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Driving Revenue Growth In Retail Banking

Annual revenue growth for U.S. retail banks has hovered near 2 percent since 2010, hindered by historically low interest rates and tighter regulations (including restrictions on fees and increased transparency requirements) that make it easier for consumers to comparison shop. Given these challenges, banks have focused for the last several years more on cost reduction than on revenue generation. However, a number of trends suggest that the time is ripe for banks to return to a focus on growth.

A challenging environment harbors growth opportunities

Retail banks attain scale by capturing market share, merging with or acquiring other banks, and pursuing fast-growing markets. Increasing revenues is fundamental to this process and strategically vital because it enables banks to compete effectively over the long term. However, faced with tighter regulatory restrictions and low interest rates, many banks have shifted their focus away from revenue growth, hoping that more favorable regulations and rates will eventually return.

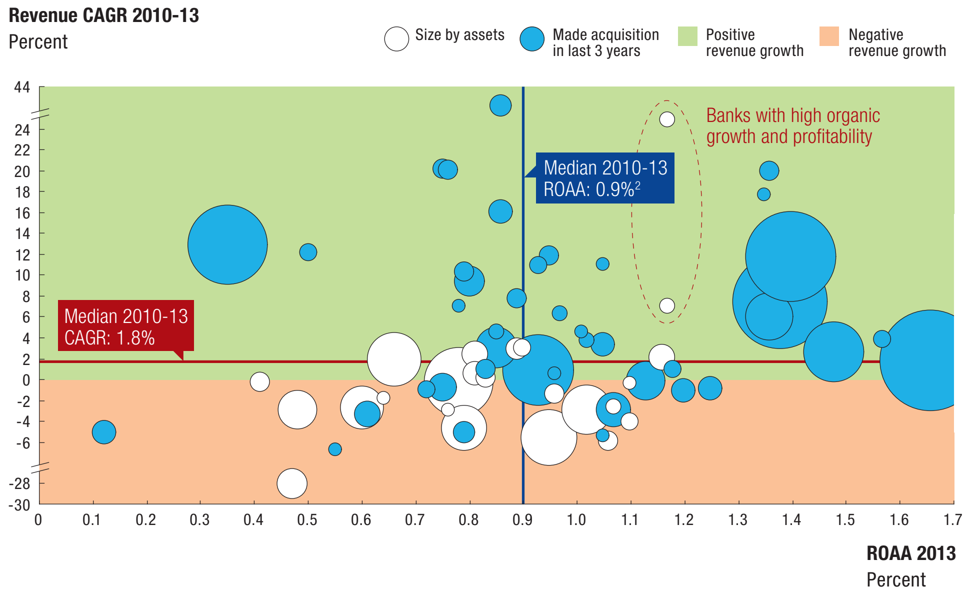
Banks have tried to shore up profits by pursuing a variety of cost-control measures and by asking sales teams to do more. Results have been mixed and are reflected in lackluster returns on average assets (Exhibit 1, page 2). Furthermore, using cost controls alone to drive bottom-line performance can lead to short-term actions that shortchange investments in growing revenues.

There are, however, a number of opportunities in today's market for banks to return to a growth focus. Rates and regulatory restrictions may not improve soon, but changes elsewhere in the economy are cause for optimism for banks. Foremost among these is technology's expanding role in the daily activities of consumers and businesses. Banks can use technology to enhance products and services (e.g., remote advisory services for affluent customers; stronger customer engagement through real-time chat) and to acquire deeper insights into consumer behavior. With

Exhibit 1

Balancing growth with profitability has been challenging, with acquisitions generating the most meaningful growth among regional banks

Comparison of banks under $370 billion in assets[1] by 2013 return on average assets (ROAA) and 2010-13 revenue CAGR



[1] 69 banks with less than $370 billion in assets; some banks omitted for lack of data.

[2] ROAA for all U.S. banks reported as 1.06% according to Federal Reserve Economic Data.

Source: SNL; FRED

a better understanding of customers and prospects and by employing a wider range of channels, banks can deliver more personalized offerings and attract pockets of previously underserved consumers.

An organic path to revenue growth

McKinsey sees three main paths to revenue growth in retail banking today: mergers and acquisitions, major innovation and organic growth. The first two may appear to be the best ways to achieve rapid revenue growth, but closer analysis shows that they rarely meet expectations and are a poor fit with the growth needs of most banks. M&A and significant innovation are both difficult and demand substantial upfront investments, approval from regulators, high tolerance for risk, and the capacity to take on major new ventures while maintaining and growing the core business. For most banks, therefore, a robust plan for organic revenue growth is essential.

To grow organically, banks must stay current with evolving consumer behavior, a task that presents a unique challenge today, given the fast pace of change. However, there are also more data, tools and techniques available to banks for developing consumer insights and acting on them. Big-data analytics, digitally enabled sales and service channels, and other “new science” tools and approaches are playing a high-profile role in unlocking revenue growth. Banks adopting some of the steps detailed below have seen revenue growth of 3 to 6 percent; implementing all of the steps could generate even stronger improvements.

1. **Use data to better understand customers and develop customer-centric products.** Consumer packaged goods companies use sophisticated analytics and other advanced research techniques to generate insights into how customers per-

ceive and react to specific products. Financial services institutions are starting to follow suit. One consumer lending firm discovered through analytics that its customers (particularly those who use cards to revolve) were generally unhappy with their borrowing experience. The bank found that a customer's choice of product for revolving is frequently linked to specific occasions, such as home renovations or travel. Based on this insight, the bank decided to more closely align its credit offerings with those events.

2. **Use big data insights to map the customer journey.** Analytical tools can help banks connect millions of customer touch points that span multiple channels. Banks can then identify key decision points in critical customer experiences, such as the initial sales process, problem resolution, and loan renewal experiences. Mapping the customer journey and identifying flashpoints for customer leakage and opportunities for service enhancements can have a powerful impact, generating up to 20 percent increases in customer satisfaction, 10 to 15 percent improvements in revenue metrics (such as churn rates, upselling and customer acquisitions) and substantial improvements in employee engagement.

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3. **Uncover niche market opportunities through micro-segmentation.** U.S. retail bank profit pools will likely grow at a modest 3 to 6 percent annually over the next five years. In this environment of modest growth banks need tools to pinpoint pockets of opportunity in their existing markets. Advanced data analytics can cross-examine revenue and profit data along multiple dimensions, including demographic, geographic, product, channel and even third-party data. Banks can then reallocate marketing and other resources to areas of high potential that were previously unrecognized.

4. **Adopt intelligence-driven pricing.** Banks can fine-tune pricing and build market share by using price elasticity information derived from transactional data and competitive analyses that use Web-crawling techniques. The latest front-line and management dashboards are also effective for identifying price leakages. For example, a U.S. auto lender had based its pricing on gross margins and made price decisions according to anecdotal information on competitors' pricing. The lender subsequently did a market-wide scan of product profitability and used it to build elasticity-based pricing models that have multiple levels to reflect risk scores and geography. The resulting dealer price sheets produced net margin improvements of about 50 bps within three months.

5. **Boost sales performance with data-driven management tools.** Most banks use sales effectiveness programs with some success, but results usually erode with time. Accelerating and sustaining these programs can be three to four times more effective than common front-line transformation programs. The key is to leverage new tools to identify the unique skills, practices and mindsets that define top performers. Armed with such information, managers can construct programs that teach those specific

skills and mindsets. They can also develop metrics, dashboards and other tools (e.g., game theory) to shift mindsets and reinforce desired sales behaviors. One large retail bank pursued such a program and found its biggest driver of sales performance is collaboration—their best performers are particularly effective at partnering and drawing upon the knowledge of specialists in other areas of the bank. So they introduced a program that reinforces existing sales capabilities while focusing on collaboration skills. They also realigned their incentive program to encourage partnering between bankers and specialists. Sales grew 15 percent during the next 12 months and have remained at the new level for two years.

6. **Exploit new customer insights to improve affluent business models.** The affluent segment continues to present attractive sales opportunities for many banks. For some, it represents more than 40 percent of projected profits. Banks large and small are consequently targeting this segment. How can a bank stand out from its rivals and ultimately succeed in this segment? McKinsey's research finds that two attributes drive success here. First, banks must develop a deeper understanding of the affluent segment and identify its most promising sub-segments. Next, they need to construct value propositions and offerings that are more relevant, flexible and supportive of affluent customers who prefer a largely remote-oriented interaction model. One North American retail bank recently designed a remote advisory model that supports holders of small accounts and affluent customers who prefer to bank remotely. The results were significant, with remote financial advisors reporting strengthened client relationships and increased sales despite carrying larger customer loads than those of traditional branch-based advisors.

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7. **Perfect the small business sales and service model.** Small businesses are another compelling segment for banks. The Economic Advisory Committee of the American Bankers Association believes that business lending will grow at nearly double-digit rates during the next few years. This growth could well become a significant source of bank revenue. In addition to capturing lending wallet shares, banks should also use new-science tools to more deeply mine this segment. As with other segments, new-science tools can help find pockets of customers offering strong profit potential, create innovative customer-centric products, and align sales staff more closely with marketplace opportunities.

8. **Rethink the traditional care center as a source of needs-based solutions for customers.** Retail banks can make revenue improvements of 5 to 10 percent by rethinking the traditional care center model. Care centers have traditionally been structured around the "first in first out" model, which leads to sub-optimal utilization of a pool of agents. Advances in real-time analytics offer opportunities for a new approach. Interactive voice response, for instance, can analyze and assign calls to those agents whose skills best match the customer's need (e.g., strength in explaining and closing on products; high customer satisfaction scores related to problem resolution).

Banks can then refine this routing engine by applying analytics to capture successful pairings between callers and agents. Banks taking this new care center approach have improved revenue through increased sales conversion, retention and cross-selling, and have realized cost savings through decreased call times, fraud reduction and higher first-call issue resolution. One Canadian bank forecasts a revenue gain of $150 million to $180 million from a combination of new customer acquisition, enhanced collections, improved retention and increased cross sales.

Clearly defining the bank's growth strategy is a vital step in creating the focus needed to implement the revenue growth approaches outlined above. Banks therefore need to reflect deeply on their current capabilities, culture and recent performance before they aggressively pursue revenue growth. To successfully build revenues over the long term, managers will also need to closely align strategic planning and growth agendas with their institution's core beliefs and capabilities. For banks, regardless of the revenue paths they choose, driving organic growth will be essential for long-term success.

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As the U.S. economy experiences positive signs of renewal and growth, proactively setting a revenue growth agenda will become increasingly important for banks, and a consumer-centric approach to product development and services should be a central part of this agenda. The confluence of trends in data ubiquity, data transparency and declining costs for mega-data computing is enabling banks to draw on new-science approaches in their efforts to identify and pursue pockets of revenue opportunity. Aggressive cost-cutting leads to diminishing returns, so it is time for retail banking leaders to focus anew on revenue growth and profitability—the direction most likely to consistently deliver returns in excess of the bank's cost of capital.

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