TRANSFORMING RETAIL BANKING DISTRIBUTION

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THE EVOLUTION OF THE MISMATCH BETWEEN DEMAND AND SUPPLY

Retail banks face a discontinuity. If they want to keep pace with their customers, in ten years’ time they must look very different from today.

Customer behaviour has already changed dramatically in the last decade:

- Branch traffic has decreased significantly and we forecast a further decrease of 20-30% in the next decade across Europe with some countries showing even greater declines. The use of direct channels will continue to rise across Europe, driving the change in branch usage (Exhibit 1)
- As a consequence, incumbent retail banks will see the percentage of “fully remote” customers (with no yearly interactions with the branches) rise from current levels of 20-30% to nearer 50-60%

This effect will be amplified by two factors: the “Apple wave” (growth in smartphone and tablet usage) increasing the convenience of digital self-service banking and the maturing of a new, and, in future, wealthier technology and web-oriented generation

- Customer service level expectations are changing and are strongly influenced by immediacy and convenience of direct channels. In the near future banks will need to find convincing reasons for customers to visit their branches

Despite this clear shift in customer demand, a coherent evolution of the supply of retail banking has not yet emerged:

- Tellers’ operational productivity has decreased by more than 50% during the last 10 years, especially in big branches, with no compensating increase in the commercial value of their work (Exhibit 2)
- Branches’ outbound activity has not reacted sufficiently to the decrease in inbound traffic. Our research indicates that less than 40% of customers usually receive a yearly proactive contact from their branch. This threatens revenues. Today “fully remote” customers typically contribute revenues that are 40 to 50% lower than multichannel customers with a similar profile (assets, income, age etc) who maintain an ongoing relationship with the branch. Continuation of this trend, if accompanied by a change in purchasing behaviour, could additionally squeeze incumbent retail bank revenues by a further 15 to 20% within the next five years
- The huge volumes of inbound contacts via direct channels are rarely exploited for cross and up-selling due to weak processes and infrastructure. Fully remote sales still represent less than 10% of total sales in Europe, although substantial strides have been made recently in more developed markets proving that this potential exists
EXHIBIT 1: DEMAND EVOLUTION

CURRENT CHANNELS UTILISATION

TRANSACTIONS MULTICHANNEL DISTRIBUTION (AVG EU VALUES, INDIVIDUALS, NORDICS EXCLUDED)

<table>
<thead>
<tr>
<th>Channel</th>
<th>Operations Per Year (#)†</th>
<th>Penetration*</th>
</tr>
</thead>
<tbody>
<tr>
<td>Branch</td>
<td>~ 70%</td>
<td>6-8</td>
</tr>
<tr>
<td>Internet</td>
<td>~ 50%</td>
<td>100-120</td>
</tr>
<tr>
<td>Telephone</td>
<td>~ 4%</td>
<td>5-6</td>
</tr>
<tr>
<td>ATM</td>
<td>~ 70%</td>
<td>30-40</td>
</tr>
<tr>
<td>Mobile</td>
<td>0-0.5%</td>
<td>N/A</td>
</tr>
</tbody>
</table>

BRANCH TRAFFIC EVOLUTION (2020E) – EXAMPLE OF THE ITALIAN MARKET

<table>
<thead>
<tr>
<th>Evolution Drivers</th>
<th>Expected Variation (Δ%) by Quartiles of Branches</th>
</tr>
</thead>
<tbody>
<tr>
<td>Demographics</td>
<td>Q1 (High) -30%</td>
</tr>
<tr>
<td>Cash transactions</td>
<td>Q2 -20%</td>
</tr>
<tr>
<td>Age buckets size</td>
<td>Q3 -18%</td>
</tr>
<tr>
<td>“Cohorts effect” on behaviours</td>
<td>Q4 (Low) -10%</td>
</tr>
<tr>
<td>“On line banking” growth</td>
<td>AVG: -20%</td>
</tr>
<tr>
<td>Wired transactions further migration</td>
<td></td>
</tr>
<tr>
<td>Increasing appetite for direct purchases</td>
<td></td>
</tr>
</tbody>
</table>

Source: Oliver Wyman multichannel survey 2010; trends based on Oliver Wyman analysis on client’s data

* % of customers using the channel at least once a year
† Average among channel users
‡ Including info enquiries

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A RAPIDLY CHANGING INDUSTRY: A CLEAR CALL TO CHANGE

At the same time external factors are accelerating the development of retail banking distribution, putting pressure on the industry’s economics. A weak macro-economic growth rate, low interest rates, intense competition across countries and industries, increasing customer protection, higher costs of funding, higher capital requirements and cost of equity will severely deplete retail banking revenue.

Banks must adapt to the industry’s transformation agenda by moving away from expensive paradigms of the past:

- The clear separation between tellers and commercial roles. This is no longer effective or efficient for managing inbound branch traffic
- Portfolio-based service models for affluent and small business customers. Segmentation is too basic, under-serving the most valuable customers and does not work in smaller branches
- The model of doing everything, everywhere (each branch, each direct channel) no matter branch size and channel peculiarities. Banks can no longer afford this and need to be more selective, agreeing on a specific role for different types of branches and channels

It is essential to rethink the role of physical channels in the new multichannel context. The final objective must be to deliver a better and simpler service with fewer resources. Without this clear change in the distribution model, neither distribution effectiveness nor cost to serve will improve to the degree required by the economics of tomorrow’s retail banking markets.
A RETAIL DISTRIBUTION TRANSFORMATION AGENDA

Our proposed transformation agenda focuses on three initiatives:

1. Redefine and re-size branch coverage
2. Deliver on customer experience
3. Enhance capabilities in digital channels

1. REDEFINE AND RE-SIZE BRANCH COVERAGE

Branch resources must be better aligned with traffic volumes, customer complexity and value. This implies wide-reaching changes in branches’ roles and format and in the delivery of specialised services to premium customers.

1.1 RETHINK THE “BASIC LAYER” OF BRANCH SERVICE

The basic branch format (roles and layout) must be completely reviewed to align costs with value and improve customer experience. The first step is to create a front line of customer assistants (CA) merging the roles of teller and basic relationship manager (Exhibit 3). These CAs, fully trained in the commercial chain, processes and tools (e.g. commercial workstations), will welcome all customers in dedicated areas. They will:

• Address all basic needs (“over the counter” sales, enquiries and transactions using simple cash in-cash out machines)
• Exploit cross-selling opportunities using inbound traffic marketing triggers (generally conversion rates are four to six times greater than outbound campaigns)
• Show direct channels’ convenience and help customers during the early stages of use

CAs need to be provided with fully guided sales processes (“wizard”-like). For instance, they need a simple and fully automated credit process to directly manage basic credit inquiries and give quick answers to customers.
EXHIBIT 3: RETHINK THE BASIC “LAYER” OF PHYSICAL SERVICE

FROM

Entrance

Print Manager

Tellers

Generic Customer Assistants (GCA)

RM

TO

Entrance

Branch Manager

Generic Customer Assistants (GCA)

• Serve all customers’ basic needs (sales, enquiries and transactions when it’s needed)
• Fully commercially “on board” (processes, workstation, leads)
• Use all “face 2 face” contacts to create human relationship, understand needs, and…sell
• Explain and promote the value added (for the customer) of direct channels

1.2 IMPROVE ALIGNMENT OF SPECIALIST COVERAGE

Premium and specialised service must be delivered only to those customers whose needs are sufficient complex to require it and sufficient value to justify it. This target group is much smaller than the one served by most banks using a portfolio-based service model. It requires specialised professionals in order to ensure high quality delivery – meaning fewer, higher quality advisers serving fewer more valuable clients. This means that specialists will regularly be multi-branch and increasingly multi-channel.

In this scenario, dedicated RMs will typically be suitable only for complex upper affluent and small enterprises (up to €7 MM turnover) with composite working capital and investment needs. Such specialists will often be multi-branch and should be able to contact their clients according to their preferences (phone, mail, video call, etc.).
1.3. RESIZE THE NETWORK

Given changes in branch traffic, underlying economics and customer value, banks must review their local presence by analysing the attractiveness of each micro market and optimising location selection. Typically this will mean fewer branches (particularly in micro-markets with multiple branches) with fewer staff in those remaining, in part driven by changes to the service and specialist coverage roles outlined above.

Small standalone branches operating a standard branch model will perform poorly in this evaluation. The costs of under utilised specialised staff are typically too high relative to the value of the customer base. These smallest branches need to evolve from a standard model to a spoke or satellite model to cover their micro-market at a lower cost.
2. DELIVER ON CUSTOMER EXPERIENCE

Customers have become more demanding and are less satisfied than ever with their retail banks. This has a real financial cost. A recent Oliver Wyman project has shown that 1-2\% of annual revenues are lost via “avoidable attrition”. This can be prevented with a stronger customer service discipline.

It is now time for retail banks to change their mindsets and focus on creating a great customer experience by removing many of the industry’s compromises that customers are still forced to accept, such as unclear card fraud prevention processes, poorly targeted outbound calls, complex and counter intuitive online sales processes. Removing these customer hassles is the only way for a bank to differentiate itself and create a competitive advantage in this increasingly commoditised and trust-based industry.

How to do it?

1) Work out what matters to customers and what type of experience is required:
   • Excellence on the critical “moments of truth” (1 out of 20 interactions) where significant customer goodwill can be created or destroyed
   • Everywhere else, a great customer experience makes the bank “invisible” by delivering an error-free, hassle-free process that simplifies the customer’s life

2) Apply strict disciplines to the centre and in the front line.

In the centre:
   • Drive for simplicity in products, processes, and channel interfaces re-design
   • Define the role of each channel
   • Establish a central customer experience team to drive change

In the front line:
   • Ensure a clear and consistent understanding of the target customer experience. Create a practical “customer experience handbook” with a limited set of specific “calls to action” and behaviours (distilled into simple shorthand) that front line can easily grasp and work with
   • Monitor and report performance and propagate best practice
     - Recognise that sales and services are not exclusive: good services start with good sales and vice versa
     - Align individual performance management and incentives with the desired behavioural change
3. ENHANCE CAPABILITIES IN DIGITAL CHANNELS

Despite the substantial investments made by all banks in Europe, the massive volume of customer interactions via direct channels is rarely exploited for retention, acquisition, cross sell or upsell.

To take advantage of this huge opportunity, retail banks need to switch their remote channels focus from transactions to customer experience and sales. This requires banks to develop three new capabilities:

1. Develop trigger marketing to hook clients at the right time. The process is quite complex but the payoff is great: conversion can be 2-3 times higher than in traditional outbound campaign.

2. Develop digital processes to enable a fully remote sale. This requires banks to completely rethink their sale processes for basic products (savings accounts, cash advance, personal loans, credit cards) and “side” products (P&C insurances, pre-paid cards). These are familiar to customers and could be bought in immediate or “impulsive” purchases.

3. Build customer intelligence and analytics to deliver dynamic pricing and marketing strategies.

4. Direct channels allow demand elasticity for different periods, type of products and type of customers to be tested by launching an instant online offering with a small variation of the proposed price (as airline companies often do).

START THE CHANGE NOW

Retail banks must keep pace with their customers. Market and regulatory challenges are necessitating some major changes to banks’ distribution. To deliver the retail bank of the future, incumbent players must operate with fewer, more effective branches; they must simplify customers’ experience; and they must invest in building their capabilities in digital channels.
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