



Photo credit: Getty Images

# Six digital growth strategies for banks

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Banks that know where to look can find new sources of untapped value.

**Despite the headlines** about digital disruption in financial services, big banks are actually holding their own. Globally, financial-services revenues have grown 4 percent annually over the past ten years (thanks largely to growth in emerging markets), and fintech start-ups and large tech companies have so far captured only tiny slivers of market share.

But digital technology and big data/analytics are still poised to shake up the financial-services industry. Investors believe fintech start-ups will become a significant force in the

future, valuing those in the US at \$120 billion, or 7 percent of the total equity of US banks.

As we see it, many banks haven't set their sights nearly high enough in response to disruptive attackers. They've been overly cautious, playing defense, with me-too digital initiatives primarily designed to counter moves by actual or potential disruptors. Even banks that would like to be more aggressive find it difficult to know exactly what to do. Large banks—like many incumbents—have been inundated with new technologies and business

opportunities, leaving them confused about where to focus and dissipating their resources.

Most big banks have the tools and advantages to push the boundaries of their existing business models. And they're certainly motivated. What hampers their progress is uncertainty about how best to build on core strengths to create sustainable outcomes. To provide a structure for navigating this chaos, and to galvanize the shift to bolder thinking, we've identified six opportunities for banks to fuel future growth.

## 1. Grow beyond your core into relevant ecosystems

Banks have long relied on making customers aware of relevant products as a path to growth. In the past, that approach was about introducing other banking products. For example, a customer with a checking account would be encouraged to consider a personal line of credit, a home-improvement loan, or a bank credit card (see inner circle of exhibit, labeled Core).

A narrow focus on core adjacencies ignores the broader role a bank can play on behalf of its customers. By moving into ecosystems beyond the traditional core, banks are able to tap their existing client base and operational capabilities, strengthen engagement, and capture data that will provide a more complete view of customers' needs.

Ideabank and ING, for example, have extended into banking adjacencies (see middle ring in exhibit) by providing services like accounts-receivable management, factoring, accounting, and cash-flow analysis to small and medium

enterprise (SME) customers. The fintech start-up Moven built a pioneering mobile money-management app and is now partnering with financial institutions to provide this service to retail customers.

Some banks have even gone farther and moved into nonbanking adjacencies (see outer ring in exhibit). Post Bank, for example, has become the largest provider of mobile phone services in Italy. Other banks are partnering with care providers and health insurers to provide a consolidated billing platform that makes it easier for consumers to pay for medical expenses.

Extending beyond the core can allow banks to form a network of value across industries and create their own "ecosystems" that provide the services customers want at lower cost and with greater convenience. In addition to generating new revenues, ecosystems of this sort can protect banks from the efforts of fintech start-ups and digital giants to invade banking's traditional turf.<sup>1</sup>

*Banks should consider this option if ... they have significant market share in one or more core product areas. Banks in this position may find it difficult to increase their share in existing segments. Moving into adjacencies—both banking and nonbanking—allows them to take advantage of their already strong franchises by offering new services to current customers.*

## 2. Create a financial supermarket

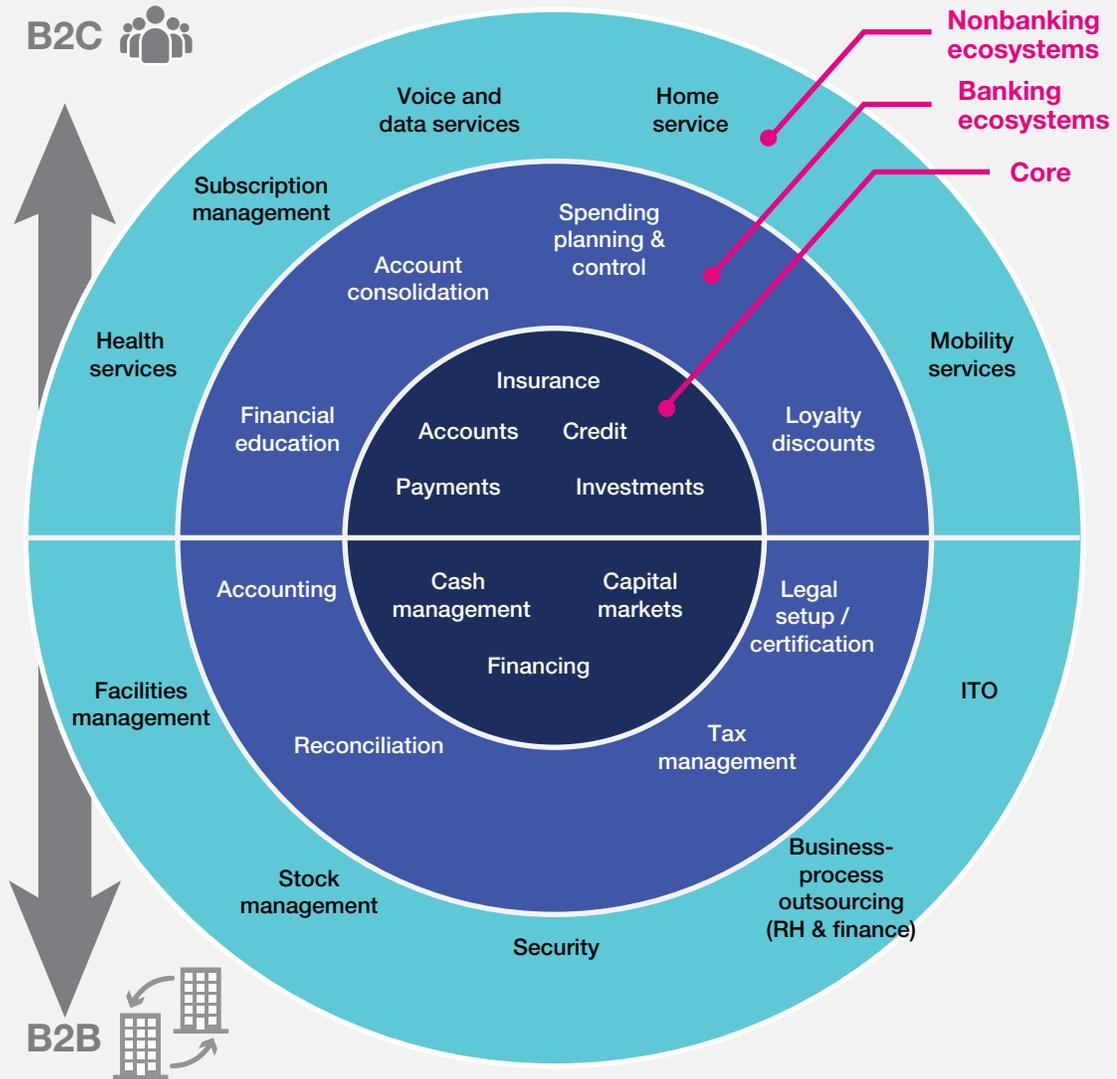
Taking a page from some of the larger digital businesses, banks can offer a curated and vetted mix of internal and third-party offerings. This aggregation model provides customers

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<sup>1</sup> Miklos Dietz, Matthieu Lemerle, Asheet Mehta, Joydeep Sengupta, and Nicole Zhou, "Remaking the bank for an ecosystem world," *McKinsey & Company*, October 2017.

EXHIBIT

Banking ecosystems extend out from the core business into three levels.



with easy, one-stop access to financial products and the ability to address multiple financial needs through a single, integrated channel. Building a financial supermarket allows a bank to focus on the high-return side of the industry: average annual return on equity (RoE) for providing credit from bank balance

sheets is only 6 percent, while RoE for product origination/sales is 22 percent.<sup>2</sup>

In the United Kingdom, for instance, 60 percent of auto-insurance policies are sold through aggregators. And Bank Bazaar in India, a pure-play financial supermarket with no proprietary

<sup>2</sup> Miklos Dietz, Philipp Härle, and Somesh Khanna, "A digital crack in banking's business model," *McKinsey Quarterly*, April 2016. ROE figures based on analysis by McKinsey's Financial Services Practice.

offerings of its own, offers a full set of services from more than 50 institutions to more than 23 million customers.

To build privileged relationships with customers, some financial supermarkets rely on recommendation engines, which use transaction, merchant, and customer data generated from the platform to provide personalized suggestions and offers. This kind of helpful, concierge-style service can reduce the risk of disintermediation.

*Banks should consider this option if ...* breadth of choice or price comparisons are important to customers. The former is often the case with investment products, for example, and the latter for property-and-casualty insurance. A supermarket approach can allow banks without a strong position in such areas to grow in these segments as a complement to their current offerings.

### 3. Extend value across the customer journey

For most consumers, working with a bank is just a means to an end: ensuring a secure retirement, growing a business, or buying a home, for example. Most banks, however, tend to focus only on discrete, bank-centered moments in the customer's overall journey, such as offering a mortgage, when the customer's larger goal is buying the house. By attending only to the bank-related part of the overall journey, banks leave considerable value on the table.

Banks can grow by engaging with consumers at other stages of their decision journey. For example, a bank might give advice to customers on how much to save for retirement or borrow for a home, or help them to determine the best rates

and maturities for financial instruments.

Commonwealth Bank in Australia (CBA), for example, wanted to play a bigger role in the home buyer's journey. CBA created an augmented-reality app that allows users to point their smartphone's camera at a property and instantly see its current price and sales history. The app also provides a mortgage calculator and other financial tools, plus the option to connect with local realtors. In the six months after the app's release, customers searched more than a million properties, and the bank estimated the project's return on investment at more than 100 percent.<sup>3</sup>

*Banks should consider this option if ...* they have significant market share in financial products that are integral to a larger buying process. Mortgages (tied to home buying), auto finance (tied to car buying), and credit cards (tied to taxi/ride-sharing trips and restaurant visits) are examples of such products. Engaging across buying journeys can allow banks in such a position to gain access to a larger pool of potential revenue and enrich the overall relationship with their customers.

### 4. Monetize your data

More than half of financial-services respondents in a recent McKinsey survey<sup>4</sup> said their companies have begun monetizing data. What's more, data monetization seems to correlate with industry-leading performance.

There are multiple ways to monetize data. The first is for a bank to use its internal data more effectively for its own operations by adding new analytics capabilities. Another is to create new offerings, such as reports or benchmark analytics, based on bank data. Several of

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<sup>3</sup> Peter Weill and Stephanie L. Woerner, "Thriving in an Increasingly Digital Ecosystem," *Sloan Management Review*, Summer 2015, 27-34. See also Commonwealth Bank, Investorville Case Study, 2013.

<sup>4</sup> "Fueling growth through data monetization," Survey, McKinsey & Company, December 2017.

Canada's biggest banks have partnered with Toronto-based SecureKey in a system that allows individuals to use their bank credentials to access online services from the federal government. The system works in much the same way as websites that allow users to log in using their Facebook account—except in this case, Canadian government agencies provide access to online services when visitors enter their bank credentials. The banks just use the data they already have to verify their customers' identities, but then provide it as a secure capability at a truly national scale and gain access to new potential customers.

Most banks have a rich set of exclusive information on their customers (key demographic details, where they live, their lifestyle preferences). When used responsibly, with respect for regulatory constraints and privacy concerns, this bank data can be analyzed for insights valuable to companies in industries outside of financial services, such as telecom, retail, consumer goods, or automotive. Bank-issued credit cards, for example, have access to data on both consumers and merchants, which can be sold to retailers.<sup>5</sup>

*Banks should consider this option if ... they already possess an information advantage over competitors—or if they have the prospect of creating an information advantage, or extending an existing one, via external investments or partnerships.*

## **5. Become a product- or infrastructure-sourcing factory**

Many banks and fintechs are locked in a battle over the customer-facing front end.

But large institutions can create significant value by leveraging back-end assets to create and provide products or services to smaller banks and other businesses. That's because many small and nontraditional institutions lack core banking products, infrastructure, capital assets, or even banking licenses, and don't have the reach or resources to acquire them.

Large financial institutions can address this need by developing a portfolio of white-label products to sell to or through third parties, providing infrastructure as a service, and even "renting" their balance sheet to small and nonfinancial players. The classic example of this kind of service is banks providing credit-card processing to retailers. In the evolving digital era, many new opportunities to offer services like this are emerging.

ING, for example, has partnered with US-based fintech start-up Kabbage to serve SME customers in Europe. Kabbage's easy-to-use interface and novel risk-management algorithms allow it to deliver decisions on loan applications in a matter of minutes. As a start-up, Kabbage had a distinctive new capability but lacked capital and customer relationships. ING brought to the partnership its deep reservoir of capital and its existing relationships with prospective SME customers.

*Banks should consider this option if ... they possess a significant back-end capability that others don't have and the ability to extend it into other environments securely. Banks considering a factory plan, for example, should have enough tech talent (particularly around APIs) to be able to maintain appropriate levels of security while serving the given product or*

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<sup>5</sup> For more, see Alessio Botta, Nunzio Digiaco, and Kevin Mole, "Monetizing data: A new source of value in payments," McKinsey & Company, September 2017.

service to third parties. In addition to opening up new revenue streams, this approach can also be a useful way for banks to collect new data.

## 6. Become a digital attacker

By employing digital channels or novel business models, incumbent banks can enter new geographies or market segments that would be prohibitively expensive targets using traditional approaches.

ING Direct was the original digital attacker, starting as an exclusively online bank in 1996 and attracting more than 20 million customers in 9 countries over a little more than a decade, before spinning off several of its national subsidiaries in the late 2010s.<sup>6</sup>

*Banks should consider this option if ... they want to enter new markets or segments without the need to invest in the physical infrastructure that would otherwise make such moves prohibitively expensive. This approach is useful for exploring market opportunities, but it requires sufficient digital skills (design, customer experience, analytics, etc.), the expertise to scale wins, and the management discipline to kill off poor performers.*



How should banks decide which unconventional growth opportunities to pursue? There is no one-size-fits-all answer. We've found that most large institutions already have some initiatives underway that involve pursuing one or more of these six growth strategies. Existing efforts can provide important information about which

opportunities are promising and what's required for success. That said, most such initiatives are small and typically need to be scaled up to take full advantage of opportunities large banks face.

To begin, banks should think hard about a series of questions:

- Which unconventional growth opportunities represent a good fit with current resources and competitive position?
- How many of the opportunities can reasonably be pursued and over what time?
- What governance structures should be established, and what organizational approaches employed? Innovate from within existing businesses, set up separate units, or partner with/acquire from outside?
- What capabilities should be in place to go after these opportunities?

No matter which opportunities banks decide to pursue, they will need to commit to—and invest in—new digital capabilities in areas like design, innovation, data and analytics, personalization, and digital marketing. A headlong dash toward developing “all” these capabilities isn't the answer. We have seen companies lose focus and dissipate energies by trying to do too much at once.

In our experience, the most effective route is to develop a clear view of which capabilities can deliver the most value quickly and power a broader digital transformation. The important thing is to get going, to act with a sense of

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<sup>6</sup> Arkadi Kuhlmann and Bruce Philp, *The Orange Code: How ING Direct succeeded by being a rebel with a cause*, Wiley, 2008.

urgency—like an attacker seeking growth, not merely a defender hoping to hold onto a legacy position. ♦

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