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The bank of the future

Somesh Khanna

Digitization is challenging the very way banks operate. Yet it also represents a significant opportunity, as McKinsey's Somesh Khanna explains.

Digitization promises to automate and improve many banking processes. Yet it's not without peril: customer demands and expectations are increasing, and technology is fueling the emergence of significant new competitors. In this interview with McKinsey's Simon London, McKinsey director Somesh Khanna discusses how financial institutions can maintain their core operations while embracing new technologies and explains what the digital transformation means to customers and executives. An edited transcript of Khanna's remarks follows.

The bank of the future

My kids may work with a very different type of bank, but I do see branches as being quite important to a multichannel representation of a bank for the foreseeable future. Will they be as important as they are today? Absolutely not. They will be significantly less important. They'll play different roles, including being a destination for complex advice and problem resolution.

Some people are experimenting with very large showcase, highly tech-enabled hub branches that are surrounded by much smaller branches in different formats, some ATM-only, some with a few or even no tellers. Some have had quite a lot of success with those.

There are others that are thinking that the branch of the future may be a very different model, where they have six to ten strategically located branches in a city that supports a very strong digital presence. I believe that many of these types of models might end up being successful. But over the next seven to ten years, we're going to find out exactly which ones will be more successful than others.

Personalizing the customer experience

Digital capabilities can turn the customer journey into something that's highly personalized.

It's the way in which the device connects with the interaction that you have with a branch teller, how that connects with the messages you get as a customer with your mailbox, and all of that being delivered in a way that is seamless, that knows you, that recognizes you, that rewards you for your relationship with the bank. There's a lot of amazing stuff that will likely happen—and is happening today in that space. And I think there will be a huge opportunity for banks to innovate. They will need to challenge everything, never settling on the status quo—much as the airline industry transformed air travel from an in-person, paper-based experience to one of almost complete automation. It'll also be important for banks to be relentless about learning from every customer interaction. After all, 86 percent of customers stop doing business with a company due to poor service.

Why digital is a CEO topic

Being able to take advantage of, or react to, the digital revolution requires banks to behave in ways that they are not quite accustomed to. It requires extremely clear and quick cross-functional collaboration. Because of the horizontal nature of the work, this naturally becomes a topic for CEO facilitation or intervention. That's because the CEO sits above all of these issues. He or she can encourage collaboration, break ties when one part of the organization wants to go in one direction and another wants to go in another direction, and make investments that wouldn't naturally fit into any one of their investment thesis but are right for the company as a whole.

Who should drive digital? Sometimes, the CEO would like to tap the head of operations and technology and have them drive it. Sometimes they want to name a "chief digital officer" and have them drive it. Sometimes the role is viewed as the natural extension of what a chief marketing officer does. I actually think that it's less dependent on the role. It's much more dependent on the person. If the person is someone that is able to visualize a future, get the organization rallying around a bunch of different objectives, and inspire people to actually pursue that path, it's their real leadership capabilities that'll come to bear to pull off digital agendas.

Core processes vs. new technologies

This is a hot topic for banks. The issue of having to deal with legacy platforms has been a thorn in their side for such a long time, because technology continues to do what it always does: it evolves. I can imagine one taking a pessimistic view of this and saying, "We have been working at this for so many years. We haven't figured it out."

The optimistic view—and I'm prone to that view—is there are very few institutions that are adept at understanding and trying to figure out how to embrace and work with new technologiesas banks are. The discontinuity I see right now is that the technologies that people are working with, with Google and Apple and so on, are very different from the technologies that people that have worked in the tech area at banks have grown up with, and the capabilities that they've grown up with.

So I can imagine a bit of a disconnect. And there's going to be some furious paddling required to cross this pond. More progressive incumbent banks and financial institutions are already investing heavily in transaction migration, significantly upgrading web and mobile capabilities, creating centers for innovation and testing, and adopting the habits and culture of digitally native companies by, for example, opening up APIs,[1] pursuing agile development, and hackathons.

Some banks say that they have not yet learned some of the important skills that digitally native companies have from birth: how to visualize and participate in far more broadly defined customer journeys—such as shopping, travel, and vacation—as opposed to product-level processes, account opening, and onboarding; how to match or outperform digital natives in user experience or user interfaces; how to become deeply proficient in technologies, data, and the rapid experimentation of leveraging them; how to tolerate failures in experimentation; how to acquire or imitate high-value capabilities early; and how to develop a highly prioritized agenda that leverages digital to truly differentiate business models and key customer journeys.

Will banks get there? They always do. They will. But I can see there being, at least from a talent standpoint, some reshuffling required at a pretty rapid pace. When technology is so central to what you do, the scale of the change that is required is actually quite immense. How do you decide how much to invest in maintaining the core banking platforms versus building new functionality? Could you overdo functionality and starve platforms and suffer from it at some point in the future?

[1] Application programming interface.

Changing the efficiency ratio

The efficiency ratio is a metric that many analysts look at very carefully. The simplest way to think about it is the expense base of the bank divided into its revenue. There are lots of adjustments that analysts make. But simply think of it as: What is the cost that I incur for every dollar of revenue I produce?

Digital changes that paradigm. The ability to automate processes—to take a lot of work that is currently done in a very manual, and therefore error-prone, way and to transform those processes into ones that deliver the same outcome every time and that eliminate a lot of manual work— can shave off large parts of the cost structure that bank CEOs have considered unapproachable until now.

I can imagine us about five, ten years from now talking about efficiency ratios in the low 40s, high 30s. The value at stake is quite substantial. Between a 30-percent plus and a 20-percent minus, in terms of value shifts, could be achieved through those that actually adopt and embrace high-quality digital strategies early, versus those that don't. ☐

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[2] Today, typical efficiency ratios are in the low 60s, high 50s.