

Retail Banking Insights

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The Future of U.S. Retail Banking Distribution

Now in their seventies, the Stephens live in a suburb of New York City. For more than 30 years, they had their entire banking relationship, including a small business account, with a large bank in their neighborhood. The bank had a leading brand and a broad product suite. The Stephens were so close to their bankers that they would bring Christmas presents to the branch manager and tellers.

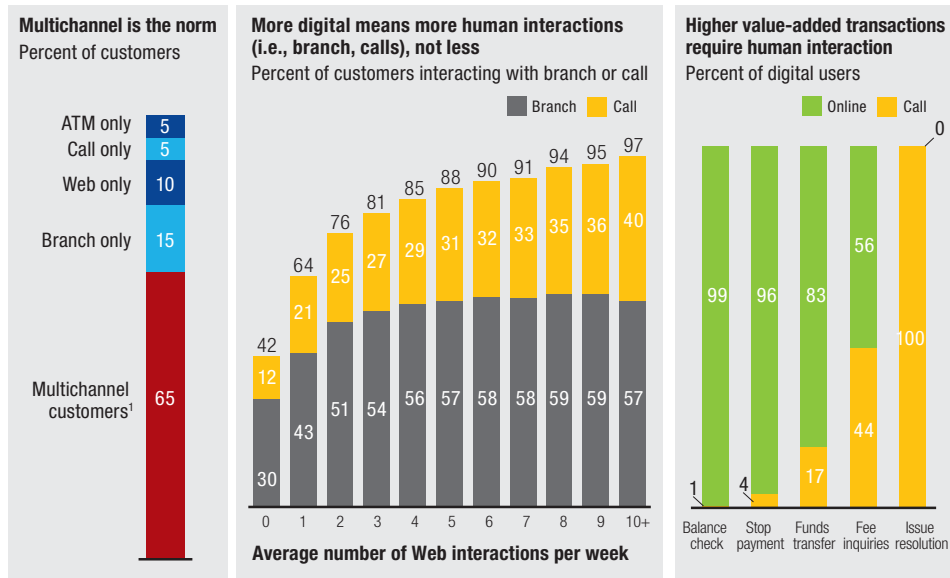
Things began to change in 1990s. Eager to wean customers off the branch, the bank sent an assistant branch manager to the Stephens' home to set up their dial-up banking system. In the 2000s, a series of cost-cutting measures caused rapid turnover in branch staff. To the Stephens, their banking relationship no longer felt personal.

A few years ago, the Stephens severed their 30-year relationship with the bank. Today they have accounts at three different banks, but most of their assets are with one national institution. This new bank is not as conveniently located as their former bank, but it provides great service, encouraging the couple to come in if they ever have a problem. The Stephens view their accounts and make transactions on a daily basis through iPhone and iPad apps. They rarely use online banking and almost never dial the call center.

The Stephens' story is not unusual; it is representative of how bank customer behavior is changing. Today, 65 percent of customers interact with their banks through multiple channels. Human interactions are generally reserved for more complex problems: only 25 percent of agent phone calls are inquiries that could be serviced in other channels. Most intriguingly, digital channels have not replaced physical channels. Customers using mobile and online banking more than once a week are over 60 percent more likely to be active retail branch users than those who do not (Exhibit 1, page 2). So while customers have embraced multichannel access, they also expect higher value from face-to-face interactions at their bank branch.

Exhibit 1

Human interactions remain important in a multichannel world

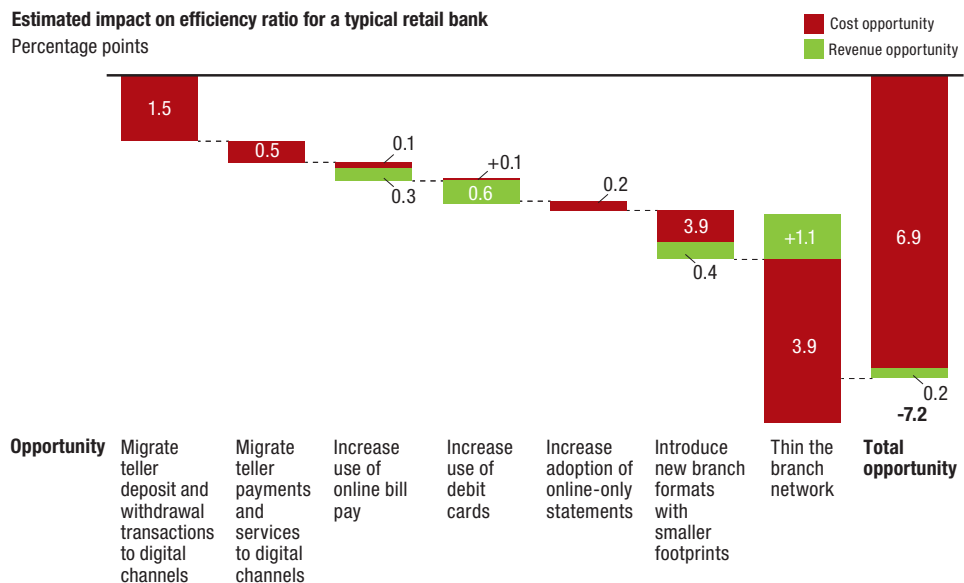


¹ Using at least two channels out of: branch, agent call, IUR contained, web, ATM, mobile banking
Source: ClickFox

This shift in customer behavior is both a rare opportunity and a potential threat for retail banks. Those that act now to migrate transactions to digital channels, transform their physical distribution networks, and revamp their go-to-market strategies can significantly improve their efficiency ratios (Exhibit 2). Those that do not may fall victim to emerging disruptive models that leverage alternative distribution networks to acquire customers and provide a superior customer experience. For example, American Express's Bluebird debit card, which is distributed through Wal-Mart stores, signed up more than half a million customers within three months of launching in late 2012.

Exhibit 2

Transforming distribution and go-to-market strategies can improve efficiency ratio by up to 7 percentage points



Source: McKinsey Consumer & Small Business Banking Practice

The creation of a new distribution model that meets the evolving demands of customers is founded on four imperatives:

1. Shift from a linear customer funnel approach to optimizing multichannel journeys for customers
2. Design the branch network to achieve the “minimum effective dose” through multiple format types and carefully built networks
3. Empower the front line to provide distinctive face-to-face interactions with customers
4. Increase marketing sophistication to meet customers’ emotional needs

1. Optimize multichannel journeys for customers

One large retail bank recently adopted a customer experience strategy centered on “simplicity with a smile.” Realizing that customers are acquired and served through streams of activity across channels, this institution abandoned the classic “funnel” approach to customer acquisition and focused instead on cross-channel “journeys” that follow customers across multiple interactions. One of the bank’s first insights was that inconsistencies across channels were creating difficulties and increasing operational cost and risk. To solve this, the bank borrowed a move from the start-up playbook and created a cross-functional, front-line-led rapid prototyping design lab to build a unified customer experience across channels, targeting the most common journeys taken by customers during the first 90 days of their banking relationship. The result was a 40 percent increase in products per new account and a 30 percent drop in time to open new accounts.

McKinsey interviews on consumer attitudes about online bill payment underscore the importance of looking at interactions from the customer perspective. For customers, receiving, queuing, paying, confirming and then storing a paper bill offers benefits that standard online bill pay offerings do not replicate. For instance, by queuing bills in a paper pile, customers retain physical control over which ones still need to be paid (e.g., it will be there until I move it), as well as over cash flow (e.g., wait to pay until payday, know exactly what is outstanding). And after payment, the statement provides a confirmation (e.g., writing “PAID” and a confirmation number on the bill) and a sense of satisfaction from completing the task (ritual). By simply solving for the process of executing online bill payment, banks miss the opportunity to address the behavioral and emotional needs of their customers (e.g., feelings of safety and security, aversion to change, visual representation of the process, habitual workflow). Consequently, the penetration of online bill pay in the U.S. is only about 50 percent.

The capabilities required to effect “customer-back” improvements are new to most banks:

- **Big data analytical methodologies.** To map and quantify customer pathways that lead to specific positive (e.g., successful cross-selling) and negative (e.g., silent attrition, customer complaint) outcomes, banks will need to use big data analytics. This data can also be leveraged to make the business case for customer experience efforts and to prioritize those efforts.
- **Design-to-value economic approach.** Bank P&Ls are typically highly disaggregated into functional areas. They know how much they spend on branches, call cen-

ters, technology and marketing and have methodologies for cost allocation to the household level. However, when designing target customer experiences, many banks do not design to an economic goal. They must be able to measure the all-in economics of pathways (e.g., in-branch versus call center service costs) and design target end-states that meet economic objectives.

- **Cross-functional, rapid prototyping capabilities.** Banks often take a pilot approach, where one element of an ecosystem is well-built (e.g., a product or a technology), but the rest is neglected. Armed with a big-data approach to analyzing customer pathways and a design-to-value economic tool, banks must develop rapid, cross-functional processes to create “minimum viable experiences.”
- **Treat changes as a design exercise.** Few banks designate an “owner” of the customer experience. Instead, they typically have functional owners: head of branches, head of call centers, head of online, head of products, head of marketing. As a result, the customer experience can be inconsistent. In most cases the “axis of power” in these institutions is still the retail branch distribution team. Some banks are now shifting to a “segment led” approach, but still lack the language, tools and techniques to design and build customer experiences.

2. Design the branch network to achieve the “minimum effective dose”

Almost 90 percent of U.S. households live within 10 minutes of three or more different banks. Seventy-five percent have a choice of six or more. For banks, this apparent saturation presents an opportunity for cost reduction. It also posits a genuine game theory challenge: no bank wants to be the first to thin its network when there are com-

petitors within striking distance of its customers. Many institutions are taking this step, however, as almost twice as many branches closed their doors as opened in 2012.

In interviews with recent bank switchers to understand how bank location played into their decision, McKinsey found that there continue to be customer segments focused on community banks, online-only banks and even classic convenience drivers. But another segment is emerging that is focused on a new twist on the

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As customers shift to online and mobile channels and increasingly automate other interactions through direct deposits and online bill pay, the idea of changing banks seems less appealing and often unnecessary. Instead, customers in this new segment are increasingly looking for banks that seem to be ubiquitous, even at the expense of a denser local presence.

The growing importance of ubiquity—combined with the rapid shift of transactions from bank tellers to ATMs and other self-service channels—presents an opportunity for

banks to redesign their branch networks and develop new approaches to market entry. There are four capabilities required to build the distribution network of the future:

- **Multiformat versus one-size fits all branches.** To maintain the sense of ubiquity, meet customer servicing needs and maintain viable economics, banks should explore a multiformat branch distribution model. This approach requires significant changes in the areas of human capital (e.g., organization, business processes, job design) and technology (e.g., ATM upgrades, sales platform capabilities).
- **Geospatially enabled capabilities** that allow banks to build the right format for the right segment. This approach (see sidebar, next page) will require banks to predict both how and where their desired customer segments will grow.
- **Demographic insights.** McKinsey research suggests that there is a sweet spot in density and coverage levels for retail bank branches—they become less efficient at any level below or above this optimal point. Banks must have the capacity to determine what these optimal levels are for given segments.
- **Optimize branches in locations that are difficult to exit** (e.g., due to long leases or low property values). Banks should consider increasing the utilization of branches that cannot be exited. One approach—sharing space with partners (e.g., Sears' leasing out excess space to Whole Foods)—could provide an early-mover advantage.

3. Empower the front line to make face-to-face interactions distinctive

Within five years, more than 95 percent of banking transactions are likely to take place through direct or digital channels. When customers do visit a branch, however, the stakes will be higher. They will be coming for sales and advice or to resolve a complicated service or transaction requirement. The traditional front line in most banks does not have the support or capabilities to meet these new demands. In order for their branch networks to remain a source of competitive advantage, banks must act in three areas:

- **Build front-line skills and capabilities to advise customers and address their service issues.** One bank's branch staff routinely redirects customers with complicated service issues to a call center, and tells customers inquiring about investment products offered by the bank that they are better off going to a dedicated investment firm. To address issues of this kind requires transforming the role and skill level of tellers and potentially empowering other employees, such as assistant branch managers, to play a dual sales and service role.
- **Construct systems and processes to enable the front line to deliver advice and service.** At a minimum, this means that in-branch personnel are able to access the full relationship and service history of the customers they are speaking with and can resolve service issues in real time. One bank doubled the number of pro-active (i.e., advisor-generated) meetings per week simply by leveraging a customer relationship management tool.
- **Create a culture that empowers the front line.** The retail banking front-line mindset should resemble that of small business owners who are serving customers rather than that of salespeople and order-takers. Front-line skills, capabilities, systems and processes are wasted investments if the front line is not empowered and motivated to use them.

4. Engage customers emotionally with sophisticated marketing strategies

Money is emotional. It causes happiness and anxiety. It empowers and deflates. As stewards of customers' hard-earned assets, banks must deal with emotions in ways that few other retailers must contend with. Banks can learn from financial services firms that know how to emotionally engage through direct channels. There are three major archetypes for customer engagement:

- **Belonging:** USAA orients its value proposition around “integrity” (e.g., highest-ranked bank in response to “My financial provider does what’s best for me, not just its own bottom line”) and a strong community focus (e.g., active-duty military receive reduced fees). The company has created a feeling of belonging among its customers that has led to disproportionate success. From a single branch in Texas, USAA has increased its deposits more than five-fold over the past decade and achieved industry-leading rates of cross-sell.
- **Autonomy and empowerment:** American Express has always relied heavily on direct channels (phone and online) for customer acquisition. Through decades of effective marketing, the company has created a brand of empowerment, helping customers achieve their aspirations and experience life. Through recent digital initiatives such as “Sync, Tweet, Save” and “Mobile Offers” American Express provides

Optimizing the physical distribution network

A spatially enabled branch transformation plan is a four-step process that mixes quantitative insights with on-the-ground market intelligence:

1. Ensure digital and direct capabilities are in place to enable service and transaction migration following the alteration of the physical network. Incorporate future in-branch versus out-of-branch transaction activity volumes into network optimization.
2. Baseline current branch performance in one or two test markets by comparing the actual to the predicted performance of each branch. Quantifying specific drivers of branch performance through advanced spatial and statistical analysis provides the foundation for this benchmarking exercise. Each branch is compared to its predicted performance given its unique surroundings, and specific drivers or inhibitors of performance are revealed.
3. Create a “clean sheet” future network and customer interaction model. Using advanced spatial techniques, banks can create an idealized “what if” future network that explicitly accounts for changing customer behavior, demographics and financial realities, as well as a multiformat world. Producing multiple future network scenarios using different sets of assumptions allows banks to compare and contrast the return on investment for different network models (e.g., thin network, ATM-heavy).
4. Develop a practical migration roadmap. The final step to optimizing the network is working with market planners to incorporate market intelligence and real estate availability into the business case. Comparing optimal network scenarios with existing branch networks facilitates branch-by-branch decision-making. A plan is crafted for each branch that includes details on space, product mix, staffing, performance plans per segment, transaction migration targets and acquisition targets.

customers with access to unique, personalized and convenient tools for making purchases (e.g., tweeting the name of the item).

- **Trust and security:** Charles Schwab's value proposition focuses on "Ask Chuck," combining personalized investment advice largely by phone and a full-service online channel, while maintaining premium pricing. This personalized, high-quality service has built deep trust among customers, in some cases leading to lower price elasticity even in commoditized products like mortgages.



Retail banking customers are changing their behavior, making greater use of multiple channels and moving almost en masse to digital or direct access. Banks have encouraged these changes by offering customers more ways to connect. But, as always, behavior is more complex than at first it appears. Many banking customers still want branch access, and when they do visit they are expecting the highest levels of service. Other customers are more interested in having a bank that is "everywhere." Still others have financial-emotional needs that are not being met.

The challenge for banks is to first understand what their valued customers really want and then to build the distribution model of the future based on those needs.

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