THE URGENT BUSINESS MODEL CHOICES FACING RETAIL AND COMMERCIAL BANKS: WHAT STYLE OF SHOE DO YOU WANT?

WINNING IN THE DIGITAL ECONOMY
“...if you don’t make your own decisions, someone else will make them for you.”

— Ronald Reagan, former US President
Back in the day when shoes were handmade, former US President Ronald Reagan went to order a pair from a local cobbler. The cobbler asked young Reagan, “Do you want square toes or round toes?”

Reagan could not decide, so the cobbler gave him time to think about it. A few days later, the cobbler asked him again. When Reagan still could not decide, the cobbler said, “Well, come back in a couple of days. Your shoes will be ready.” When Reagan returned, he found one square-toed and one round-toed shoe waiting for him. “This will teach you to never let people make decisions for you,” the cobbler said to his indecisive customer. Reagan later commented, “I learned right there and then that if you don’t make your own decisions, someone else will make them for you.”

The danger many retail and commercial banks now face is similar to that of the young Reagan. By hedging their bets and failing to make clear business model choices, they run the risk that other more decisive actors will dictate the evolution of the banking industry, leaving the incumbents either barefoot or with mismatched shoes that limit their ability to compete.

It is clear that the global retail and commercial banking industry is changing. Uber is probably the largest originator of small business checking accounts in the US. The company’s interest in banking is an outgrowth of their business model, with ease of payment greasing the wheels of the critical driver sign-up process. India’s Aadhaar biometric system now makes it easier to open a personal checking account in Bangalore than in Birmingham (England or Alabama); and a barely-decade-old newcomer like Alibaba Group affiliate Ant Financial has a valuation of $60 billion, which puts it among the top 30 global banks.

Pressured by inhospitable macroeconomics, increased regulation, and an erosion of their privileged place in the economy, there is now plenty of evidence that the traditional shoes of the banking industry are wearing thin. However, it is dangerous to think of retail and commercial banking as a homogenous global industry, because the extent of the wear and tear varies greatly by country. In markets like Canada and Australia that have maintained robust shareholder returns and stable industry structures, a quick repair trip to the cobblers may suffice. In other more disrupted markets, quick fixes such as adding more analytics and mobile apps could be like buying new laces for shoes that have holes in their soles. For banks in these markets, it is time to go shopping for a brand-new pair of shoes that will be fit for purpose in a digital world.

In this report, Accenture explores why the traditional business models of retail and commercial banking may be wearing out, and describes four directions that could allow banks to win in the digital economy.
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The pressures on the traditional retail and commercial banking business model arise from three distinct factors that together are reshaping what successful business models might look like: macroeconomics, regulation and market maturity.

**Macroeconomics**
Banking is a derivative industry that relies on underlying economic growth to create new balance sheet assets and liabilities. When the economy struggles, the impact is felt in non-performing loans and balance sheet write-offs. The spread on balance sheet assets is then determined by the interest rate environment, while the amount of fee income is also driven by levels of economic activity like payments and investments. This close connection between the economics of banking and the underlying economy is part of the reason why banks in Canada, Australia and many parts of Asia have recently done well, as those economies were less traumatized by the great financial crisis than the US and Europe. It is also part of the reason why banks in continental Europe are still struggling, as Eurozone economies continue to find it difficult to maintain meaningful economic growth, lower unemployment, and shed non-performing assets.

A specific cause of pressure in many geographies is the sustained “long and low” interest rate environment that has compressed the spreads that traditionally account for some 60 percent² of retail and commercial banks’ income. When rates are close to zero or, in the case of some markets, negative, the ability of banks to earn an attractive return on assets to spread across their fixed cost base is greatly diminished. When there is a glimmer of hope of long-term rising rates (as is currently the case in the US), we see bank valuations respond accordingly. Yet, with expectations of a rate cycle that may peak at around 3.5 percent for US 10-year Treasury Bills, the amount of spread expansion may be limited. There is also legitimate fear that with more restrictions on global trade on the horizon, emerging market economies that rely on exports may see their credit expansion (fueled by cheap money) morph into a sharp decline in credit quality and a spike in write-offs.

**Regulation**
Following the financial crisis, the pressures on retail and commercial banks from increased regulation are coming from two directions. The first is attempts to de-risk banking through increased capital levels, rigorous compliance processes, and stringent conduct regulation. The steep rise in capital levels post-crisis means that banking has become a lot safer, but also that shareholder returns have been depressed. De-risking affects product-level economics. For example, the all-in cost to originate a US residential mortgage more than doubled between 2007 and 2016.³ However, de-risking also reshapes business portfolios. High capital requirements, for instance, forced Swiss banks to exit a lot of the capital markets businesses and prompted major commercial lenders like GE Capital to decide that being regulated like a bank was no longer attractive.

A second type of regulation, and one which potentially has longer lasting
effects on business model choice, is regulation that seeks to actively change the competitive dynamics of the banking sector. In Europe, the Payment Services Directive 2 (PSD2) will break the link between underlying current accounts and the initiation of payments from them, and could help put 43 percent of bank payments revenue at risk over the next five years. In the UK, the Open Banking initiative goes further and aims to atomize many traditionally integrated banking services to encourage more competition. The introduction of regulatory sandboxes and tiered banking licenses are also intended to tempt more players into the banking sector. GAFAs (Google, Amazon®, Facebook® and Apple®) and financial technology (fintech) companies are taking advantage of existing regulations and regulatory gaps. They are breaking up the value chain for incumbents and focusing on customer interaction rather than manufacturing. While other markets have not gone as far as the UK in breaking up the traditional bank value chain, regulations like Client Relationship Model 2 in Canada and the proposed Department of Labor Fiduciary Rule in the US are intended to introduce more transparency and consumer advocacy into the wealth advisory business. At the broadest level, these competitive regulations are creating an environment in which digital newcomers—from crowdfunded startups to the GAFA giants—are being encouraged to encroach on the traditional bank business model.

**Bank model maturity**

The third factor undermining the traditional bank business model is the maturity of the industry, both in terms of the institutions themselves and the consumers using their services. This is where we see a vastly different pace of change and rotation to new business models by market. Across the board, the growth of fintech is pushing the industry to foster innovation much faster than in the past and is helping some segments like payments mature quickly. Banks will need to consider in far clearer detail how fintech relates to business choices they are making now, and how it will continue to propel bank services to customers in developed and emerging markets.

For a consumer in rural India who has never had a bank account or used a branch, credit card or ATM, the idea that banking is something you only do on your phone is far less radical than
it is for a 65-year-old retiree in many developed markets. Looking closer at this distinction in our Global Financial Services Distribution & Marketing Consumer Study, we identified 40 percent of global consumers as banking “Nomads” who are ready to cut the cord and deal with non-traditional providers (Figure 1). With the rapid growth of fintech point solutions, it is now possible for consumers to create a reasonable facsimile of a traditional banking relationship from component parts that they integrate themselves. In many emerging markets where the traditional banking model is less established, Nomads represent 60 to 70 percent of the market. Interestingly, they are also prevalent in markets like Italy where many customers have lost confidence in traditional banking. Conversely, in stable, well-performing banking markets like Canada and Scandinavia, Nomads number only in the 25 percent range. It indicates that the willingness of consumers to engage with new banking business models is very much dependent on their experience with their traditional providers.

Not only is customers’ stated willingness to switch to new business models clearly increasing, we are now also seeing an increase in actual customer migration. Accenture research shows that consumers are now switching to virtual banks at double-digit levels. This rate of migration suggests that some 30 to 35 percent of retail and commercial banking revenues could be at risk by 2020.

The mix and interplay of these three factors (macroeconomics, regulation and market maturity) is why banks’ performance across various markets look so different. For example, a stable industry with reasonable returns in Canada and Australia; no revenue growth, unattractive returns, and an increasingly active and successful non-bank financial sector in the US (both traditional and fintech); and very rapid rotation and value migration to new digital business models in China and Southeast Asia.

While the nature and pace of change may be market-specific, there is plenty of evidence that the old shoes of the industry are wearing out. There is an inexorable shift occurring towards a set of new business models in the retail and commercial banking sector.

A recent Brookings Institution report assessed pre- and post-crisis financial performance data for the world’s 50 largest financial institutions. What it found was stark. Pre-crisis investors believed not only in the returns inherent in the traditional banking model, but also in its capacity for growth. Post-crisis, outside of a handful of markets, investors see both current returns at or below the cost of capital, but also little future value in the traditional banking business model. In many European markets, investors seem to have come to terms with a new normal in which the banking industry generates no shareholder value.
value. The reasons for the pessimism are market-specific and a combination of the three factors described previously. Still, the implication is clear: banks that are not capable of reinventing their business model are likely to be marginalized over time.

Accenture’s own research on the future growth value (FGV) of industry participants also paints a bleak picture, showing that financial institutions lagging in their digital transformation have a discounted FGV of -11 percent. They trail behind digital leaders (financial institutions that have launched an aggressive digital transformation program) at +20 percent, fintechs at +40 percent, and GAFA at +49 percent, as shown in Figure 2.

Even with the prospect of rising interest rates and potentially a pull back of regulation in some markets, the result is likely to be that traditional retail and commercial banks may survive, but are unlikely to thrive. The reality is that the traditional model of a vertically-integrated banking industry, where an institution with an insured and regulated balance sheet manufactures most of its products and manages its own physical and digital distribution channels, may be coming to the end of its “s” or growth curve. Banks that hope to thrive a decade from now will need to jump to the next curve.

That transition is already underway in some markets. In China, for example, 11-year-old Alipay™ already has half a billion customers and processes some 175 million transactions a day, which dwarfs PayPal® and is rapidly catching up to traditional industry players. The rapid growth of digital banking in China has also created an environment in which new digital product adoption is accelerated. It took Alipay less than a year for its retail credit scoring service to reach tens of millions of users, and the Industrial & Commercial Bank of China took only 204 days to hit 10 billion yuan generated from its new e-commerce website—far less time than the seven-year average for a startup to reach that volume.20

Outside of fast-rotation markets like China, disruptive change for most retail and commercial banks is still on the horizon rather than at their doorstep. In the US, for example, end-to-end digital sales are still on average in the low single digits, and

**FIGURE 2. Banking Future Growth Value Analysis***

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<th>GAFA</th>
<th>Fintech</th>
<th>Bank Digital Leader</th>
<th>Bank Digital Laggard</th>
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<tr>
<td>49%</td>
<td>40%</td>
<td>20%</td>
<td>-11%</td>
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*Methodology
The analysis of future growth value referred to in this paper was developed by Accenture Research based on financial performance, as of March 2017, of Google, Apple, Facebook, Amazon, Alibaba, 40 listed fintech companies (e.g. card networks, payments processors, software vendors, P2P lenders, robo-advisors etc.) and 73 banks. The analysis depicts the breakdown of the enterprise value of a firm into current operations value and future value of investments. The value of current operations is the value of the current business portfolio. The future value of investments reflects investors’ expectations regarding ability to exceed the value of current operations. A positive future growth value is a premium investors are willing to pay beyond the value of current operations. The analysis also includes a qualitative assessment of the digital capabilities of 73 large banks worldwide. We identified 22 digital leader banks that have been more vocal about their digital strategies than others. These leaders show common traits. For example, their leadership have clearly set future direction announcing multi-year digital transformation plans, released multiple digital services, appointed chief innovation officers to identify new partners, managed innovation labs, invested in multiple fintech companies, attracted talent, and established new relationships to adopt new financial technologies.
the true value migration to the much-talked-about fintech sector is, thus far, limited (although with more than $15 billion invested in fintech in 2016 alone,11 the emergence of alternative banking models at scale is on its way). Even impressive numbers by banking newcomers—for example, Starbucks® driving over 30 percent of its US payments transactions via its mobile app12 or PayPal having 197 million active customer accounts, up 10 percent in 201613—are dwarfed by the payments and liabilities in the traditional banking sector.

This creates a window of opportunity for retail and commercial banks in most developed markets. While the evidence from fast-rotation markets is that radical change is coming, for the moment the shoes of the traditional banks are merely showing signs of wear and tear, rather than gaping holes in their soles. In this window, retail and commercial banks need to become the best version of themselves, optimizing their current business model to create the fuel for growth necessary to make the critical jump to the next s-curve (Figure 3). This means taking what is good about the traditional banking model (complex advisory services, transactional trust, and physical distribution), and blending it with the best of new models (elegant, paperless, low-cost solutions delivered through digital native technology that put the customers in control) to simultaneously satisfy customers, regulators, and shareholders.

While this optimization is consuming the vast majority of management time and investment dollars in most retail and commercial banks, it does not mean that banks can ignore the question of what success on the next s-curve looks like.
If the old business model of retail and commercial banking is wearing thin, then what do the new shoes that are fit for purpose in a digital world look like? There is no one answer to this question, and one of the characteristics of the next decade will be more diversity of business models in the sector. However, as Reagan found out, that does not mean that banks do not need to make a decision. Based on Accenture’s market analysis and our experience working with both established and de novo financial institutions, we believe there are four archetypal business models that can be successful in retail and commercial banking: Digital Relationship Manager, Digital Category Killer, Open Platform Player, and Utility Provider (Figure 4) with the potential continued evolution of the Digital Relationship Manager to Banking as a Living Business (see “Exploring further evolution: Banking as a Living Business”). The four business models are not mutually exclusive and are defined by choices on two dimensions: the breadth of product offering a bank will make to its customers, and how much of the industry’s value chain a bank is seeking to participate in.

Variations on these four archetypes will exist and many institutions may try to stitch together combinations of them into more complex business models. However, we believe there is value in the clarity that comes from looking at each model in isolation.

**FIGURE 4.** Archetypal bank business models fit for the digital future…and beyond

Source: Accenture

**A travel agency future for banks?**

The danger for banks in responding to the threats they face is not that they disappear, but rather that they become the travel agents of financial services.

Traditional travel agency locations in the US peaked in the mid-1990s at 34,000. Rather than being destroyed by Expedia® and Travelocity® (the way Netflix destroyed Blockbuster), travel agents instead experienced a slow decline. The remaining 13,000 or so retail locations are now complex travel advisory businesses that serve narrow niches, like cruises, multi-destination trips, and group travel, that are not easily booked through a website or app. Overtime, as the functionality of direct booking sites improves and they begin to deploy artificial intelligence (AI) that can advise and direct on complex requests, the niche served by the traditional in-person agencies will continue to narrow and the number of physical locations will continue to decline. Banks that fail to jump to the next s-curve risk a similar fate, ceding more and more competitive ground to new entrants, while slowly retreating to a narrower business model that requires a higher level of service than can currently be provided without human intermediation.
DIGITAL RELATIONSHIP MANAGER

Is likely to be the first choice for most retail and commercial banks
On the surface, the Digital Relationship Manager looks evolutionary rather than revolutionary, in that it seeks to use a vertically-integrated bank business model (balance sheet, product manufacturing and distribution) to serve a wide range of customer needs and segments. As such, it would be easy to characterize it as just a digital version of a traditional retail and commercial bank. However, any complacency in that assessment underestimates the radical change required in most banks to deliver a compelling version of this business model in a world where nearly 50 percent of customers have already decided that traditional banks may not be necessary in the future.

This business model done well is indeed a new pair of shoes, not just a resoling of a comfortable old pair. Being a compelling Digital Relationship Manager means delivering:

- True “phygit” banking that facilitates a seamless flow of information and transactions across integrated physical and digital channels. It does not mean focusing on digital and letting physical touchpoints atrophy. One of the clearest conclusions from Accenture’s consumer research over the last couple of years is that as the digital experience for consumers dramatically improved, their satisfaction with omni-channel service markedly deteriorated. This is not because the performance of branches and call centers declined; it is because the service bar got higher. Today, customers get frustrated when they walk into a branch and find that they can learn more about their finances by using their smartphone than what Customer Service Representatives know looking at their outdated terminals.
- True customer centricity through real-time personalization that delivers hyper-relevant contextual advice (based on internal and external data feeds, such as geolocation, search, and social media) at the moment customers and bank staff need it (both proactive and reactive). This involves creating and maintaining a complete customer genome at a level of completeness that is at least comparable to the GAFA’s ability to understand customers’ needs and respond accordingly.
- Solutions, not products, that solve customers’ problems and do not force them into complex product categories often designed to maximize bank profitability rather than address a need. A survey from Blumberg Capital found that 75 percent of Americans believe fintech gives them more power over their finances, indicating consumer preference for solutions. Over 70 percent of the customers Accenture polled are now willing to accept banking product advice from a robo-adviser, but for the bank to capture higher share of wallet that advice will need to be unbiased and value-added. Ultimately, banking products need to collapse into a small number of offering categories like save, borrow, and pay. The true Digital Relationship Manager will use AI and human advisers to deliver the right solutions to meet these needs, and keep a lot of the complexity behind the curtain—if it can build the trust that the bank is always acting in its customers’ best interests.
- A curated ecosystem that brings the best of third-party products to the table and integrates them seamlessly with the bank’s own services. The Digital Relationship Manager will also think about expanding its participation in the value chain to broader solutions where the financial product is an anchor in the transaction,
for example, home buying, car buying, or retirement planning. Many such products and services may come from third parties, but be integrated by the bank. In other cases, it will mean allowing customers to connect to external services, particularly for things, like payments, that are likely to be embedded in other non-bank transactions. As such, the bank will be happy to make money “on GAFA”.

• A compelling reason for customers to consolidate multiple products with the same institution. Part of this will come from ease of use, the seamless nature of cross-product interactions, and the emotional affinity that this creates. Still, banks will also need to offer an economic incentive that goes beyond “reward point” type schemes to provide a truly compelling reason for consumers to consolidate, rather than fragment, their banking.

Without high levels of advisory trust, this will be impossible, as customers will always be on the lookout for how they are being fleeced. Instead, a true Digital Relationship Manager will provide transparent and frequent evidence that it is always working to benefit the customer.

• Shareholder returns, by executing the model at a cost that allows it to make a reasonable economic return on a broad mix of customers. This means getting the physical-digital distribution mix right and continuously adapting it as customer behavior migrates. It also means using technology to automate and strip costs out of administrative functions. A bank that aspires to be a Digital Relationship Manager without addressing the cost to deliver will ultimately end up like travel agents, delivering a high-cost advice model to a continually shrinking segment of the population.

Being a Digital Relationship Manager is likely to be the first choice for most retail and commercial banks as they seek to win in a digital world. As the above shows, while the intent is broadly the same, the execution will need to be exceptional to truly differentiate. One critical component is an open model/API approach that facilitates, manages, and differentiates a seamless, competitive, personalized, and relevant customer experience. In
areas like housing, such an experience may go far beyond the traditional bank credit offering to facilitate an end-to-end customer mortgage journey.

The Digital Relationship Manager will likely offer free banking for basic transactional services while generating revenue and value from balance sheet spreads, commissions, and the monetization of cross-offerings and data. It will protect margins through digital operations and products, efficient cost management through scale advantages and process standardization, and use IT and data as strategic enablers of better customer insights and relationships.

**THE UPSIDE**

This is a revolution, not an evolution, of traditional retail and commercial banking. It uses the breadth of the customer relationship to differentiate the entire offering. In a world where there is likely to be deflationary pressure on many fee sources from payments to investment management, this is also a business that protects the economic engine of the integrated bank balance sheet and likely generates the majority of its economic value from interest rate spreads.

**THE DOWNSIDE**

This is revolution, not evolution, and hence not every traditional retail and commercial bank will be able to make this type of transition. For most banks, this is an aspirational ambition and the cost of getting there will be material and possibly prohibitive. Without an optimized traditional model that provides plenty of fuel for growth, many banks will simply not have the investment capacity to stay competitive. There is already a visible trend in which big banks are pulling ahead in terms of customer service with millennials and affluent consumers because they have the capacity to invest at scale in a digital customer experience. Ultimately, a lot of transactional banking will disappear beneath the waves of the digital economy. The Digital Relationship Manager will need to master the art of pulling customers back into an advisory conversation at the right time with the right proposition, and convince customers that it is a more attractive proposition than building their own bank from component parts.
DIGITAL CATEGORY KILLER

Provides best-in-class branded value proposition and technology-driven product and service.
The Digital Category Killer focuses on doing one thing very well. It wins by providing a best-in-class branded value proposition and technology-driven product and service features (ease of use, rich functionality, value-added services through partners, and so forth). It serves a narrow set of customer needs while keeping its own value chain participation high. Today’s exemplars range from PayPal in payments to Quicken Loans® in mortgage to Betterment in wealth management.

A Digital Category Killer maximizes distribution through multiple channels and specialist partners to serve the highest number of customers who need the product. It earns returns through some combination of commission fees, subscription fees, interest income, and data monetization. A Digital Category Killer also relies on continuous product and service innovation to stay ahead of customer expectations and helps develop the market for its product. Typically, it only draws on a limited number of key ecosystem suppliers, as most functions are covered in-house. It has the option to broaden its offerings over time to become a more full-service digital bank. In doing so, however, it jeopardizes what made it successful in the first place.

THE UPSIDE

While this business model would be an unlikely option for incumbent banks, it is the natural home of fintechs, with the combination of brand, people, process, technology, and scale as the basis for market domination. Such focus allows the Digital Category Killer to raise its metabolic rate and keep ahead of competition. While the digital mortgage experience offered by Rocket Mortgage® in the US is by no means perfect, it raised the bar in home financing and forced every other player in the market to react or continue to shed market share. Done well, the Category Killer can force itself into new distribution channels (like being a provider to a Digital Relationship Manager or an Open Platform Player) because it creates customer demand.

THE DOWNSIDE

The competitive advantage of doing one thing very well is reliance on others not being able to do many things equally as well. In essence, the success of a Digital Category Killer is dependent on banks not being able to master the Digital Relationship Manager model previously detailed. If they do, the pressures that can be exerted on narrow niche players include superior funding costs, better personalization using cross-product data, and consolidation incentives targeted at undermining the economics of a Digital Category Killer. Because of the focus on doing one thing well, it can also be difficult to diversify and look for a way to expand and enhance that single offering. Twitter struggles because it does one thing well and has not yet been able to broaden its product offering. In financial services, Square® made card acceptance possible for millions of small merchants, but its attempts to diversify beyond that niche have yielded little success. Ultimately, the danger is that a narrow business model can mean limited growth or, even worse, extinction when the next better thing comes along.
OPEN PLATFORM PLAYER

A platform through which other providers can interact with customers, create and sell products and share value.
An Open Platform Player narrows its participation in the traditional value chain while attempting to maintain the full breadth of customer relationship. It masters a customer-centered platform through which other product providers (most likely Digital Category Killers and Utility Providers) can interact with customers, create and sell products and services, and share value. The platform, whether core financial services-specific or cross-industry, aggregates services in a way that creates an engaging and sticky customer experience on top (via multiple supplier options, user-generated content, and compelling experiences) and partner relationships underneath (via shared basic functions like open APIs, digital identity management, digital risk and compliance management, customer data and brokerage services, and the ability to share customer views with suppliers to help generate incremental revenues).

The Open Platform Player views its ecosystem as the engine of growth, building a portfolio of products and services around a set of core offerings, which in financial services could be a transaction account. As such, efficiency in supplier and partner management for speedy onboarding of new and multiple partners, including fintechs, is critical. The economic driver for a digital Open Platform Player is enormous liquidity and engagement, ease of interaction, and seamless integration of products and services. For example, an Open Platform Provider could further extend the skills of intelligent automated systems, like Amazon’s Alexa®, by linking together banks to then allow customers to transfer money between accounts in different banks. Because the Open Platform Player does not manufacture balance sheet products, its principal revenue sources are commission fees (for third-party products and services), service or subscription fees, and the monetization of data through either advertising or value-added services direct to consumers. Think Moven®, solarisBank, or Level MoneySM.

There is also a physical version of the Open Platform Player. In this case, a traditional bank sheds its balance sheet and focuses on customer management and advice through a mix of physical and digital channels that offer third-party products. While the long-term prospects of this model may look unattractive, as more and more transactions and advisory conversations move online, a platform model focused on high-touch sectors like small business and the affluent could have a decade-long run of success. In essence, this is the travel agent strategy of sourcing third-party products and staying relevant through physical distribution and advice provision.

**THE UPSIDE**

Our consumer survey indicates that an increasing number of customers are willing to build their own bank through this type of platform. Many of the challenger and neo-banks being launched in Europe have a platform business model that promises to deliver best-in-breed products through an engaging customer experience. There is also the possibility in both physical and digital channels to build truly product-agnostic advisory services.
capabilities that have a higher level of inherent trust than advice offered by a player that also manufactures its own products. However, the digital version of the platform model is likely to be most attractive to new entrants or non-bank platform owners that do not have an existing customer base. Any large incumbent bank with a balance sheet-driven business may experiment at the margins with this type of model (adding external loan products to the Digital Relationship Manager model). However, they are unlikely to cannibalize the core of their own business as the economics of referral fees and advertising revenue will likely be unattractive compared to balance sheet spreads on hundreds of billions of dollars of assets and liabilities. In contrast, a physical open platform model may be attractive to smaller banks that believe they can source market-leading digital capabilities and products from third parties and, therefore, may choose to simply function as an intermediary for those customers who value the channel.

**THE DOWNSIDE**

There are two big downsides to the Open Platform Player model. First, the broader tech world is converging around a limited number of multi-functional platforms that include financial services as just one part of their offering. In Asia, the WeChat messaging platform has over 700 million active users who can do a huge array of things, from booking a doctor’s appointment to hailing a cab to adjusting the temperature in their house—all without leaving the app. They can also conduct transactional banking and apply for a loan. We are now past “peak app” on mobile platforms, with the number of downloads and average time spent in each app declining. Instead, more
and more digital time is being spent on a smaller and smaller number of multifunctional platforms like Facebook. Thus, the challenge for those that aim to become a digital Open Platform Player is how to avoid being assimilated into the broader social and transaction platforms of the GAFAs (and BATs—Baidu, Alibaba and Tencent) and remain distinctive. Smaller banks thinking about a physical platform play may also realize that the consumer segments that place differential value on that type of interaction may disappear very quickly as digital capabilities improve.

Multi-functional platforms may provide a great marketplace for product providers (as it seems unlikely the GAFAs will want to have a regulated balance sheet). However, it seems a lot more challenging to construct a banking-only platform that is defensible, unless the quality of advice and the product integration capabilities provide a compelling reason for consumers to exit a platform, like Facebook, and spend time on a banking-specific app or with a live adviser. This is also true for Digital Relationship Managers who may be forced to cede a lot of their transactional banking volume to multi-functional platforms. If done well, the Digital Relationship Manager should have enough leverage to pull customers back into their environment for advice and relationship management, while that leverage will be harder to generate in a financial services specific platform where they do not manufacture the products or have access to the full depth of customer information associated with the products they provide.

A second downside to this model is that the economics of a banking platform (either physical or digital) will deteriorate as markets revert to a “normal” interest rate environment. At the moment, the combination of higher funding costs with better operational efficiency makes marketplace lending platforms competitive. However, in a rising rate environment, the funding costs of an integrated bank balance sheet are likely to rise slower than wholesale rates. Depending on the rate of change, this may be enough to make lending platforms economically unattractive despite their lower operating costs. However, even in a rising rate environment the platform lending business model may be saved by pension funds and insurers that can source low-cost funding and that need to generate asset spreads.
UTILITY PROVIDER

Success hinges on being a non-threatening, technologically sophisticated, easy-to-work-with partner.
The final business model choice is to narrow both the bank’s customer focus and value chain participation to become a Utility Provider. These behind-the-curtain banks will focus on providing end-to-end product solutions or simply a regulated entity in which others can book deposits and loans. Relatively unknown names like The Bancorp already play this role in US financial services, and one can argue that established players like First Data have been playing this role for a long time. Some time ago, Mellon Bank and Bank of New York chose this business model and shed their retail businesses to focus on the business-to-business (B2B) world of asset servicing.

However, becoming a Utility Provider is not just about traditional banks shrinking their business. The recent launch of ClearBank® in the UK also shows it can be an attractive business model choice for de novo market entrants that see value in selling shovels during the digital gold rush rather than dealing with end customers.

The success of a Utility Provider hinges on being a non-threatening, technologically sophisticated, easy-to-work-with partner who can maximize its number of customer-facing clients. In doing so, it needs to master the packaging and provision of compliant financial services for other business models while using specialist talent and technology to keep overhead costs as low as possible. A successful Utility Provider builds scale by offering standardized transaction and operational services at very low margins. Run well, these business-to-business models operate digitally, and use an omni-channel approach and a scalable platform that can easily expand to different geographies through an ecosystem of partners. At its broadest, a Utility Provider can create an As-a-Service delivery model to convert capital expenses (CapEx) and fixed operating expenses (OpEx) into per-transaction OpEx. Depending on its configuration, it can generate both interest spread (if it has a balance sheet), and transaction and processing fees.

THE UPSIDE

In a world where many fee-based businesses like wealth management and payments are likely to suffer deflation due to technological innovation, being in the pure balance sheet business could be very attractive, particularly as interest rates rise. While search costs and processing costs can be compressed by technology, the maturity transformation role of a traditional bank balance sheet is harder to replicate. For traditional banks that feel they will inevitably lose on the consumer side of the business to scale digital banks or non-bank platforms, retreating to a narrow utility model may make a lot of sense, as it can be a good, steady, non-threatening way to earn income. As relationships like Uber and Green Dot® also show, being the utility behind a true disrupter can allow banks to ride the digital growth curve while retaining a more traditional business model.

THE DOWNSIDE

Giving up customers and retreating behind the curtain is a daunting prospect for most retail and commercial banks. Because of the narrowness of the business model, establishing differentiation can be hard, and scale-based processing businesses tend to become natural oligopolies—good if the bank is part of it, and bad if it is outside that group. Without differentiation beyond price, the business model could also come under increasing pressure as distribution, rather than manufacturing, starts to take more of the value, and open APIs make it easier and easier to decouple from service providers and look for a better option. Finally, for most banks, narrowing to only a fraction of the value chain means not only a fundamental rethinking of their cost model, but also their ability to quickly generate the growth and scale required to keep their overall value creation growing.

Welcome “phygital” experiences

The majority of consumers Accenture recently surveyed say they are less likely to care which channel they use to interact with financial services providers. The paradox in the data is that while 70 percent of consumers worldwide may welcome banking robo-advisors, 66 percent still want human interaction in financial services.

The message is that customers’ primary concern is getting what they need, quickly and easily, through whichever channels they choose.

Our experience is that a “phygital” transformation approach—offering the right blend of physical and digital—is critically important and can reduce a bank’s cost-to-serve. In Europe and North America there is potential to cut distribution costs by 30 percent, with no negative impact on customer engagement or experience, with integrated approaches building on remote advisory, right-channeling, and customer analytics, to prevent churn and better personalize interactions. Customers are already in control and must be free to decide when, where, and how to interact with the bank. Branches are becoming the place where digital and physical converge. Banks such as Santander®, Virgin Money, and BBVA® are experimenting with branches that look more like Apple stores.

Rather than developing banking channels in isolation, winning banks—particularly those adopting Digital Relationship Manager, Digital Category Killer, and Open Platform Player models—will have a “phygital” strategy seamlessly integrating carefully designed customer journeys across all channels.
While young Reagan could not decide which pair of shoes he wanted, many banks are equally puzzled by what sort of business they should be in the future. In many cases they are looking at multiple options and often making potentially conflicting decisions as they seek to cover the strategic bases. Often, the core of the bank is focused on trying to become a Digital Relationship Manager while, at the same time, teams in innovation labs and new business groups are experimenting with the other three models. The harsh reality is that through a combination of technology, competition, changing customer attitudes, and, in some cases, new regulation, banks are losing their privileged place in the economy.

While only a small amount of value in North America and Europe has migrated outside of the traditional bank business model thus far, the experience of Asia suggests that the time is rapidly approaching when retail and commercial banks will need to make clear and specific choices about their future business model, and then focus on executing it to the best of their abilities.

The starting point for making the choice is a clear-sighted self-assessment. Who is the bank? Where do you want to go? What do you do well, and better than others? What do

### FIGURE 5
Self-assessing banks’ fit to a future banking business model

Source: Accenture

#### EXISTING CAPABILITIES

<table>
<thead>
<tr>
<th>Customers, Channels &amp; Brand</th>
<th>Digital Relationship Manager</th>
<th>Digital Category Killer</th>
<th>Open Platform Player</th>
<th>Utility Provider</th>
</tr>
</thead>
<tbody>
<tr>
<td>Broad, multi-product customer base that can ground the pivot towards a new business model</td>
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<tr>
<td>Trusted brand that can absorb external shocks and credibly provided advice across a broad array of financial needs</td>
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<td>Local brand and community engagement strong enough to offset better digital delivery</td>
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<td>Premium brand equity that is able to lose transactional control to others as part of an ecosystem platform</td>
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</tr>
<tr>
<td>Ability to scale winning formulas to improve time to market and revenue growth</td>
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<td>•</td>
<td>•</td>
<td>•</td>
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<tr>
<td>Masterful at creating engaging customer experiences and digital interfaces</td>
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<tr>
<td>Product spikes where offerings are differentiated from a customer experience (B2B or B2C) standpoint</td>
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<tr>
<td>Product manufacturing or transaction processing capabilities that deliver cost advantage, either through scale or the differential application of technology</td>
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<tr>
<td>Advantages from specific barriers to entry, either in the form of partnerships or physical or intellectual assets that are distinct from competitors</td>
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<tr>
<td>Ability to innovate and invest at scale, transforming the banking experience</td>
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<tr>
<td>Ability to integrate with non-banking products and services to create compelling customer journeys</td>
<td>•</td>
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<td>•</td>
<td>•</td>
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<tr>
<td>Operations</td>
<td></td>
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<tr>
<td>Ability to rapidly scale workforce to serve demand</td>
<td>•</td>
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<tr>
<td>Rapid product development using tools like DevOps and Agile to move with customer needs</td>
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<td>•</td>
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<tr>
<td>Masterful at core bank processing</td>
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<tr>
<td>End-to-end process digitization</td>
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<tr>
<td>Balance sheet management and financial engineering skills</td>
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exploring further evolution: Banking as a Living Business

While revolutionary and aspirational for most banks, the outline of what a winning Digital Relationship Manager needs to look like is already clear. What is interesting is that the next evolution of that model is already coming into view in the form of Banking as a Living Business. The evolution of the Digital Relationship Manager is being driven by two things. First, the “digitization of everything” in which the Internet of Things creates a continuous and personalized stream of data that allows for true, real-time customization and hyper-relevance of financial and non-financial products and services—the kind of relevance that consumers want. Second, to make use of that data flow, banks will need to create cultures that look like start-ups and have the vitality and resilience to recreate their business models and customer propositions on a fast cycle and continuous basis. Like Lyft™ in transportation, Banking as a Living Business will update its services every hour and will evolve its business model every few weeks to adapt to changing customer needs and behavior. “Run the business” will become automatic whereas most of time, talent and investment will be aligned against “change the business” activities.

In the world of Banking as a Living Business, the vast majority of transactions are likely to be “on GAF” (or equivalent multi-use digital platforms). Thus, building ever-stronger relationships with ecosystem partners will be critical, and plug-and-play functionality for all products and services will be table stakes. However, this deep integration with other digital platforms will put even more focus on the ability of banks to identify and trigger the small number of high-value “on us” transactions where the bank can seamlessly provide slower, more complex services, such as financial advice. While Digital Relationship Managers are more likely to evolve first to Banking as a Living Business, Digital Category Killers, Open Platform Players and Utility Providers will also evolve over time as banking moves from something that consumers step outside their regular activities to do, to something that is deeply integrated with the rest of their daily life.

others do better? The decision also requires an equally clear-sighted view of the bank’s fit to each archetypal business model. Figure 5 offers a high-level start.

While a bank pursues one model, it can also experiment with a few others to determine which best serves its business. Treating the four archetypes as independent models, and understanding how different markets and customer segments map to them are good disciplines. Yet, the reality is that a large, complicated, multi-country bank may end up with a portfolio of business models. BBVA, for example, is demonstrating how to play across all four models to some extent, building a business portfolio from a series of discreet choices about how to go to market. Some banks may simply opt to become the best version of themselves and maximize shareholder returns in the old business model, and bet that true digital revolution may be a long time coming. To many US regional banks this option may be appealing in a market likely to consolidate — especially when short- to medium-term market valuation may be the difference in being predator and being prey; and where consolidation may provide shareholder value before the business model becomes obsolete. Having clarity on whichever model is chosen for a particular business, market, or segment is the necessary goal. Intentionality is key. Whether a status-quo, single- or multiple-model approach, the choice should be explicit.
Picking new shoes and focusing on a clear business model choice is necessary, but not sufficient for success. Like any fashion item, the allure of design needs to be backed up by craftsmanship to create true quality. Regardless of the destination, Accenture has identified a few key execution rules for building a bank that can win in the digital economy:

- Understand that optimizing the existing business model is not a long-term strategic choice unless investors are looking for an exit. While tight economic management of legacy business models can create fuel to jump to the next competitive curve, often the legacy develops strong immune reactions that make them difficult to disassemble when the time comes.

- Be courageous and change the organization to ensure focus on the new business model. A bank that remains organized around products and channels will never make the jump to being a Digital Relationship Manager. Many banks hope that customer centricity will be an emergent property that will materialize from an organization built for efficiency and control, but a true Digital Relationship Manager will require intense personalization and customer-level integration to be successful. Likewise, as BNY Mellon shows, a multi-product bank will never become an effective Digital Category Killer until it sheds its non-competitive lines of business and organizes everything around the one thing at which it wants to excel.

- Investment dollars are scarce, so they need to be directed towards creating the bank of the future, not sustaining the bank of the past. This means revisiting the entire CapEx portfolio and asking whether the projects that it contains will really make the difference when it comes to winning in the digital economy. Often the business cases will be many years old and the world will have passed them by, even if the projects deliver against their plans. Specifically, for incumbent banks the decisions would focus on the "phygital" agenda to determine the highest priority segments.

- Technology thinking and bank leadership needs to be digital-first regardless of the chosen business model. Even if the choice is Digital Relationship Manager, physical distribution and face-to-face interactions need to be added to a compelling digital experience, not function as an alternative center of gravity in the organization. Core systems transformation can be long and arduous cultural change occurs only on the back of technology changes that enable new behaviors.

- Change performance metrics to focus on what matters. For a Digital Category Killer, it is market share and channel dominance. For a Digital Relationship Manager, it is share of wallet and customer experience. For a Utility Provider, it is a combination of cost to serve and ease of use to drive market share. For an Open Platform it is traffic and stickiness.

- Finally, transform the workforce. If the people do not change, then the business model will not change either. The traditional hierarchical “run the business” approach that has characterized most banks will need to give way to a far more agile and fluid “change the business” approach that lifts the metabolism of the organization, encourages innovation, and keeps a bank relevant in a digital world.
SQUARE TOES OR ROUND TOES? CHOOSE NOW

The path of least resistance for most retail and commercial bankers is to talk themselves into believing in evolution and not revolution. They opt to think that banks will continue to be all things to all customers, and that while fintechs may nibble at the margins of the business, a fortress balance sheet, regulatory barriers to entry, and ubiquitous distribution will be enough to ensure that the traditional business model survives (and maybe even thrives with a little tailwind from rising rates and regulatory relief).

Hopefully, this paper illustrates the danger in taking that position. Change is indeed coming, and it will require banks to make clear business model choices to win in the digital economy. Incumbent banks in North America, Europe, and Australia still have time to optimize their existing businesses and invest in what comes next. If they only optimize and do not fundamentally change, then they are likely to become the travel agents of banking who find themselves trapped in a narrower and narrower niche over time.

Before that happens, banks can choose to control their own path. If they choose to continue with a model that serves all customers with broad value chain participation, then they need to recognize that success will still require revolutionary change. A compelling version of a Digital Relationship Manager is the likely aspirational target for most banks. Recognizing the challenge in excelling in that business model, banks should also consider other options—from narrowing their product focus to becoming channels for third-party products to being simply the wizard behind the curtain that makes the rest of the industry run smoothly.

Whichever shoes they choose, banks need to be ready to compete in a very different competitive environment. They will also need to strategically map the journey to the intended destination and be focused enough to execute it well. Time is running out, but in most developed markets banks still have attractive strategic options. However, they need to learn from Ronald Reagan that the failure to make a clear choice is often worse than making no choice at all.
REFERENCES


