

Retail Banking Insights

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Radically Simplifying the Retail Bank

What would a newly designed retail or commercial bank look like? How many and what kinds of products and services would it offer? How many layers would its organizational chart show? How many IT platforms might it need? How would it distribute its products? How would its efficiency ratio and return on equity (ROE) compare with those of legacy banks? And how smoothly would it function as a unified customer-centric entity?

Few banks have the luxury of rebuilding their businesses from the ground up, but the answers to these questions can help banks think about how they need to transform for a new environment. Most have grown highly complex and inward-focused over time and are a poor fit for the current banking landscape.

The need for simplification is understood by many bank executives, but simplification attempts frequently fail to generate significant performance improvements. McKinsey research suggests this is because bank simplification attempts are too narrowly focused. Meaningful benefits flow through when simplification efforts are designed, implemented and sustained on a broad scale.

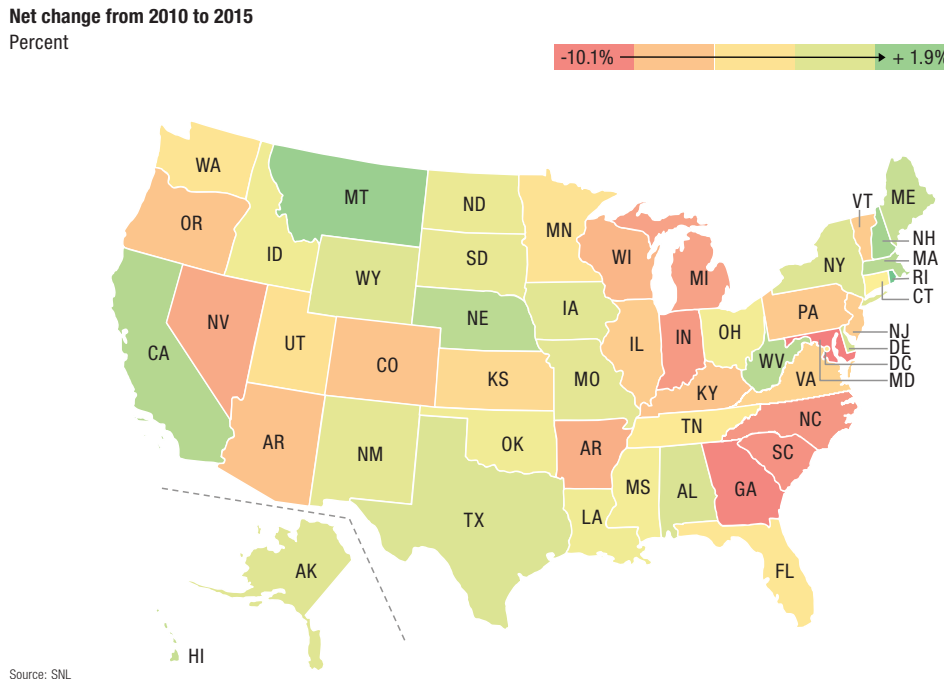
Fragmented approaches, mixed results

Most banks have evolved to become highly complex institutions with intricate matrices of management layers, departments, products, distribution channels and IT systems. Most also serve multiple markets with diverse regulations and customers, further complicating the task of delivering appealing and effective banking services.

Thus far, banks' efforts at simplification have included everything from business process reengineering to lean business management techniques. Often, these programs have positive results, including lower costs, faster service times and increased

Exhibit 1

U.S. banks
closed about
5% of branches
between 2010
and 2015



customer satisfaction. The improvements, however, are usually short lived, sometimes due to the fundamental limitations of the techniques used or shifts in management focus.

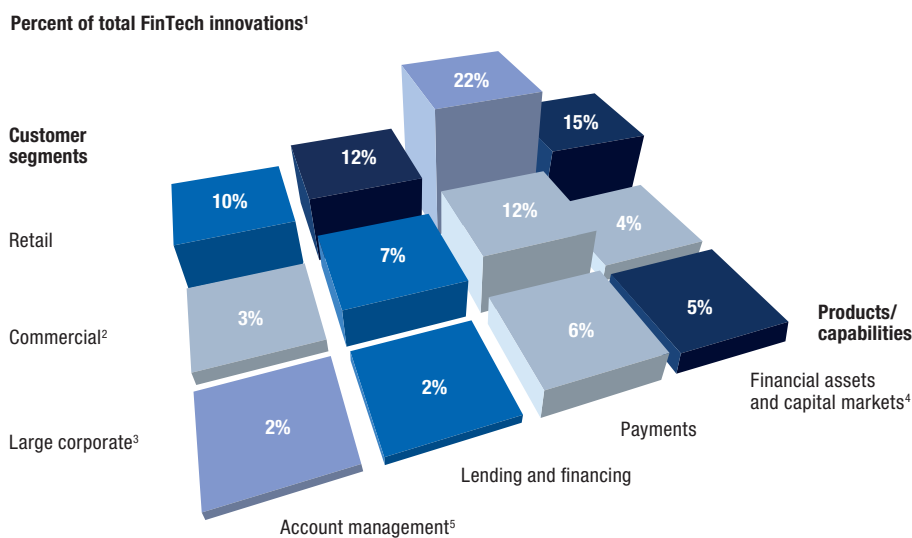
Today, however, the environment is in some ways ripe for a new run at a simplified retail banking model. After a period of minimal rate spreads and extensive regulatory activity, the landscape is relatively stable, and capital requirements are a less overwhelming concern. Bankers have been devoting more attention to long-term institutional growth and sustainability. Many have turned to redesigning their distribution footprints and adopting new digital technologies.

McKinsey research indicates, however, that these changes have not kept pace with evolving customer expectations. U.S. banks, for instance, have closed about 5 percent of their branches since 2010 to reduce costs, but many of those branches were redundant as a result of M&A or had been opened in non-growth markets (Exhibit 1). Branch networks in core markets have remained relatively unchanged. And while banks are beginning to invest more in digital capabilities and channels, most still lack a clear vision of what role branches will have in their multichannel strategies, if any.

Although changes in regulation and technology are leading to more favorable conditions for large-scale simplification, they are also creating opportunities for non-bank competitors. Armed with the latest financial technologies, FinTech firms are targeting the most profitable segments of consumer banking. According to McKinsey's Panorama database, which tracks global private and venture investments in financial

Exhibit 2

FinTechs are making significant inroads into retail banking



¹ Includes both innovations from fintechs startups (80%) and banks. Bar height and numbers represent distribution of innovations. Bar colors represent share of banking pools

² Includes small and medium-sized enterprises

³ Includes large corporate, public entities, and non-banking financial institutions

⁴ Includes investment banking, sales and trading, securities services, retail investment, non-current account deposits, and asset-management factory

⁵ Revenue share includes current account deposit revenue

Source: McKinsey Panorama

services technology, 22 percent of FinTechs globally are focused on disrupting retail payments, which represents about 40 percent of retail and wholesale banking revenue pools worldwide. An additional 12 percent of FinTechs are focused on consumer lending and financing, which accounts for approximately 15 percent of revenues (Exhibit 2). Many are well funded and present a disruptive threat to established banks.

The benefits of broad simplification

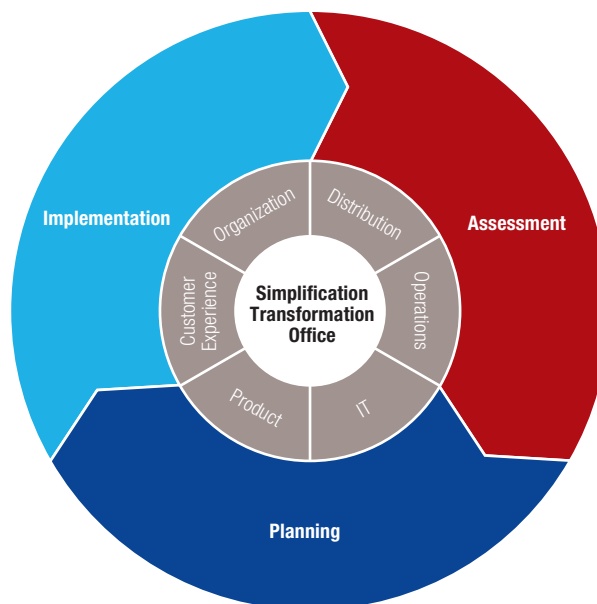
Broad, well-executed simplification can improve both the top and bottom lines. Simpler banks have the potential to be more operationally efficient, due to a cost base that can be 30 to 50 percent lower than that of most banks. McKinsey experience shows that efficiency ratio improvements of 15 to 30 percent are also attainable. Simpler banks drive top-line growth by improving the customer experience, minimizing customer loss, going to market with new products faster, and deriving deep customer insights through data and analytics.

Broad simplification has additional benefits:

- *Reduced regulatory risk* as processes are digitized and streamlined, improving audit trails and monitoring capabilities
- *Lower operational risk and improved balance sheet strength* as undue complexity is replaced by leaner, more efficient operations
- *Increased institutional agility* that enables more rapid response to financial technology threats and opportunities and faster innovation

Exhibit 3

Simplification efforts must address multiple business functions simultaneously



Source: McKinsey & Company analysis

- *Advanced analytics capabilities* derived from simpler and better connected systems and data warehouses that provide deeper marketing insight and a competitive edge.

Breaking through the barriers of complexity

The complexity that bogs down legacy banks is centered in six broad areas: *distribution, operations, IT, product development, customer experience* and *organizational structure*. To be effective, simplification must address these elements simultaneously (Exhibit 3). For each, a comparison of the present state with a view of how a newly designed process might look can help illustrate the challenge and the benefits.

Distribution

Most banks understand the need to align distribution with emerging technologies and customer expectations. Changes in branch distribution to date, however, have occurred primarily at the margins. Many banks are still prioritizing investments in website development despite the fact that online banking growth has leveled off (at about 35 percent of customers, according to McKinsey research) and mobile use has doubled, to about 25 percent. Meanwhile, the pressure on call centers to accommodate the service needs of digital channels is growing exponentially. And while most banks today have four or more channels for distribution, those channels do not usually communicate very well.

A bank designed today would have multichannel distribution, but those channels would operate as a single, highly integrated system. The role of each channel would

be defined at the market segment, customer journey and product levels, based on customer needs, associated costs, cross-selling capabilities, and the channel's ability to maximize customer satisfaction. All channels, moreover, would be interconnected and governed by technologies that draw on advanced analytics and diverse data flows, including sales attribution and incentive information. To ensure simplicity and optimal cross-channel outcomes, leading banks are increasingly shifting to customer journey and mobile-first design approaches.

Operations

Today, bank operations focus on developing functional expertise at the management level and performance metrics at the functional, process and channel levels, with incentives aligned accordingly. Operating costs in high-volume business areas are viewed on a per-activity basis and controlled largely by leveraging key vendors. The cost savings—typically 4 to 5 percent annually—are often consumed by volume and strategically vital investments.

Rather than extracting customer data and insights through functional silos, a newly designed bank would develop insights holistically. An integrated and fluid working model would span all levels of the organization, with objectives and incentives closely aligned with business and customer outcomes. Operations would focus on delivering seamless multichannel customer journeys throughout the sales cycle, from customer onboarding to servicing.

Information technology

The IT function is seldom considered on a bank-wide level. So developing innovative systems and products is challenging for banks. Rapidly growing demand for digital services has often led banks to concentrate on systems stability and their branch networks, instead of on speed-to-market and products built for a multichannel environment.

IT in a new bank would take an iterative and highly customer-centric approach to systems and software development. New-product release times would be counted in weeks, not quarters. Systems architecture would be simpler, more flexible, more service-oriented, and might include “micro-services” (e.g., services that do one thing extremely well). IT would effectively be a central player in the new bank.

Product development

Bulging product portfolios are major contributors to institutional complexity, cost and response time. Today, many portfolios include more than 100 products, about 15 percent of which represent 95 percent of a banks' liability. Remarkably, however, digitization has rarely been a key element of either the products or their support systems.

A simplified bank would offer customers a leaner, better integrated product portfolio that is tightly focused on strategically selected markets. A simplification exercise at one retail bank, for instance, reduced its total number of products by approximately 30 percent. In a new bank, product innovation would occupy a central role, and product design would focus on improving the customer journey.

Customer experience

Companies like Amazon, Apple, Starbucks and Uber are rapidly changing the dynamics of customer interaction, and in the process raising the customer expectations bar for all businesses. In this context, banks have seldom been quick to respond to evolving customer expectations. Many are still highly product-centric and branch-focused, and rely heavily on mass marketing and time-consuming manual processes. This creates clear opportunities for disintermediation by FinTech and other non-bank competitors.

What would the customer journey be like at a bank designed today? Customers would find an organization highly focused on their unique needs, and offering a limited number of innovative products that are accessible from anywhere, anytime. And they would enjoy frictionless processes with personalized, relevant communications.

Organizational structure

Banks have long been organized with rigid hierarchies and functional silos intended to provide the highest levels of stability and experienced management oversight. While this model was effective for many decades, it is increasingly hindering banks' ability to deliver the seamless integrated services and innovative products customers now demand.

A new bank would have a more agile and streamlined organizational structure. It would center on a leaner management core, with flexible teams that adapt their expertise to changing market demand. Boards would similarly streamline their decision-making processes by categorizing decisions according to complexity and risk and determining responsibility and procedures by category.

Paths to bank simplification

A fragmented approach to simplification in banking is difficult to both implement and sustain. There are two effective paths open to banks today. The first is to implement a holistic bank-wide transformation that simultaneously addresses the six key areas of complexity. The second is to establish an entirely new, separate bank while maintaining the core institution, then migrate customers to the new bank.

Holistic simplification

A holistic transformation must begin with management's full commitment to a rigorous process that requires two years or more of intense effort. Sustaining high levels of commitment and action throughout this period is vital.

The journey comprises three main phases: *complete teardown*, *solution development* and *implementation*. The complete teardown is a top-down examination of the bank, with deep, targeted analyses of each area of complexity. Opportunities for simplification are identified, and the health and capacity of the underlying organization is assessed.

The *solution development* phase builds on this foundation through a process that engages all levels of the organization and instills a vital sense of ownership. Well-designed plans contain target dates for completion, assign implementation responsibilities and provide meaningful performance measures.

Bank-wide simplification in action

A leading bank with about \$50 billion in assets and \$2 billion in revenues recently engaged in a bank-wide simplification transformation. Before the effort, operational execution was generally poor, and best practices were lacking in many areas. The bank's cost-income ratio was in the 40s, higher than its peers. Customer satisfaction was low, and shareholders were demanding improvement.

A new CEO and management team committed to improving profitability and began with a thorough top-down assessment focused on each level of the business. In the process, they consulted about 1,000 of the bank's employees and hired experienced turnaround professionals and area experts. They then collectively identified, quantified and prioritized opportunities for creating value through simplification. Armed with deep organizational insight, the team engaged in a bottom-up planning process that resulted in a clear executable plan. The plan incorporated more than 400 initiatives and identified approximately 200 line managers as their "owners."

The transformation resulted in 15 percent revenue growth and 20 percent cost savings. The bank's net cost-income ratio improved by 10 points. Reinvigorated by this transformation success, the management team shifted its focus to establishing the bank as a leader in both financial performance and customer satisfaction.

A well-designed and well-communicated set of solutions paves the way for successful *implementation*. Execution requires a carefully coordinated, simultaneous implementation of many major and lesser initiatives. It demands a bias to action, a focus on the bottom line and continued vigilance for downside risks. Designating an experienced chief transformation officer can greatly facilitate the transformation process.

Banks and other institutions that have successfully simplified point to a few key factors. First, effective transformations simultaneously address revenue, cost and risk with a blend of small and large initiatives. Next, many initiatives are developed by line management, creating deep engagement. Finally, an accelerated multidimensional approach generates results much earlier, thereby reducing cost and risk exposure.

The brand new bank

Transforming a large, long-established bank is a significant management challenge; in some instances bank leaders might conclude that it would be easier to launch a brand new bank. This is a viable option, but an important assumption here is that the existing customer base can be successfully migrated to the new bank with minimal, if any, loss.

The new and old banks usually operate under a single bank license, but are managed by different leadership teams. The design approach for the new bank focuses on the six dimensions of complexity, but aims for the simplest possible organizational structure, products and systems while delivering superior customer journeys. For example:

- **Distribution:** Digital distribution channels predominate, with a strong emphasis on mobile and online channels. The branch footprint, if any, is extremely small.

Simplification as a draw for younger consumers

A mid-size Chinese bank with a strong corporate client focus aimed to build its retail customer base by targeting the young affluent segment. However, the bank's primary source of retail customer acquisition had long been life insurance products, which typically appeal to more mature consumer groups. The bank's chairman recognized that simple, digital banking options were more compelling for young mass-market consumers.

The bank centered its simplification initiative on digitizing its products, processes and systems wherever possible. Instead of using the customary sequential approach to technological change, it adopted an agile method that saved time and allowed for substantial flexibility. As a result, the bank was launching new products, systems and channels in six months rather than the customary 24. The effort transformed more than 20 customer journeys.

A year and a half after launch, the bank had acquired five million new customers and added about \$800 million in assets.

- **Operations:** New-bank operations are optimized for a multichannel environment. Everything from incentives to back-office processes is highly integrated, streamlined and designed to deliver the ideal customer journey.
- **IT:** Some banks, such as Ping An (ING Direct) and AXA Banque (Soon) leverage present leading-edge systems, while others, such as mBank in Poland, choose to design entirely new core systems.
- **Product:** Product portfolios are far leaner and simpler. A new bank might launch by offering only one or two product categories and then build on those in ways that will not add undue complexity.
- **Customer experience:** The new bank pursues select high-potential customer segments with targeted customer experiences. Millennials are often the initial target group. Providing anywhere and anytime access combined with a frictionless customer experience are important objectives.
- **Organization:** The new bank is designed and built by a separate team, free of all legacy bank encumbrances. The new streamlined organization has few layers and is highly cross-functional. Flexibility, adaptability and customer orientation are its by-words.



Banking customers are eager for simple, digital ways to manage their money. And banks are making efforts to deliver these tools. However, as they take this digital route, most banks are still burdened with the complexity of legacy IT systems, rigid organizational hierarchies, bulging product portfolios and time-consuming manual processes. Simplification is therefore vital to long-term success.

The new, simpler bank will be focused on the customer, with seamlessly integrated products designed for an individual's life stages. IT systems will employ open architec-

ture to link with the eco-environment to improve customer knowledge and facilitate broad-reaching services. Organizational structures will be streamlined and flexible to respond quickly to customer demands, new technology and regulatory change. Efficiency ratios will improve by 25 to 50 percent, driven by reduced costs and more productive distribution channels.

Broad transformations of this high order are not easy. Simplifying a highly complex legacy institution is a daunting challenge. It poses difficult questions for management teams. How will broad scale simplification affect quarterly results? Does management have the necessary bandwidth? And how does simplification work in institutions with organizational silos?

However, a number of banks have already succeeded in simplifying key areas of complexity. The common success factor is a deep commitment by management to stay the course despite the high hurdles.

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