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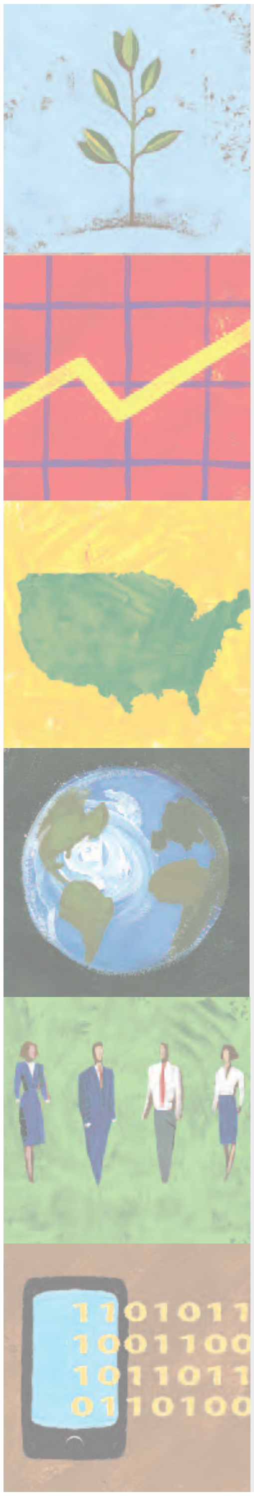

McKinsey on **Payments**

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The new rules for growth through customer engagement

Ongoing change in the banking and payments ecosystem has been well documented. McKinsey expects that the next three to five years will bring more change to the consumer financial services landscape than has been seen in the last decade, driven by three primary trends. First, the flows of investment funds continue to support innovation. Global investment in financial technology, or "fintech," reached over $12 billion in 2014, increasing at more than three times the rate of overall venture capital investment. These largely non-bank fintech players leverage digital distribution channels to enhance customer experience and drive rapid customer acquisition and engagement. Although the long-term viability of many of these new providers remains to be seen, their lower cost structures and aspirations to "disrupt" the landscape will accelerate change (Exhibit 1).

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Second, the explosion of information and transparency has altered the decision journey in consumer financial services. Sites like Credit Karma, NerdWallet and Bankrate equip consumers to make borrowing, deposit and rewards program decisions in fundamentally different ways. Meanwhile, consumers' increasing comfort with mobile and Web channels and the efficacy of online marketing opens consumers to a wider array of bank and non-bank suitors. Technologies such as Uber and Apple Pay are integrating payments within the customer journey, raising consumer expectations for a seamless experience. This moves us closer to the "retail nirvana" of frictionless payments, and furthers change in the banking and payments ecosystem.

Third, the rise of cloud-based services and data center investments by tech players (including Amazon, Google and Microsoft) combined with improved tools for data analysis and insights is driving low-cost data availability. This third shift enables companies to react to customer behavior in real time, delivering a more fulfilling experience. For example, startups like Affirm in the U.S., Klarna in Sweden and Paidy in Japan use data to offer instant credit for online purchases.

The foregoing trends are likely to accelerate in the near-term. As a result, incumbent consumer financial institutions need to quickly position themselves to compete in a digitally enabled environment.

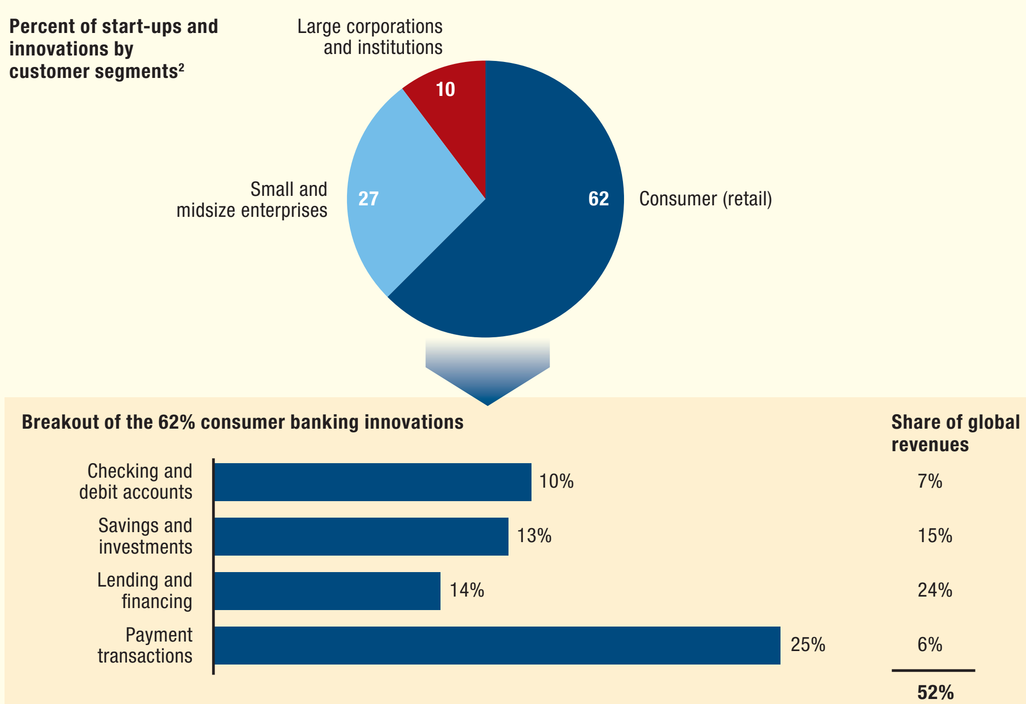
The new rules of consumer financial services

We are living in what Target chief marketing officer Jeff Jones has dubbed The Age of Impatience, in which "one of the greatest expectations our guests have is to shop and engage wherever and whenever they want." Over the course of the past decade tech players have forced retailers to accelerate their digital strategies, transforming their physical stores into leaned-out strategic components of a broader, multichannel customer engagement approach. Similarly, for banks, digital engagement with customers has become an imperative to preserving existing relationships, let alone growing customer value. McKinsey sees five rules that financial institutions need to embrace in order to thrive in the new landscape:

1. Be where your customers are—develop an integrated multichannel presence
2. Publish like the news media—deliver content at an hourly pace
3. Personalize the experience—increase relevance with targeted and dynamic content
4. Act like a venture capitalist—buy and partner for new capabilities

Exhibit 1

Fintech innovations are targeting the consumer banking segment[1]



[1] Analysis based on commercially well-known cases registered in the Panorama database; might not be fully representative.

[2] Sample size exceeds 350; Figures do not sum to 100%, because of rounding.

Source: McKinsey Panorama, a McKinsey Solution

5. Execute like a tech company—drive rapid pilots to test and learn at scale

1. Be where your customers are

Today's consumer decision journey is an iterative process of consideration, evaluation, purchase and experience across online and offline channels that is more dynamic than the "funnel" model of the past (Exhibit 2). This means banks and payments players need to grow their presence on desktop, Web, tablet, mobile and social media as well as their marketing across display, paid search, search engine optimization, social, affiliates and email. While banks and credit unions are already shifting budgets away from traditional channels (eMarketer forecasts an 11.7 percent growth rate in digital advertising budgets among U.S. financial institutions), the share of marketing spend on digital still lags the 47.1 percent share of time spent per day by U.S. adults on digital media. Retailers often see increases in spending of three to six times for cross-channel customers versus single-channel customers. In McKinsey's experience designing multichannel strategies in payments, we have seen overall increases in spend of at least two times for customers using both mobile apps and branches versus branches alone.

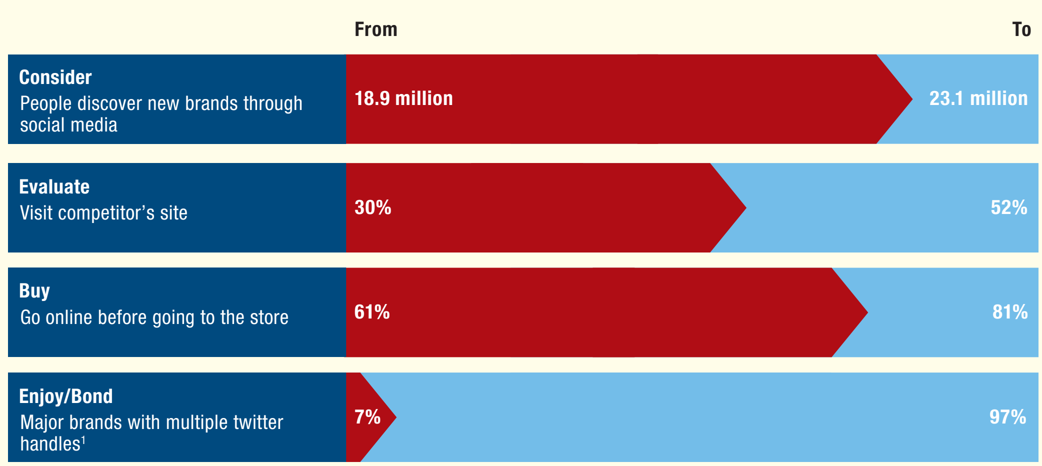
More than just establishing a digital presence, financial services firms need a near-real-time, single view of consumer behavior and actions across products and services, household accounts and channels. This enables consumer-cue-based marketing to drive optimal engagement. One payments provider achieved a three-fold increase in incremental transactions by implementing a near-real-time (within an hour) "abandoned payment" campaign that increased capture of consumer intent to make a transaction. In another example, PNC Bank in the U.S. used a data hub of customer information across multichannel interaction points to equip call center agents with the most relevant message to share with each customer.

2. Publish like the news media

Deepening consumer relationships requires a

Exhibit 2

A new, digitally driven consumer decision journey is emerging



Source: Brandwatch;The Future of Commerce; Forrester; iConsumer; Cisco; Nielsen, Strategy Analytics, eMarketer two-way, continuous dialogue, a steady stream of original, fresh and relevant content connecting consumers with the brand. Instead of a few campaigns a year, financial services players need to convey hundreds of messages a week, through blogs, videos, interviews, reviewer forums, photos and so on. One payments player built a library of offers and scored their effectiveness along multiple dimensions to enable rapid deployment to appropriate customer segments (e.g., higher-value offers to higher-value prospects). Others banks have turned to customer-generated content such as crowdsourced photos for campaigns (First Direct in the UK) or reviews (Knab Bank in the Netherlands).

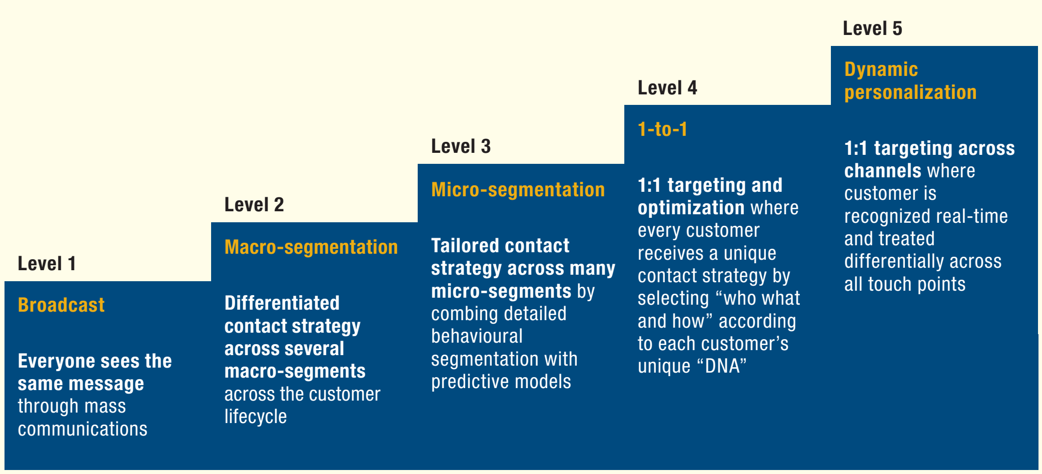
This approach requires both a complex content management system and content supply chain to align millions of impressions across multiple platforms. Each mobile coupon, email, Web page, text message and in-branch promotion must be coordinated so that their messages are consistent and relevant. An electronics manufacturer discovered that a third of shoppers who researched a specific TV brand online walked out of their stores during the "buy" phase, frustrated by inconsistencies between product data found online and in the store. For banks, given their "trusted agent" relationship with customers, poorly aligned offers are even more of a risk.

3. Personalize the customer experience

Increasing revenue through consumer engagement centers around the next action, not the next product. As opposed to the traditional product upsell mentality, optimal engagement relies on knowing what behaviors will enhance the customer-bank relationship (e.g., app downloads, clicking to chat, redeeming an offer, watching research videos), which may not always take the form of another transaction or product. Developing this knowledge requires an understanding of consumer expectations by segment. The greater the shift from broad segmentation to microsegmentation to one-to-one targeting using customer data insights, the greater the impact (Exhibit 3). Banks have only recently begun to tap into the potential of personal-

Exhibit 3

Banks need to increase the level of personalization over time



Source: McKinsey Payments Practice

ization; for example, the location-specific imagery provided by Chase's mobile app or the iGaranti app that enables customers to create a customized mobile app homepage.

Tech titans like Facebook organize into a thousand teams of ten rather than ten teams of a thousand in order to test then rapidly scale pilots that demonstrate early success.

Even without reaching one-to-one personalization by customer, however, significant revenue impact can be achieved with tailoring by segment. A global card issuer facing growth challenges, high consumer churn and drops in engagement at early touch points revamped its onboarding process by determining behavioral customer segments. A distinct journey and contact strategy was developed for each segment based on data that revealed the optimal sequence of actions to drive the highest value (e.g., completing a second transaction within the first week, using the card for purchases across two verticals). More than 50 pilots were then designed and executed to drive the desired behavior for each segment. Within weeks, a six percent lift in transaction volume was achieved versus a control group.

4. Act like a venture capitalist

IT talent skilled in newer disciplines such as agile development represent a severe constraint for banks. Incumbent financial firms have often adopted aggressive buy-or-partner approaches to start-ups, realizing that building in-house capabilities can take too much time in a competitive market. Notable examples include BBVA's acquisition of Simple, SunTrust's acquisition of LightStream and Green Sky, and Capital One's acquisition of Adaptive Path, a design firm providing user interface/user experience and agile development capabilities. Denmark's Danske Bank has taken a distinctively "tech" approach to its mobile person-to-person rollout, focusing first on building market share (reaching 40 percent penetration of the adult population) before pursuing monetization strategies.

Similar moves have been made by service providers and established disruptors (e.g., PayPal's acquisitions of Paydiant, Braintree and Venmo). The challenge is to time acquisitions to optimize the tradeoff between proof of concept and rich valuation. One solution is the incubator/portfolio approach taken by firms such as FIS and First Data, which take minority stakes in a variety of mid-stage companies.

5. Execute like a tech company

Increasing revenue in a digital world involves rapid execution of pilots, robust measurement and quick action on lessons learned, optimizing subsequent iterations and scaling quickly when a winner hits. Launch and release cycles must be far more compressed than those to which banks are accustomed. Tech titans like Facebook organize into a thousand teams of ten rather than ten teams of a thousand in order to test then rapidly scale pilots that demonstrate early success. One payments provider found that two of the first 13 tests on its homepage increased conversion by 10 percent from site visit to transaction or registration.

Financial institutions often cite regulatory and compliance barriers to moving faster, constraints from which their tech-centric competitors are largely exempted. But banks can do more to enable faster testing and learning. For example, one issuer shifted from a siloed compliance, legal and marketing team to a cross-functional team with dedicated compliance and legal time to support testing, three-day service-level agreements on approvals, and fast-track processes for tests within agreed upon guidelines. Another payments provider reduced its conception-to-launch cycle for email marketing from 30 days to 10 by creating a small team with ownership of a streamlined end-to-end process.

> While concern over cannibalizing branch business can make executing multichannel strategies challenging, the overall value of an engaged multichannel customer exceeds that of "brick and mortar only."

How to get started

Banks acknowledge the importance of digital engagement to drive revenue growth, but frequently cite organizational siloes (e.g., digital and retail) as well as lack of bandwidth or investment, as reasons for limited progress.

While concern over cannibalizing existing branch business can make executing multichannel strategies challenging, the overall value of an engaged multichannel customer exceeds that of "brick and mortar only," as noted earlier. Tactics to foster alignment across the organization include designing loyalty programs that reward multichannel engagement and evaluating teams based on an integrated yardstick. For instance, credit should be shared for customer acquisition through digital and physical branch channels. Teams should also operate under shared goals and metrics (e.g., mobile app downloads).

In addition, the beginnings of a digital revenue growth strategy need not entail a multiyear initiative, major commitment of investment dollars, or even a roadmap addressing all five rules. Here are three approaches to quickly establishing a foundation without significant organizational commitment:

- Pick your spots. Select quick-hit opportunities with clear value and an existing degree of organizational enthusiasm. This could be within one line of business or one customer segment. Design 10 to 20 pilots to run within the next quarter and ensure robust measurement via test and control, to generate learnings and insights to inform subsequent versions of each test. Fertile ground for experimentation includes email marketing and mobile push notification, which can be low-friction ways to start consumer-cue-driven engagement, leveraging a library of regularly-updated content and offers that are fresh and eye-grabbing; in addition, if an A/B testing tool is in place, starting with a regular cadence of tests to optimize the homepage and landing pages yields high immediate impact.
- SWAT up. Convene a group of six to eight enthusiastic participants to drive a set of pilots, ensuring representation from key functions; e.g., a marketer, product lead, developer, data scientist, designer and compliance and legal leader. Create a

"project thermometer" tracking two to three targeted metrics, including a mix of financial metrics (revenue per customer, transactions per customer) and engagement metrics (open rates, click-through rates, time spent on site).

- Laser focus on results. Establish a war room to review what worked and what didn't, and what to do next, on a weekly or biweekly basis. Then trumpet the results throughout the organization when a winning test is found, whether it is an educational email stream with significant increase in the use of a product for test versus control customers, or an A/B test with significant increase in conversion in the registration flow, or an onboarding program resulting in increased transactions. Target specific customers rather than system-wide impact. Celebrate small moves of the needle rather than waiting for a "big bang" unveiling after two years.

In pursuing the above tactics it is essential not to expect to get it right the first time. The mindset shift in driving revenue through consumer engagement in a digital world is the power of incremental improvement—"every pixel matters" and the result of hundreds of small tests and pilots that are optimized and quickly scaled can deliver big payoffs. While the landscape is changing rapidly, and fintech players are competing for consumer mindshare and loyalty, banks and other incumbent consumer financial services providers that understand this and execute on the five rules will be positioned for growth.

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For information on McKinsey's Panorama database of more than 1,500 fintech innovations email *fintech@mckinsey.com* or visit *www.mckinseypanorama.com/products-services/panorama-fintech.aspx.*