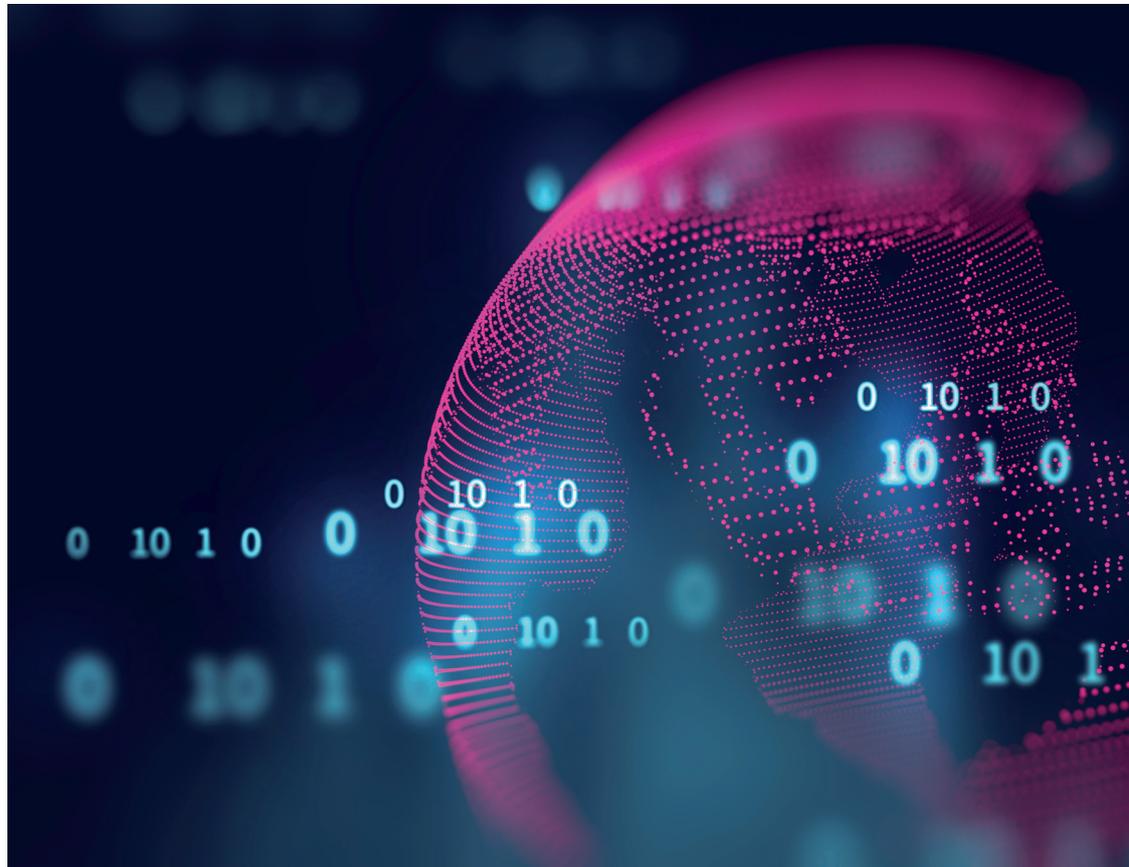


The future of customer-led retail banking distribution

Retail banking distribution September 2017



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Introduction

Retail banking distribution is an increasingly digital proposition, with customers accessing more services on their smartphones and desktops—even in countries that are not considered digitally advanced. According to McKinsey’s 2016 Retail Banking Multichannel Survey of 20,000 customers in 10 countries, and the Finalta Digital and Multichannel Survey, banking customers are also increasingly adopting web-based chat sessions with advisors and video-based remote advisory services. However, despite the growing prevalence of digital distribution in banking, no market is fully digital—for the next three to five years the human touch will remain important for 30 to 50 percent of consumers in most markets.

Our new research shows that banks are adapting their distribution models at very different paces. In many cases, consumers appear to be ahead of banks in terms of their willingness to use new channels. We see tremendous white space for banks to innovate on network shape, new formats, refreshed customer conversations, remote advisory, and digital sales and service. And, in fact, there is emerging evidence that distribution innovators are pulling away from the pack.

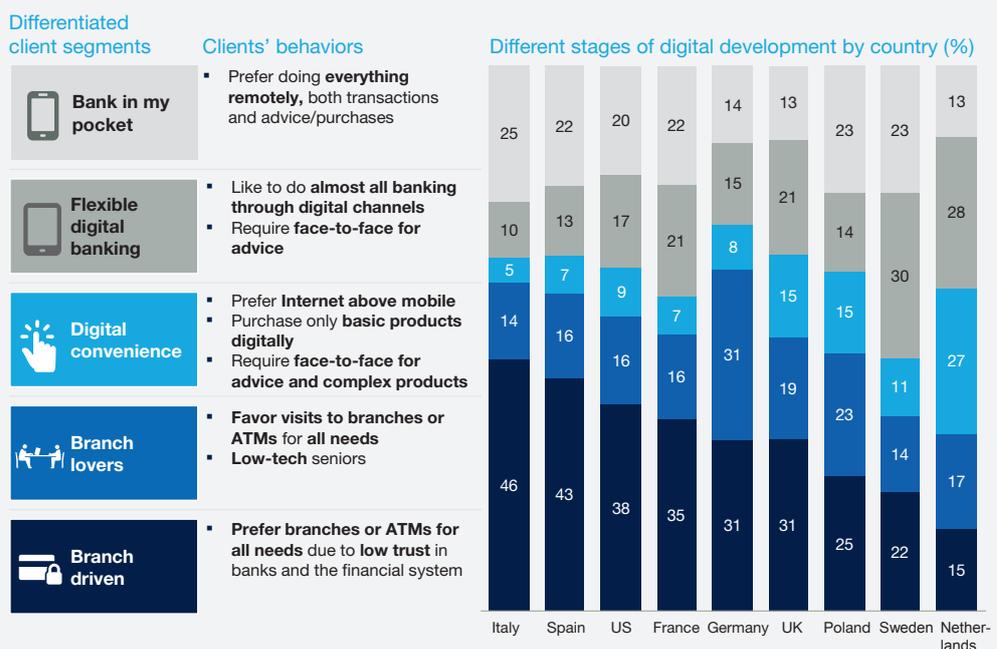
In this paper we examine the shifts in consumer preference revealed by our multichannel survey, which also serves as a benchmark to measure banks’ digital and multichannel progress. We then outline four battles banks must win if they are to succeed in an era of customer-led distribution.



Distribution preferences today

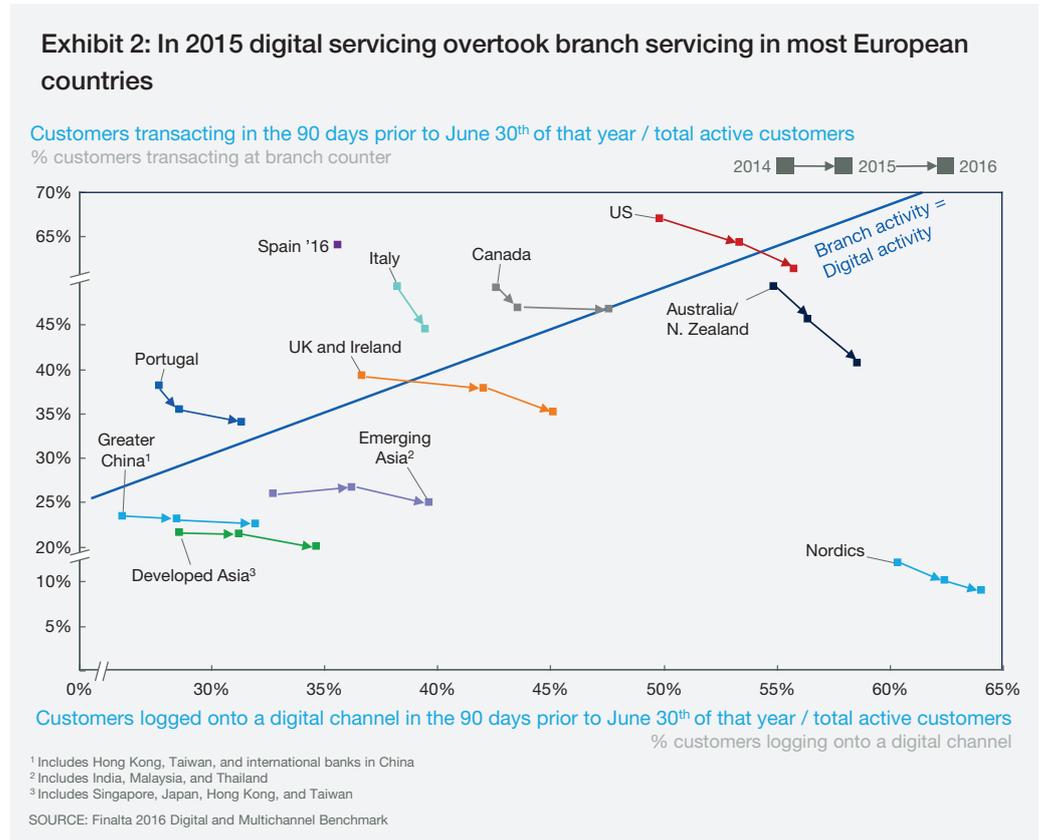
Our survey revealed five clear customer segments, from those that prefer remote and digital interaction for everything (“bank in my pocket”) to those that abstain from digital (“branch driven”). There were striking differences in the size of these groups across countries (Exhibit 1). As expected, northern European countries show the greatest tilt toward digitization; southern European countries and the United States have seen slower development thus far. Interestingly, even in the Netherlands, the most advanced country in terms of digitization, 32 percent of customers still prefer the branch or an ATM for every banking need. Even as digital marches on, the branch is not dead.

Exhibit 1: Markets are at different stages of digital development; human touch is still important in most markets



SOURCE: McKinsey Retail Banking Multichannel Survey 2016

Exhibit 2 shows how digital is advancing on two measures: visits to the branch, and log-ins on a digital channel. In every country, we see the same pattern—fewer trips to the bank branch, and more online visits.



Customers are not merely logging in to check balances or buy simple products and services. Many bankers have long thought that human interaction is needed to make a complex sale, but our research suggests that is not true. Customers are happy to buy and be advised online and via remote advisors even for such products as a mortgage loan—provided they can easily find the best product for their needs, and get enough information to be confident in the purchase (Exhibit 3).

Exhibit 3: Customers are willing to try remote advice and digital purchasing



¹ Willingness to purchase current accounts through digital channels in the future

² Consumers with a high willingness to switch to full remote advice models (online or mobile banking with screen sharing, voice and video)

SOURCE: McKinsey Retail Banking Consumer Survey 2016

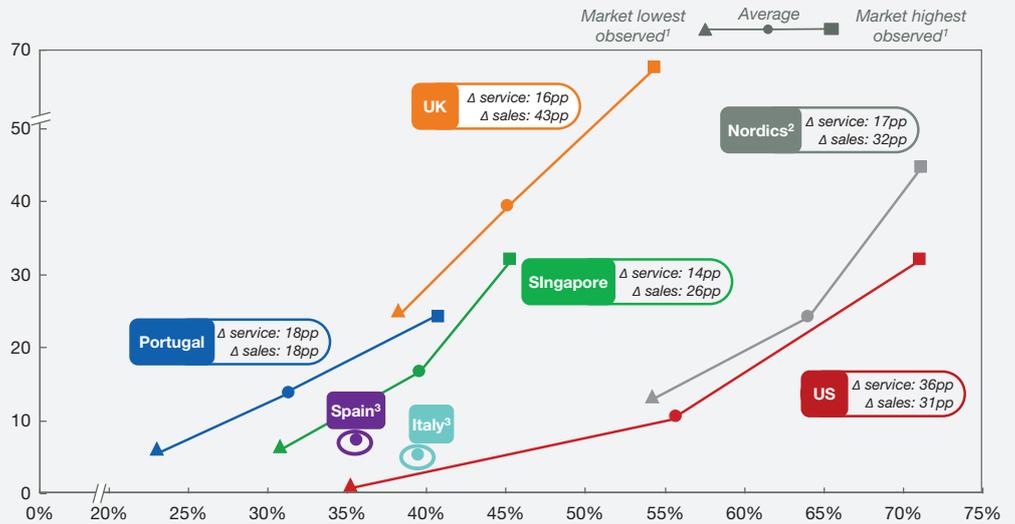
The big differences in digital development between banks reflect different strategies within those institutions. Some banks are moving fast and adopting digital and remote as the main channel for all interactions. At the most digital Nordic bank, 75 percent of customers logged in for service, and 40 percent of sales were made through digital channels. That's considerably above the market average in the Nordic countries, which is itself high, compared to other countries. Other banks are moving more gradually and keeping branches as the main channel. The least-digital US bank in our survey did not sell a single digital product, and only one-third of customers logged in for service (Exhibit 4).

Finally, digitally savvy banks in each country are pulling away from the rest of the pack (Exhibit 5). Almost all banks are getting their digital act together; but evidence shows that those that did it first, and continue to push hard on their efforts, are getting much bigger rewards. This suggests that the path forward for most geographies will be ever deeper digitization, much like the path the Nordic banks are on. If that's right, then the slower-adoption strategy pursued by many banks in the US and elsewhere looks vulnerable.

Exhibit 4: Markets are polarized with gaps between top and bottom digital performers

Digital sales penetration

% sales made through online or mobile channels / total channels (July 2015 - June 2016)



Digital servicing penetration

% customers logged onto a digital channel in the 90 days prior to June 30 2016 / total active customers (as at end 2016)

Δ service = difference between highest and lowest observed digital servicing penetration

Δ sales = difference between highest and lowest observed digital sales penetration

¹ Lowest/highest observed for each metric in given market—not necessarily the same bank

² Nordic banks include banks from Denmark, Finland, Iceland, Norway, and Sweden

³ For Spain and Italy only the average is presented

SOURCE: Finalta 2016 Digital and Multichannel Benchmark

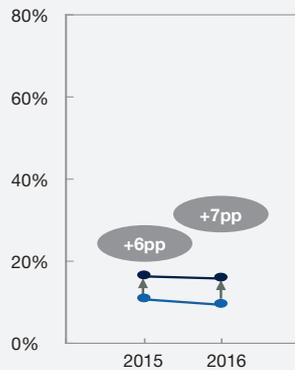
Exhibit 5: Digital leaders are pulling away from the pack

Sales made through online or mobile channels/total annual sales (2014-2015)

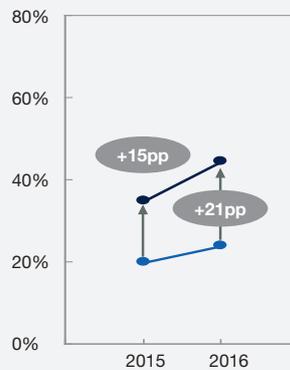
% sales made in digital channels

Country average (blue line) 2015 top performer (black line)

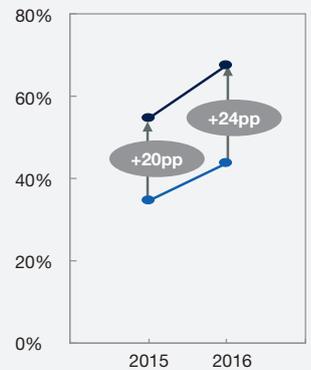
Southern Europe¹



Nordics²



UK



¹ Southern Europe includes Spain, Portugal and Italy

² Nordic banks include banks from Denmark, Finland, Iceland, Norway, and Sweden

SOURCE: Finalta 2016 Digital and Multichannel Benchmark



Must-win battles

There is no magic bullet to succeed in distribution; instead, leading banks are innovating on several fronts at once. There are four must-win distribution battles (Exhibit 6).

Exhibit 6: Banks have four “must-win” battles to win in customer-led distribution

1	Reshape the distribution strategy	Set new targets for channel mix for advice, sales, and service	Optimize branch formats and network	Make staffing more flexible
2	Introduce and migrate to new channels	Introduce and scale remote advisory as a new channel	Migrate customer interaction to self-service channels	Introduce robo/cognitive tools for customer interactions
3	Drive a new sales approach	Drive sales choreography and customer conversations based on data	Apply advanced analytics as the core engine for lead generation	Scale marketing and sales across digital channels
4	Become digital in all channels	Make branches digital and paperless in their operating model	Optimize performance management model toward digital interactions	Create digital customer journey applications that can be applied across channels

Reshape the distribution strategy

As customer preferences shift, banks need first to *set new roles and targets* for their channels. The roles should reflect the mix of interactions to which the bank’s market seems headed, which for most will be more digital and remote than today. Some of the shift will happen automatically, as more consumers go digital. But banks can also accelerate the shift.

Banks in many markets will find that the new role of the bank branch will be mainly to provide advice and handle complex service interactions—a shift away from its traditional focus on transactions and cash. To aid that shift, many banks will need to *optimize their branch formats and network*. This journey will typically have four main thrusts:

- Reducing the share of branches and of FTEs that provide transactional sales and service
- Closing branches on main streets and opening new ones in lower-cost locations that are easier for customers to access
- Fully automating branches with a complete set of tools – ATMs, cash deposit machines (CDMs), coin machines, tablets for digital banking, cash-pickup stations, and so on
- Pushing branches to become either one-stop-shops, or specialists in a single segment or activity (advisory, affluent, service-only branches), will also be important. In Southern and Eastern Europe, banks also use franchises as an integrated branch format to deliver their products and services

Optimizing the branch network successfully requires an understanding of customer demand in every micro market, indeed at every branch, and the economics of making changes to every branch. Scenario planning can be helpful in finding the right solution. Machine-learning techniques can provide even more sophisticated guidance. Leading banks are using “combinatorial optimization” algorithms to optimize the NPV of the branch network for a defined period of time. The algorithm takes into account specific criteria, including customers’ willingness to travel, the size and space of branches, the potential for modular branch concepts, and some forward-looking metrics to produce a blueprint for network optimization.

A European bank recently used the algorithm to redesign and optimize its branch network strategy. As a result, it expects to dramatically lift the rate at which key services are provided digitally: customer on-boarding from 30 to 50 percent, the provision of complex needs and advice also from 30 to 50 percent, and simple services such as transfers and payments from 80 to 90 percent or more. This migration toward digital will allow the bank to close 25+ percent of outlets and re-deploy 35 percent or more of in-branch FTEs. The bank will also change the mix of formats, moving from a network where all branches provide full service, to a mix of about 20 percent flagship branches, 20 percent convenience branches, and the remainder unchanged.

These big changes in the network must always be accompanied by *an improved staffing model that features multiskilling and flexibility*. Banks are moving toward a concept of branches where all employees can advise customers, and opening hours and days are aligned with customer traffic. This trend has proven its ability to reduce total in-branch FTE costs by about 8 to 10 percent. A European bank transformed its tellers into basic bankers. While they still keep their teller functions of counter transactions, enquiries, and support, they are also trained with additional skills including digital onboarding, remote advice support, simple product needs, and offering an introduction to mortgages. With these additional skills, at off-peak hours they can turn from tellers into basic bankers and contribute to sales growth.

Educate customers about the greater convenience of digital channels

Branch operations are not standing still. Even as transactional business flows out of branches and on to smartphones, branches are also transforming the way they do the remaining work, especially advice.

Migration of transactions from the branch to self-service continues to be a large opportunity for retail banks: we estimate that 70 percent of transactions can be migrated in this way. According to our recent research, the top reasons that consumers have not yet fully shifted to digital channels include mistrust (cited by about 45 percent of non-digital customers) and inertia and lack of incentives for migration (40 percent).

Successful migration programs, like those run by several Nordic and UK banks, focus on the heaviest users (the top 10 percent of retail customers typically generate 40 percent of all transactions). Such programs use ATMs and targeted new technologies (for example, automated greeter machines). And they drive engagement and cultural change by supporting branches and monitoring implementation closely. Over the long term, these programs have reduced the number of clients going to the branch by up to 60 percent, and tellers by up to 50 percent. More important, their migration to self-service is going three times faster than peers.

Transactions are not the only interaction on the move. *Advisory* sessions are going remote, as banks set up video and touchscreen functionality to connect with customers' devices. Remote advisory is a perfect match to customers' needs, providing them with more convenience, and the opportunity to talk with a specialist who also understands their questions. Banks get more satisfied customers, greater control of the interaction (and more data, as interactions are recorded), and a more flexible staffing model that can better accommodate staff vacations and sickness. The remote model is also less expensive; costs to provide an advisory session are typically 25 to 35 percent lower than in the branch.

Even more improvements are in store: next-generation advisory includes cognitive agents to meet with customers in self-service sessions, at any time.

Data-driven sales in all channels

Digital and analytics are having an impact on every activity within banking. Recently we've seen three ways that banks are applying new analytics.

First, analytics are proving invaluable in new models that predict the product a customer is most likely to buy next. For years, cross-sell efforts have been weaker than expected, in part because banks often offered a product that the customer was not interested in. Machine-learning tools are enhancing the hit rates of banks' traditional cross-sell models, by accommodating more data sources (such as app usage, location, cookies, and others), and coming up with surprising insights about what customers might need next, and the right channel to reach them. Banks that have deployed these models have seen increases of up to 20 percent of new sales, and 20 times' better response rate to pitches for a long-term lending product.

Banks are also using analytics to acquire new customers—the second big idea in sales management. One bank set up “war rooms” in two priority markets where it hoped to expand. These teams made a number of improvements to the bank's website—improving

the content on landing pages to perform better on search engines, conducting A/B tests to improve the user experience, adding video and other media, and so on. The war rooms designed these innovations in 10 days, rather than the usual “waterfall” or sequential handover process. The website saw a 25 percent higher completion rate on product application forms, and sold 40 percent more credit cards through online applications. Another bank rethought its search-engine optimization and improved its conversion rate by a factor of 10, a gain that was worth about €60 million.

Become digital in all channels

Helping customers become thoroughly digital will only be possible if the distribution channels that the banks are offering are digital enough.

Most banks are currently focused on top-notch front-ends and functionalities for their mobile apps and online web pages. Yet the leading banks know that digital must be extended to the overall client experience, including the branches and all the processes that are shared among channels.

These banks understand the importance of digitizing branches, and thus provide digital technology to their relationship managers. RMs who work with iPads to serve high-value clients can be completely mobile, and a branch that uses this technology is that much closer to being paperless.

New performance-management metrics should accompany the new customer-led distribution model. Successful performance management needs to have both push and pull elements: daily performance reviews, performance dialogues and root-cause analyses can push relationship managers to better performance. Motivation schemes, and KPIs that are measurable, actionable, and simple and can pull the best out of them. This combination of push and pull performance management levers, combined with the relevant digital technology, can boost productivity by 15 to 20 percent.

Finally, digitization can't be complete without making main processes fast, simple and consistent among channels. Customers are increasingly able to compare service among banks, especially by contrasting their experience in the most important customer “journeys”—the process of opening an account, say, or obtaining a mortgage. Some banks are prioritizing these journeys and creating fully digital experiences for the client, comparable among channels, to match the experiences that fintechs are already offering.

Prioritizing customer journeys is not a one-time effort, as they will continually evolve based on banks' own development and environment. But there are typically 15 or so journeys that matter most to customer satisfaction, and account for up to 60 percent of all costs. In addition to account opening and mortgage application, these 15 usually include customer onboarding and debit and credit card applications.

Once the critical processes have been identified, banks can redesign them for digital, using a “zero-based” approach conceived and executed by agile working teams. Players that do this well have a systematic approach to end-to-end digitization that enables them to redesign a customer journey from scratch in 3 to 4 months.

A European bank used this approach to develop a new process for customer onboarding that required just “12 swipes and a selfie.” The time to open an account was cut by 80 percent, and the number of required fields of information by 65 percent.



Every day, the ground is shifting under banks' feet. In our view, banks will need to fight these four must-win battles simply to survive. Those that find distinct solutions—and do it soon—will not only survive, but excel in coming years. In a series of forthcoming articles, the McKinsey Banking Practice will detail the key steps needed to create those solutions.

