new management competence across the organization.



Digitization will change the traditional retail-banking business model, in some cases radically. The good news is that there is plenty of upside awaiting those European banks willing to embrace it. The bad news is that change is coming whether or not banks are ready. ○