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Banking Growth Forum
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# BANKING IN THE DIGITAL ECONOMY

# CUSTOMER LIFETIME VALUE: THE PIVOT FROM PRODUCT TO PROMISE

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**Alan McIntyre:** What am going to do is sort of take a little bit of a step back, and take a circuitous route back to some of the topics that Frank was talking about.

So, what I want to talk about is the changes that Accenture sees in the banking industry, both globally and specifically in North America, and then really focus-in on the idea of fragmentation—the idea of business model evolution. And, I think one of the things we're going to see is that banks are going to have to take choices. They are going to have to make decisions about who they want to be going forward, because who they were in the past is not necessarily going to be a viable business strategy for them. And then, I'm going to come back to the idea of getting personal. So, at the end of the presentation, I'll come back to some of the ideas that Frank was talking about and give you the Accenture perspective on some of the challenges of actually executing on that type of roadmap that Frank laid out.

But, first I'm going to take a step back for you and talk about what we see as the banking business model. I think it's fair to say that the vast majority of our clients are working on what I would term "the Oprah Winfrey" version of strategy, which is being the best version of yourself. And by that I mean not challenging the business model.

So, the traditional bank business model is vertically integrated. You have an insured and regulated balance sheet, you manufacture the majority of your own products, you control your distribution, and you essentially try to be most things to most people in the market. And, that has been the history of banking, certainly in the U.S., for a long time.

But, our contention is that that business model is beginning to run out of juice at this point, and what we see a lot of management time getting into is to try to optimize that model. So, we've got clients looking at cost optimization, particularly how to get compliance cost out; how to use automation. Moving to this sort of product cross-sell that Frank was talking about; I don't think many of our clients are truly at relationship banking yet, but trying to cross-sell product. Trying to transition to digital first—particularly on distribution. So, trying to say, "OK, what's on the phone? How do we make the rest of the business support what's on the phone?" And then, really trying to create fuel—trying to create profitability that's going to allow you to invest. Because, post-crisis, we had a long period where there was very little profitability—certainly in the U.S. retail and commercial banking industry. Canada's a little bit different, and I'll come on and talk about that.

And, you just look at some of the data from the last couple weeks. Why does this green bar [slide 4] begin to trend down? You see regional banks in the U.S. with shrinking balance sheets. You look at total credit extensions to businesses last year in the U.S.—only ten percent of it came from FDIC-insured banks. Twenty percent of it came from direct lending by mutual funds. You've got a whole bunch of regional banks at this point with shrinking balance sheets, so I think you can make the contention that that traditional model is beginning to show signs of stress.

And why do you need the profitability? You need it because of something else coming, which is a business model in which businesses have to compete in the wild. It has to compete in a digital economy, and the trend is that banking is going to become a lot more fragmented. That traditionally, vertically integrated value chain is going to break down into specific pieces. Some of that is regulatory. You look at Europe, and you look at PSD2. It's an attempt by regulators to actually reach-in and cut the links between what had been connected. Cut the link between payments and underlying deposit accounts. You're going to see a fuzzy business perimeter. What is banking? Where does banking blend into other things? Banking's going to become an export and import business. You know, with the advent of APIs and Open Banking, what do we push out? What goes out beyond the walls of the institution to be used by third parties? And what do we bring into the bank in terms of third-party products and services? And, all of this sort of fragmentation and openness is going to create business model choices that haven't existed in the past for most banks.

And, you're seeing that transition happen at different speeds in different geographies. If you're a retail banker in China, you're already three-quarters the way up the blue curve at this point. I mean, it has happened. I'll come on and talk about the speed and how it varies by geography, but every geography is making this pivot and transition. And, I think even over the last few months were beginning to see it really happen in the U.S. There may be something that comes after this when we've all got our assets and liabilities in a public blockchain, but I will not be working at that point when that happens, so I don't really care too much about it. Really, I'm sort of focused on the green to blue transition here.

And, part of the reason why that transition is happening is some of the stuff that Frank talked about customer expectations. The customer base for banking is increasingly fragile. A couple of years ago—about 18 months ago—Accenture did a major customer survey: 18 countries, 33,000 consumers. We're redoing it this year, so we'll get the update, but at the very highest level, we segmented the global banking consumers into three buckets.

There are, "the good customers," the Quality Seekers. The people who want a relationship. The people who want to be engaged. They want advisory. They're willing to pay for advisory. The customers that everybody dreams about in the morning for their bank, but it's only just over a third of the global base.

There's about 24 percent that are price shoppers. They're Hunters. You know, some of those Google searches that Frank was showing. That's these people looking for the best CD rates.

But, you don't need stunt math to understand that if you put those two together there's another bubble coming here on the left [slide 5]. And, that is what we call Nomads, and it's 40 percent of the global consumer base at this point. And, the definition of a Nomad is a consumer who says, "You know what? I'm not sure I need a bank anymore. I've got a robo-advisor. I've got PayPal®. I've got Venmo. I've got the component pieces. I'm not sure that I actually need a traditional banking relationship." Now, to be clear, this is stated behavior, so it's not that 40 percent of consumers have moved outside the banking industry, but 40 percent of them say they would be open to moving outside the banking industry and don't actually think that they actually need a traditional bank relationship.

What's more interesting is if you start to break it down by geography. And I'll focus here in the U.S. versus Canada, because they're very different. You look at that global number. You add the U.S. The U.S. is slightly more nomadic—heading for 50 percent, and I think when you begin to see this speculation about JPMC white labeling current accounts for

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Amazon®, you're beginning to see how that sort of stuff may actually pick-up steam quickly.

For the Canadians in the room, you should wake-up every morning and give thanks that you work in the Canadian banking industry, because it is one of the most conservative markets in the world. Now, there is a set of characteristics here, and one of the key characteristics is markets where the banking industry didn't blow-up during the global financial crisis have a low number of nomads. So, it's Canada. It's Australia. It's Scandinavia. Well, guess what. The customers didn't get disrupted. They're actually quite happy with their banking relationship that they have. They still trust their banks to some degree—not hugely but they still trust them—certainly in relative terms. And, hence, the idea that you would just decouple from the banking system and go elsewhere isn't particularly attractive to them. So, Canada has a far more conservative base, and, hence, you see far more sort of loyalty to the existing institutions.

But, then you look at emerging markets. You look at somewhere like Brazil and you got over 60 percent nomads ready to try something different. And, this is not just an emerging markets phenomena. You know, one of the most disrupted developed markets in the world was Italy during the global financial crisis. That number in Italy is 65 percent. Your typical Italian consumer is saying, "Please, God, give me an alternative to the traditional banks."

So, there's clearly differences here, but the customer base is fragile. And, if you've got 47 percent nomad, that's customers who are open to an alternative than a traditional bank. And, this is dangerous, because once you get out into the open savannah where you're having to compete in the digital world, the data suggest that not everyone is going to survive.

This [Slide 7] is from Accenture's High Performance Institute, and this is looking at the top 343 companies in the world cross-industry; so not just financial services. And, we did this at the end of '16, and we said, "Let's rank them on financial performance—set of metrics. Who's performing well financially?" And then, we ranked them on who's made the rotation toward digital. And, what you see of those 343 is there's only 19 of them who we could legitimately say are both truly digital businesses and are performing well economically, so it's certainly not a given that you're just suddenly going to rotate towards a digital business model and be successful.

And, if you want to see…the first chart was the theoretical S-curve. You want to see a real S-curve in action? This is what it looks like [slide 8]. This is a bigger sample. This is the 1,500 largest companies in the world, and what it shows is cumulative EBITDA, or annual EBITDA over time. You look at that period '04 through—give or take—'09, you clearly have the good times…'04, '05, '06, '07…and then it comes down during the financial crisis. And then, it starts to go back up, so you start to think about '10…'11. The global economy's recovering. Everything's looking pretty good. Surely these companies will do well. No, they don't. The cumulative EBITDA peaks at around 2012/2013. And actually this group, which is the world's largest companies, are shrinking in terms of their profitability. Now, obviously within that group you have the Amazons, you have the Facebooks, you have the Apples, you have the Microsofts, who are doing incredibly, well but there's a lot of people who are not doing well in that group. And, the digital transition that is happening in other sectors of the economy is what's compressing.

If you look at consumer packaged goods, of the top 100 CPG brands in the world, 75 percent of them lost market share last year. Of that 75 percent, the majority of them had absolute declines in sales, and that is coming from the compression effect that comes from digital. So, the idea that if you are a bank this is just an easy transition from the traditional business model to something that's more a digitally enabled model does not have any basis in reality when you look outside of the financial services industry.

And, you see this in the valuations. If you look at the valuations, what the investors are saying is, "We're basically not convinced that banks are going to be able to make the turn; that they're going to transition from where they are now to a successful digital business model." So, this [slide 9] is looking at future growth value—market value versus value of existing business. So, how much is the market saying, "We trust your future prospects here?" Not surprisingly, if you look at the GAFA, 40/50 percent of the valuation of Google/Amazon/Facebook®/Apple® is forward-looking, "We see where you're going. We see the future." If you look at the big fintech players, again, a lot of value is forward-looking, "We believe that you're going to win; therefore, we believe that there's value out there." We then took the top 70-plus banks in the world, and based on our own view of the world, said, "Who are the digital leaders, and who are the digital laggards?" So, in that "Leading Digital Banks" you might have a DBS in Singapore, you might have a Goldman, you might have an ING®, you might have a BBVA in there. That's the sort of group that we were looking at. People who have clearly made major investments, and what you see is they do have future value. The market is saying, "We actually do see that something good is going to come out of this." But, you look at the 51 who are in the digital laggards category, and what you see is it's getting better, but we're no longer. We're not even at par value yet in terms of current value. And, the message that that is giving is that investors do not trust that the banking industry has great prospects going forward in this more fragmented and sort of decoupled world.

So, I want to talk about business models, because most U.S./Canadian banks have a similar business model, and it's been: "try to capture as much of the value chain as you can" and "try to be most things to most people." So, there is a business model choice, which is, "OK, let's just keep doing what we're doing, but be a digital version of that. Be a Digital Relationship Bank and make that turn and make that transition to a better version of what we were."

But, it's clear that there are other choices out there now. You could say, "Let's not be everything to everybody. Let's constrain." You look at some of the success stories. You look at a Quicken Loans®. You look at PayPal®. You look at Square®. What have they done? They said, "We're going to do one thing or a couple things really well. We're going to brand the hell out of it. We're going to build the best technology. We're going to go deep, and we're going to become ubiquitous, and that's how we're going to win." And when you think of say the mortgage origination business in the U.S., the majority of the top ten mortgage originators are now in that category. They are specialists. They are not the broad-based banks, and I'll show you some data later about what's happening in payments—similar types of feel.

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You could be in the bottom-right. You say, “OK, we're going to be the Amazon of banking. We're going to be a platform owner, and we're going to invite lots of people into our platform, and we're going to intermediate.” If you're an incumbent institution, that is a suicidal strategy, because you give up the balance sheet at that point, and the balance sheet is still the vast majority of the income for an incumbent bank. If you are a new entrant into the financial services business, that's a legitimate place that you might want to be, but the question is, “Why would you only aggregate to financial services? Why would you just have an FS platform?” The evidence from a market like China is that the aggregation will go higher than that. It will be WeChat. It will be the Alibaba platforms and that you will be aggregated up to something which looks more like an Amazon-type platform. So, the ability to build a platform that's FS-specific without going above that, I think is questionable.

And then, finally, you could just be in the bottom-left. You could say, “OK, we are going to do a limited number of things, and we're going to be constrained in what we do, and we're going to be a good partner. We're going to be a Utility. We're going to rent the balance sheet. We're going to provide at-scale transaction processing. We're going to do something that powers the rest of the industry, but we're not necessarily going to be customer-facing.

So, now you've got these choices, and not surprisingly when we look at US banking, we think…and this [slide 11] is revenue pool-based. This is not number of institutions…We think about 25 percent of the revenue pool—JPMC, Bank of America®, Wells—are beginning to pivot towards what we think is a better digital business model. They're making that rotation to the new. I think you could make the argument that many of the smaller community and smaller regional banks are not making that rotation yet. Some of the larger regionals are clearly trying but I think questionable success. So, you get about 25 percent of the revenue that is moving to some sort of digital business model, and not surprisingly the vast majority is in the top-right. The vast majority is saying, “We can be that Digital Relationship Manager. We can be a digital version of what we've been in the past. You do have some Category Killers emerging from the incumbents. You do have some Utilities. No one’s doing the suicidal thing in the bottom-right of giving-up the balance sheet—thankfully.

But, you then look at the new entrants…That [was] the incumbents…You go all the way back to 2005, and this [slide 12] is across a bunch of major markets. This is the U.S. This is the U.K., the rest of Europe, Canada, Brazil, China, Australia. So, it's not completely comprehensive but it's a fair part of the global banking market. Our guess is if you look at the retail and commercial banking space here, you have about 23,000 institutions active in the market. We've had some exits—actually over 8,000 exits some of them through consolidation, voluntary M&A—some of them less voluntary post-the financial crisis—bunch of banks went out of business. But, what's been added? Some incumbents have created new subsidiaries. You see a lot of this in Europe—your digital challengers being created out of an existing institution, but acting as an independent institution. New bank charters. There’s been the best part of 700 new banks created around the world. That's far less than you would have seen in the previous ten years, but 700 new banks. A lot of payments companies—two thousand nearly payments companies—created, which are licensed, so it's some form of licensing in the geography that they're operating in. And then, 592 non-licensed fintechs, many of which are like platform lenders. So, something like a lending club would sit in here. Somebody who's not operating in the regulated financial services environment. They're acting as a platform.

So, what you get is the industry has shrunk globally. We're down to just over 18- just approaching 19,000. About 17 percent of the institutions in that market are now new. So, listen. This is not the Blockbuster/Netflix flip-the-industry-on-its-head, but you're beginning to see a rotation with new players coming in.

And, if you look at those numbers for the U.S. [slide13]. We started off about 7,500. We've lost quite a few, and then we've added: new subs of incumbents; a lot new banks. The vast majority of the new banks have actually been in the U.S. A lot of this was prior to the financial crisis, so post-2010 there hasn't been many new banks, but new capital formation in the U.S. is one of the defining characteristics of the banking industry here and has been for a long time. Lots of payments companies. Lots of platform lenders. So, again, you look at U.S. We're down, but in the U.S. about 23 percent of it is new entrants. Now, this is number of institutions. The revenue looks completely different, so if you're looking at revenue it's less than 5 percent. I've got these numbers for Canada. It looks as if there's loads of competition in Canada. Our best guess is that less than one percent of the revenue pool has moved, so we're in the early stages of the game of something-is-happening-to-the-industry, but has it moved the stock yet? It's moving the floor, but it's not moving the stock.

What's interesting though is where's the money. And this [slide 14] is an analysis where we took 18 of the best European new entrants. So, if you had to say in the European market who's the winners—across the payments, the platform lenders, the new banks—the 18 best. As you can see the revenue CAGR is 165 percent as a group, so these are institutions that look as if they're winning. But, when you look at who's making the money—the money's still in the balance sheet. So, you've got profit margins, which is in the teens for the people who have a balance sheet, the payments guys are basically break-even, and if you're running a platform lending business or other type of fintech you're sucking wind at this point. You are spending your VC's money pretty heavily and chewing your way through it. And there's no indication yet of true profitability in that model, so I think that comes back to some of the stuff that Frank was saying about the importance—even if you're a new player—of pricing and particularly balance sheet pricing, and actually figuring out how to make the thing which is unique to the industry—which is credit intermediation...maturity transformation—make that work for you and make money from it.

So, the story is a lot of what you think of as incumbent institutions are moving to the top-right hand corner. They're saying, "We're going to try and be a digital version of what we are now. We're going to try and be most things to most people. We're going to try and capture most of the value chain if we can." And, it kind of feels evolutionary, so you can imagine standing up in front of board of directors if you're the Head of Strategy and saying, "This is what we're going to do, and it's just that we're pushing forward from where we are." I'll make the contention to you that you can position it as evolutionary, but the reality is it's revolutionary.

We do not think there are many banks in the world who are at a point where they're actually capable of making this transition. We think we know what a world-class Digital

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Relationship Manager bank looks like now, and it's an aspiration. It's an aspiration for the vast majority of the industry. Why? Because, what it looks like is omni-channel, and by “omni-channel,” I don't mean “we have lots of channels.” I mean omni-channel where every channel picks-up the same information at the same time providing consistent advice, consistent customer experience, simultaneously. Customers get really upset when they know more about their finances on the phone from when they walk into a branch than the person at the teller does. Why is that true? Because many people in this room have invested in the mobile experience. When we ask people, “How’s your omni-channel experience?” It’s getting worse every year. Why is it getting worse? Not because thebranch experience is getting worse. Digital is getting so much better that the gap between the two is getting very wide, so you walk-in now to a branch, and it feels old. It feels like a different type of experience than you're having on your phone. And, until the rest of the channels catch-up with where digital are, there's going to be a challenge with truly positioning as an omni-channel institution.

Now, my personal view, the view of Accenture is that the branch networks still have enormous value in the business model. We think if you're an incumbent, and you have those assets, you should sweat those assets and there's a role for them. But, at the moment, very few banks are truly omni-channel in terms of that seamless interaction.

We think that you need real-time personalization. As Frank said, customers are being trained to expect contextual advice in the moment. You know, if you go by even five years and you talk to a lot of bankers about advice, it conjured-up images of sitting in a wood paneled office talking about what your retirement plan is, or what your business transition plan is, and it's an important, meaningful conversation about the future. The digital experience in other parts of people's lives has trained them to think about advice as something that happens right now. “Buy this.” “Watch that.” “Do this.” “Don't take the A Train. Take the F Train, because it's quicker.” And that type of personalization in the moment that says, “You should use that card rather than this card, because you'll get double rewards.” That's what customers are looking for in terms of personalization. They're not looking for advice that is a periodic, episodic thing that the bank brings to them. And, again, I think we're a long way from that.

The way in which we have constructed banking as an industry is very product-centric particularly in the U.S.—less so in Canada which has always been a little bit more relationship focused. I think that what we'll see, particularly as AI really gets traction in the industry, is that products are going to disappear, and products should disappear. And, what we're going to move to is promises. You sit in focus groups with customers and really talk about what they want. Retail customers want three things. “I want to be able to save at the highest possible return. I want to be able to borrow at the lowest possible rate, and I want to be able to pay in the most rewarding and convenient fashion.”

And, if you can satisfy those three and make the promises that “I will always give you that. You’ll always get the best return. You'll always be able to pay in the most rewarding way.” The products don’t matter. The products may still exist as categories, but they'll disappear behind the curtain. Now, why are we not there at the moment? We're not there, because there's no advisory trust. So, if you ask customers, “Who do you trust to look after your money?” They will say, “A bank.” But, it's transactional trust. It's a mentality that I give you ten bucks. What do you do with the ten bucks? You go put it in a vault. You shut the door. It's safe. Do I trust as a bank you'll clear that check? Yes, I trust. So, transactional trust is very high.

But, then you ask customers, “Do you believe that your bank will always, in all circumstances, act in your best interest?” That number is in the single digits in the U.S., and Canada is in the low 20s. So, the Canadians should feel better but not that good about their level of advisory trust.

And without advisory trust, you don't get to the promises. Why? Because, without advisory trust, the customer is always saying, “Ehrrr…I’m not sure how you’re screwin’ me, but I’ve got this sort of feeling that you may be screwin’ me. Therefore, I'm going to be very skeptical about it.”

And, you look at the U.K. You look at payment protection insurance in the U.K. You know, a perfectly legitimate product, which has cost the industry I think something like twelve billion pounds at this point—you know over the last decade. So, without advisory trust you don't get to promises.

Ecosystem curation: I’ll talk about the complexity here. We are moving into an Open Banking world. So, as one of these institutions, you’re going to have to choose what you provide versus what a third party provides, and you're going to have to be able to do that in a way that is seamless; a way that protects your customers’ data; a way that encourages people to interact with you rather than with someone else.

You are going to need real consolidation incentives, and this is where the pricing stuff really comes in—which is how do you encourage someone to bring their full relationship to consolidate their wallet? And, you know, reward points are not going to do that at this point. Customers want to see a real recognition of the value of their total relationship and a personalization around the pricing and the proposition that says, “I'm recognized as an individual. My value to this bank is recognized, and I get reciprocity. Somebody is saying to me, ‘I value you, and here's what you get in return for that.’” And, again, when we talk about pricing, we're a long way from that.

And then, finally, you need to be able to do all this with good economics. So, as you try and pivot from the old model to the new model, do you have enough profitability to invest at-scale in this type of proposition? And, I think, one of the things we're seeing in the U.S. is the big dollars mattering now. You look at the J.D. Power customer satisfaction statistics from a decade ago. The big banks were generally mid-tier at best. Who got the best customer satisfaction scores? Community and regional banks—personal engagement. “You know who I am.” That's flipped. Pouring billions of dollars into the digital customer experience is making a difference. You see it in the current account acquisition statistics that now the digital experience matters. So if you're sitting, and you are a ten billion dollar regional bank at this point, how are you going to compete with Chase® putting three billion into its digital customer experience? I think that's an existential threat for a lot of the banks in the U.S. if they don't figure out how to do this cost effectively within their market.

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As I said, the degree of difficulty of becoming a Digital Relationship Manager gets amped-up by Open Banking, and Open Banking is a regulatory reality now in Europe. So PSD2 requires you to make certain data available. It is going to become a regulatory reality in Australia, in Singapore, in Japan, in Hong Kong and Canada…and, you know, I'm on a panel next week in Toronto at the Payments Canada conference and the whole panel is about Open Banking. It's coming. From a regulatory standpoint, it's not coming in the U.S., but it's coming from a competitive standpoint. So, when Capital One puts out its developer portal, what's it doing? It's saying, "I can push out these products and services." So, it's important to think about Open Banking as both import and export.

On the outbound side, you can create a better customer experience. You know, the PayPal button, "Pay With PayPal" on e-commerce websites has become somewhat ubiquitous. And why? Because, it's a good customer experience. If you don't have it, then customers are saying, "Where's the PayPal button?" So, PayPal got ahead of that, created that type of ubiquity, and it makes a better checkout experience. The idea that Visa® and MasterCard® that are about to combine the PayPass and the Visa Checkout is a somewhat of an admission of defeat that they got late to that game. You can acquire new customers. One of the things that Capital One had done is created APIs for account opening that can be embedded in other people's sites. Product unbundling; part of what has made PayPal successful is Mastercard taking tokenization, unbundling it and selling tokenization to PayPal. And, you have to move from bilateral to multilateral. I got into a fight with somebody on an American Banker Webex about a month ago, because this individual was saying, "Oh, we're very open. We have APIs that connect us into this institution."

I said, "That's not Open Banking. That's a better bilateral connection that you've established." True Open Banking is saying, "Come one come all." It's saying, "Here's the capabilities. Come work with us;" not "I'm just going to work with you or you or you and make it easier." It's a true ecosystem of many-to-many not one-to-one.

In terms of the inbound Open Banking, open your walls and say, "How do I enhance the product?" So, you see all the advertising that Wells Fargo® does about, you know "turn your debit card off in the taxi because you've left it." Why does that work? Because, Visa made available a very simple API, which is a turn-off-your-debit-card API, which Wells could embed within its mobile app. So, they imported that capability from their issuer and said, "Yes. We'll sell it to the customer." You can add products. We're beginning to see this happening where people are moving towards platforms. Starling Bank in the U.K., which is one of the digital challengers, has pivoted to be an open platform now. So, you're going to go into Starling for your current account, but lots of other things will be third parties, which they're importing in. And, you move beyond banking…I'll tell you about that in the next slide…And, then cost reduction. Accenture's just launched an Anti-Money Laundering Utility for small regional banks in the U.S. Why? Because, it's a scale activity. You can consume it from the outside. You don't need to own it. Data scale matters. So, that makes it more complicated.

Getting outside the fuzzy boundaries can create revenue though. This [slide 17] is data from Canada. This is analysis saying, "If you're a first-time home buyer in Canada, over the first three years where does the money go?" So, there's about $7,000 sitting in the mortgage. You think, “OK, that's worth having. It's only about ten percent of the money that that consumer spends over the first three years. There’s about six to eight thousand—the revenue—in there. And, where’s it sitting? It’s sitting in lawyers’ fees. It’s sitting in real estate commission. It’s sitting in moving fees. It’s sitting in renovations.

So, if you move from thinking about selling the mortgage to selling a home buying experience—to have a shelter proposition—suddenly you begin to think far more broadly about the revenue opportunities. That's why you see banks integrating with real estate search; beginning to integrate with your white goods manufacturers in Spain. You know, I don’t know if you saw the announcement that Zillow is moving in the other direction. Zillow's going to move from providing real estate listings to buying houses. It's trying to change the way it participates in the value chain, so Zillow will buy your house at the guaranteed rate that is on the Zillow site. Now, they’re doing it at small scale, but this blurring of the boundaries between who plays in the sort of ecosystem is happening very, very quickly.

So, if you think about the Digital Relationship Manager; I'm going to go back and paraphrase some of the stuff Frank talked about from the Accenture perspective, and what we see. It's clear to me that there is a journey here [slide18]. You start with product pricing. You then get cross-sell pricing. You end-up with something that's more relationship-oriented, and I would agree that most of our clients are still in the blue box at this point.

And, the blue box is a constrained optimization. It’s constrained within the product, but it’s easy. It’s easy organizational alignment. At most banks there’s somebody who runs home equity who will get a promotion if they make more money from home equity. Therefore, the optimize the pricing for home equity, and it goes up, and everyone's happy. On the liabilities side, sometimes it's not even the person who runs a product, it’s the treasurer. It’s ALM saying, “We need some liquidity. Please, go get us a couple billion of savings deposits. Don't care how much we pay for it.” I have a client who—the Head of Savings—got that request. They put a promo rate out. They raised four billion dollars. Everyone was happy. I had the conversation with the client. He said, “You know what? We're happy, but we've got no idea why it happened. If we had raised it by 25 basis points, rather than 20, would we have got six billion? If we had done ten would we still have got four billion?” So, blunt instrument of liquidity management on the savings portfolio. And, to Frank’s point, often there's nowhere near enough granularity at the product level. Why? Because people are frightened of complexity. They’re frightened of the complexity that comes from having 100 sales. The reality is that the technology doesn't mean that you need to present 100 sales. You can have it behind a curtain, and you can use the technology to present the right price at the right time. So, there's a false dichotomy between simplicity and being able to optimize the economics here. You can be complex in the back and simple in the front. And, I think some of the stuff Frank talked about helps get you to that good combination.

If you then move to cross-sell pricing, that requires a customer profit view. It requires a holistic view. The sad reality is that there are many banks—leading banks in the world—who still do not have a stable customer profitability view that is fully costed and that really understands economic contribution. If you say, “OK, we think we've got enough of this.

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Let’s cross-sell using pricing.” There’s different ways you can do that. You can have product incentives. You can have product packages. You can use rewards to wrap around it, but fundamentally you're still selling products. You're selling Lego® bricks—one after the other—to build a relationship. And, again, go back to the omni-channel point. The more complex this becomes, the more it becomes channel-specific. “We can do it on the website, but God help us if somebody walks into the branch and asks for this sort of customized packaging.”

And then, the relationship pricing is the nirvana, but I think when you see what's happening in other parts of the world, you see people moving towards it relatively quickly. It requires a sophisticated, long-term value analysis. Not only one that has the geeks in the corner somewhere with the computer knowing what it is, but actually something that impacts the business. And, the problem is that that challenges the organizational model, because that guy who is really happy on the left-hand side about running home equity just gets told that we're no longer going to make home equity a priority, because we're using other types of products to optimize the relationship. So, the people who are running the traditional product silos don't fit very well into a model where you're trying to optimize relationship pricing over time.

And then, the other challenge that you have here is explainability and regulatory risk, which is an innate fear of anything that feels like a black box, which says, “OK, maybe we can explain why this customer is getting this bundled pricing, but can we explain it to the OCC? Can we explain it to somebody who's going to come twice a year and dig into this?” So, there's a lot of restrictions here about moving to the right. The danger is that the current industry is going to stay to the left, and somebody else is going to come in and intermediate, and be on that right-hand side and provide that type of platform layer that's going to do all this on the right. It is going to provide the optimization, and that disintermediation is the existential risk.

So, let me wrap up with what I think the takeaways are from this little excursion ‘round the banking industry. One is that banking is definitely changing, and the speed varies greatly by geography. You know, if you're not familiar with what's happening in China, you need to go read what's happening in China. China accounts for over two-thirds of all mobile payments at this point. Something like 15 trillion dollars’ worth of transactions last year on WeChat and Alipay. And, the idea that that’s something that is not going to affect the U.S. and Canada, I think is a pipe dream. That technology—that type of move towards a customer-centric mobile payment environment—is already rippling through the rest of the industry in Asia and will arrive on these shores as well.

Open banking and customer expectations are driving fragmentation…the special place that banking had in the economy—the sort of closed value chain, the protected industry—is changing. Banking is going to be a lot more open, it's going to be a lot more fragmented, and you're going to have to compete in different ways.

It may feel as if there's a lot of challenges at the moment. The data suggest that banking is way behind the rest of the industry. Banking has not been disrupted to the same extent yet. You take an industry like advertising, and you look at the level of disruption in advertising. Last year 90 percent of all digital advertising growth in the U.S. went to Google and

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Facebook. Absolute control over that channel in a duopoly. That has not happened in banking yet, but you begin to see things moving in that direction. Speed is picking up, so the digital impact is coming. We're at the early stages, I think, of the wave. It's higher in certain markets than others, but it is coming.

That no one business model is going to win…I think what we're going to do is we're going to move from a somewhat homogenous industry to one which is a more heterogeneous industry—more of a plug-and-play. And, the Digital Relationship Manager, while it looks like a easy evolution, it's actually an aspiration. It's a revolution. The challenges of getting that right in a way that you'll be able to compete with leading digital industries is high. It's a high bar.

The blurring business models is going to create more opportunities. So, you look at something like trade finance, and you look at the way the physical and the digital has been integrated. Enormous opportunities for people to control those types of ecosystems and be the leader in them and harvest revenue in a different way.

The balance sheet is critical. One of the things, which I see a lot is that if you go back even a few years ago, you'll get equity analysts. Equity analyst would always bang-on about fee revenue, "You need more fee revenue if you're a bank." I think that that's going to completely flip on its head. Why? Because, fee revenue gets compressed by digital. Why would you pay a fee? You pay a fee either because somebody has expertise that you need to pay for, or you pay because of some sort of administrative process that needs to be executed that justifies that. Both of those get compressed by digital. AI compresses the advisory piece. Robotics, automation—all that sort of stuff—compresses administrator piece. You look at fee income in any part of the world, and you're seeing compression on the unit fee income. Now you're seeing volume increase, but you're seeing compression on the unit fee. You don't see that compression in the balance sheet. Why? Because digital doesn't affect the balance sheet in the same way. You know, credit intermediation and maturity transformation on their balance sheet are not as susceptible to digital as fee income is. So, I think what you'll see is more emphasis on the balance sheet, which is where pricing makes an enormous difference. How can you get your NIM to be market leading versus market laggard?

The Digital Relationship Manager will mean that level of price and sophistication which is challenging for most North American banks, but I think it will be a competitive differentiator going forward.

And, that's why we're delighted to be an investor in Nomis and also an implementation partner, because I think pricing as a strategic discipline within banks is going to really go up in terms of importance over the next few years. And, that's not just because it's a rising rate environment. It's because the expectations at the customer-level about the customization, the recognition of them, the recognition of the value that they bring, in-the-moment advice. All of that stuff is going to become table stakes. And, if you can't manage pricing effectively, then you're going to fall behind.