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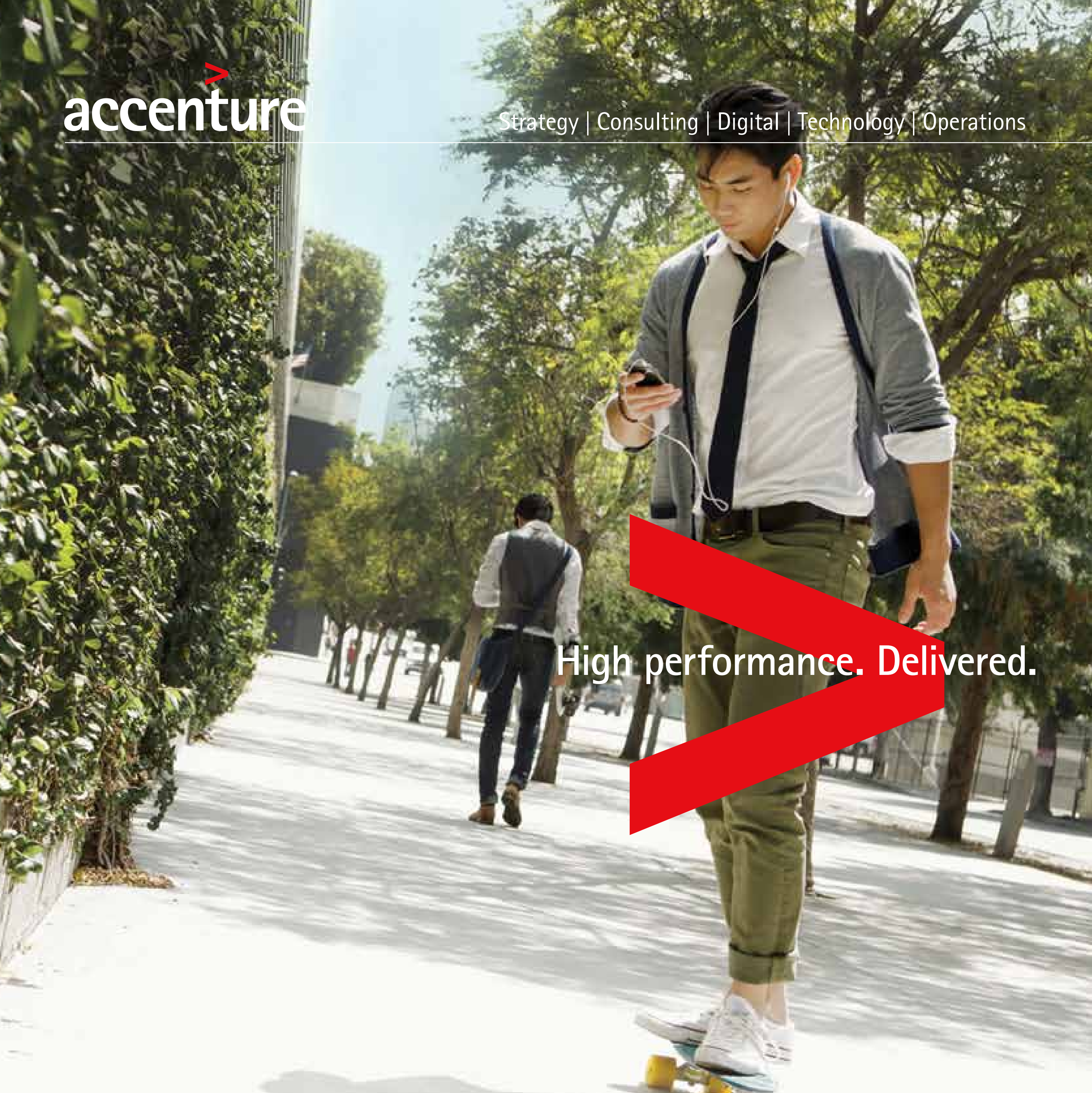

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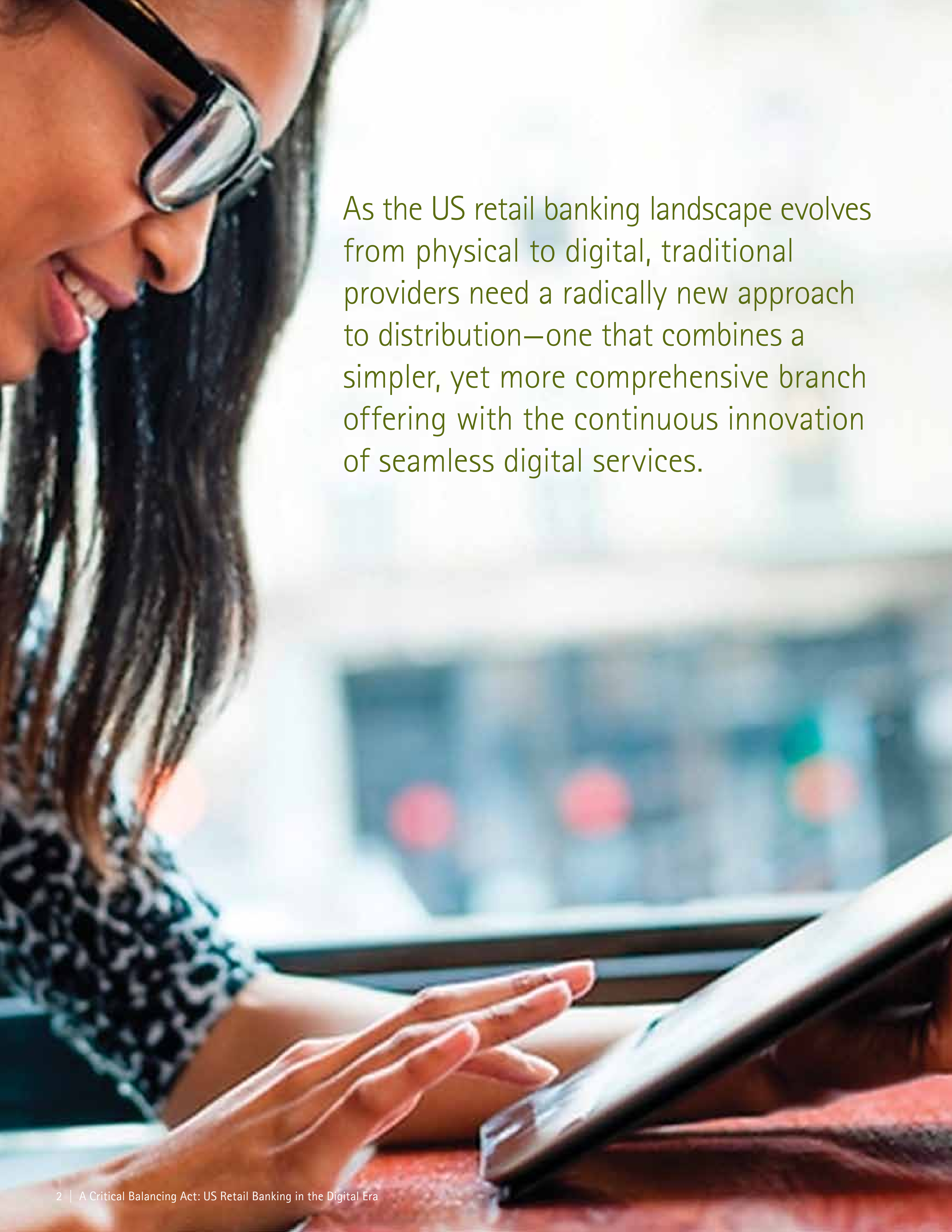
Banking 2020 Thought Leadership Series

A Critical Balancing Act: US Retail Banking in the Digital Era



As the US retail banking landscape evolves from physical to digital, traditional providers need a radically new approach to distribution—one that combines a simpler, yet more comprehensive branch offering with the continuous innovation of seamless digital services.

The Digital Challenge

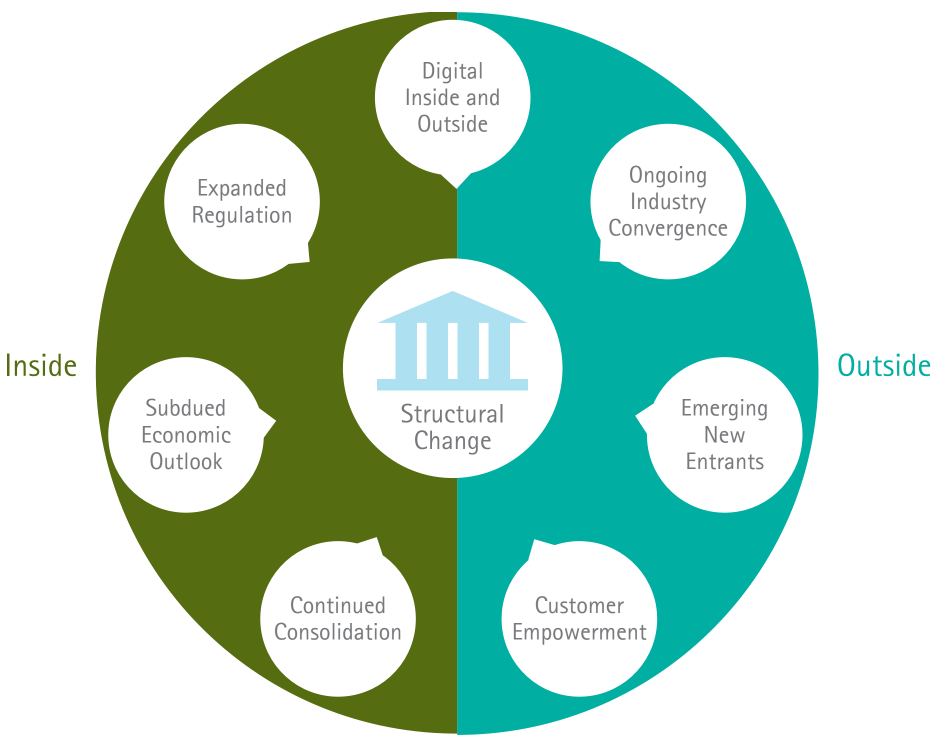
For US retail banks, today's markets are fraught with challenges: new digital competitors and digitally empowered customers prominent among them. Yet most still pursue business as usual, striving to be all things to all customers. Despite their best efforts to focus on the customer, many still don't offer what their customers actually want. These banks also tend to manage their extensive channel networks—including digital—separately, and not as a holistic function impacting all aspects of their retail operation.

This slowness to react to the digital challenge is understandable. Accenture conducted online interviews with more than 2,000 US retail banking customers of the 15 leading retail banks doing business in the US today. When asked how happy they are with the performance of their primary bank provider, 71 percent declared themselves "satisfied" and 68 percent said they would be "extremely likely" to recommend their primary bank to a friend, family member or colleague.

Our research, however, also reveals just how fragile this apparent customer loyalty really is. More than a quarter (26 percent) of bank customers who remain with their primary provider do so simply because they consider switching to be a hassle. Among them, about half just haven't seen competing offers compelling enough to make them move, and the other half believe the process of switching to another bank is just too difficult.

This not only exposes the tenuous relationship banks have with their customers. It also confirms that the right offering and approach can induce them to switch.

FIGURE 1. Convergent Disruption



Convergent Disruption

Multiple disruptive forces are converging on the banking industry at the same time, both from inside and outside the sector, creating an increasingly complex and highly dynamic future environment with permanent volatility.

New Questions, New Answers

Industry newcomers have understood that in the post-financial crisis environment the most fundamental question in retail banking has changed from "how do you find your future customers?" to "how do new customers find you?" And they are leveraging their innate advantage as digital pure plays to deliver the speed, convenience and low-cost personalized service that today's customers increasingly seek.

Traditional players, of course, also have an innate advantage—the extensive branch networks that customers still value, as our research confirms. But they cannot afford to ignore what the nimble new entrants are telling them: winning with digital in the future will be all about winning more satisfied and loyal customers with trusted, transparent and compelling offerings. And that means becoming an integral part of customers' lives: an agile, ubiquitous presence, wherever those customers may be.

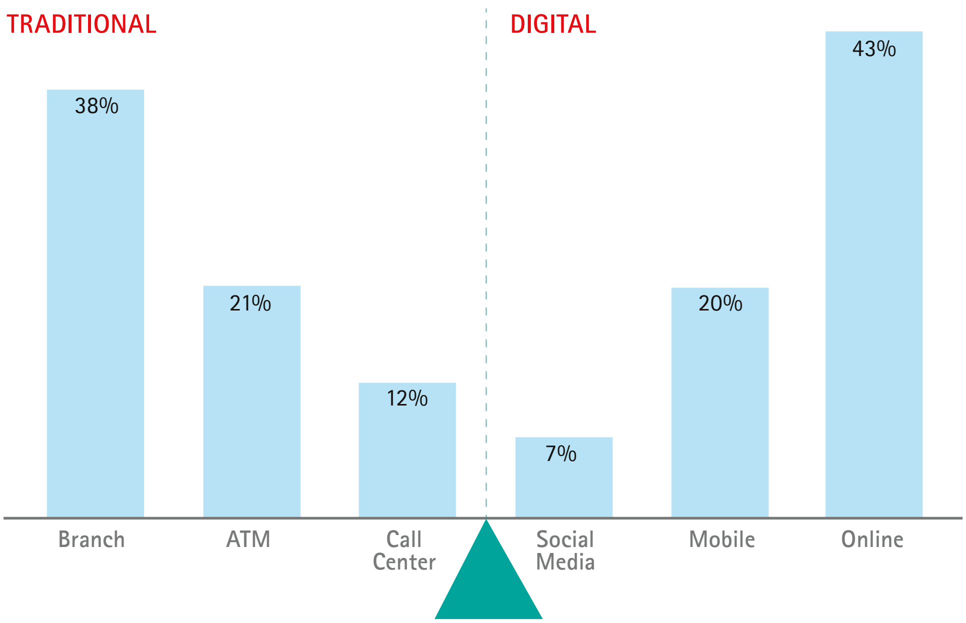
In an era of industry consolidation, new entrants, expanding regulation, more onerous capital requirements, and continuing economic volatility, retail banks urgently need a lower-cost operating model that can generate more predictable and sustainable revenues.

Indeed, if banks don't move swiftly and decisively to build such a model, they will lose more customers. On present trends, as a complementary Accenture analysis shows, full-service banks (collectively) could lose around 35 percent of their market share by 2020, and as many as a quarter of US banks could disappear altogether[1].

The core challenge for banks: how to build a seamless digital customer experience—and optimize its power with a better and more cost-effective complementary offering in the branches that customers still find so attractive.

FIGURE 2. Channel Balance

In which areas should your primary bank be developing and investing?



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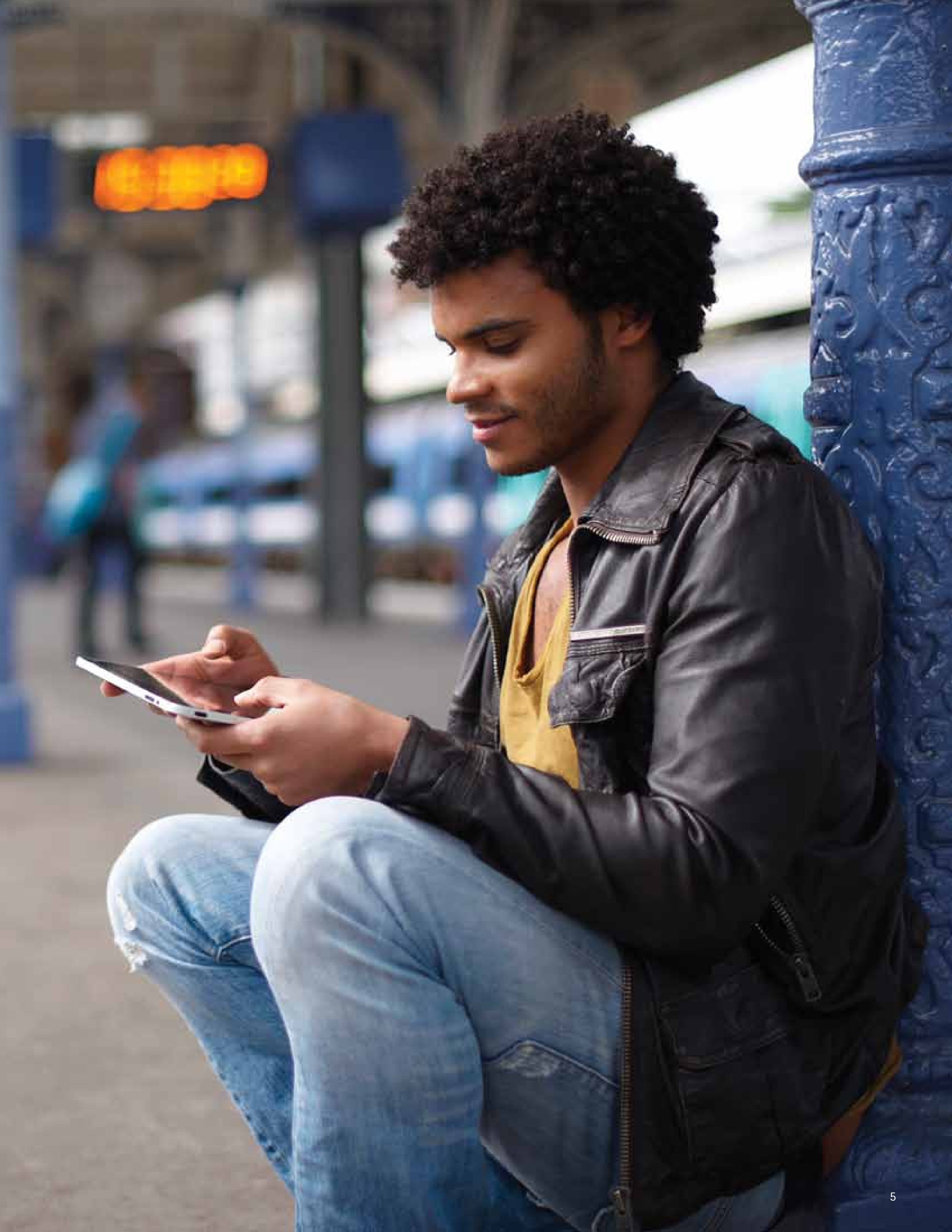


Five Key Findings

Our research—the second consumer banking survey in as many years—has highlighted five key findings that underscore the need for a more forceful approach.

1

Banks are managing a tenuous relationship with their customers

Future customer relationships are plainly at risk. Customers still value what they get from branches—but they also want more online. Furthermore, many of the offerings that keep them with their primary providers—good online services, low fees, and personalized service (Figure 3)—are also available from alternative providers, which often do them better and are easy enough to switch to. Customers acquired more than one third (34 percent) of traditional retail banking products—from CDs, money markets, and personal and auto loans to new checking and savings accounts—from institutions other than their primary bank, for example.

While only a few customers currently bother to switch primary banks, those that do switch are in search of significantly better options.

If retail banks don't build trust and transparency with more compelling offerings the attrition risk will intensify—and threaten their revenues. One need look no further than the success of American Express and Walmart's Bluebird—the prepaid card emphasizing fee transparency that grew to 1 million accounts in less than a year. Or consider the digital banking start-up, Simple, which focuses on financial management tools and reported 60 percent growth in accounts over a three-month period.

2

The branch-banking conundrum

Branches still constitute a significant strategic asset for US retail banks—and will likely continue to do so for some time. Nearly four out of five customers (78 percent) say they expect to be visiting their local bank branch just as frequently—or even more frequently—five years from now, for example (Figure 4 on page 7); in large part because 66 percent of them still prefer to "talk to a person" rather than purchase a banking product online. Two-thirds say they consider branch closures more than a minor inconvenience, and nearly half would switch banks as a result.

FIGURE 3. Why Customers are Loyal

What are the main reasons you've stayed with your primary bank?

Base: 1,822

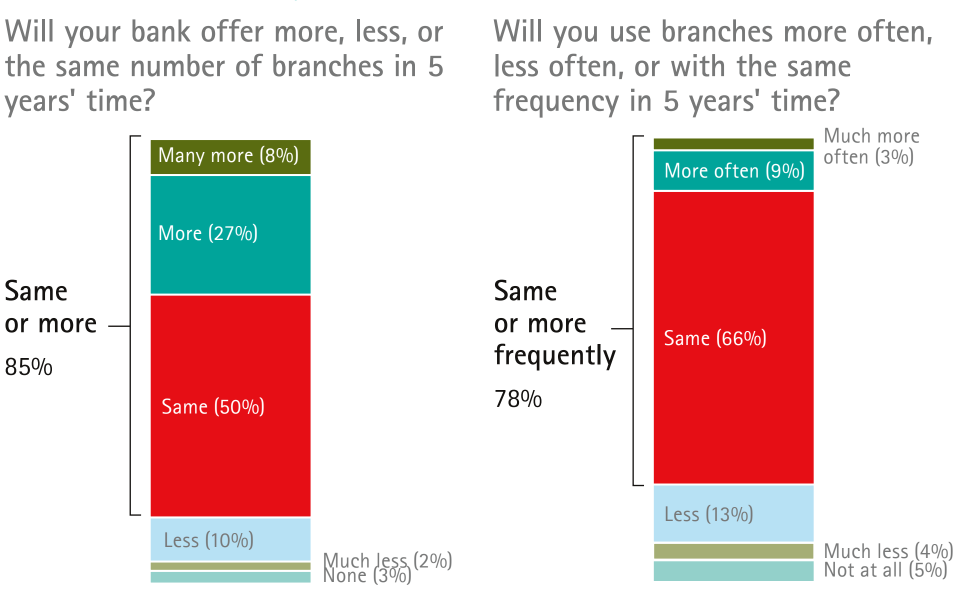
Branches also remain banks' primary engine for sales. Nearly 60 percent of traditional retail bank products were sold via the branch, according to our survey.

Right now, in short, the branch remains the pre-eminent channel. Even so, though bank customers still prefer branches to websites, the margin is narrow—41 percent to 35 percent. Over time, online and mobile banking are likely to push branches into second place.

Branches, in addition, are expensive to build and maintain. Our research shows that the 25 largest US retail banks spend in excess of $50 billion each year on maintaining more than 43,000 branches nationwide, and opening a new branch costs more than $2 million on average.

What's more, there's a significant mis-alignment between the cost of operating a typical full-service branch and the value of the products and services—predominantly simple transactional products and services, such as check deposit and cash withdrawals—that branches offer to customers. It is up to 95 percent cheaper to process deposits digitally than through a teller, for example; and the cost of online and mobile payments is 65 percent lower than payment via physical checks.

FIGURE 4. Future Branch Expectations



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3

The cross-selling challenge persists for full-service providers

US banks still need to work a lot harder at cross selling higher value products. They already have plenty of information about their customers, but they don't necessarily know how to make sense of it. Meanwhile, our research shows that customers are leveraging their particular advantage—significantly more transparent information on products and pricing—to shop around. And many clearly don't think that their primary bank has the best offering. More than half (53 percent) of our survey respondents have chosen a provider other than their primary bank for credit cards, 60 percent go elsewhere for home mortgages, 68 percent use other providers for auto loans, and 82 percent do so for brokerage accounts (Figure 5).

4

The digital era has arrived

Branches remain very important—but digital banking is becoming essential. Consumers view online banking as the single most important area for banks to invest in and develop. Eighty-percent of them use this channel at least once a month. Meanwhile, mobile banking activity has increased nearly 50 percent since 2012, with nearly one-third of customers active at least once a month (Figure 6 on page 9). Digital channels are enabling customers to more frequently interact with their bank, most active online and mobile banking customer use these channels at least weekly.

FIGURE 5. Missing Revenue

From whom did you buy financial services products in the last year?

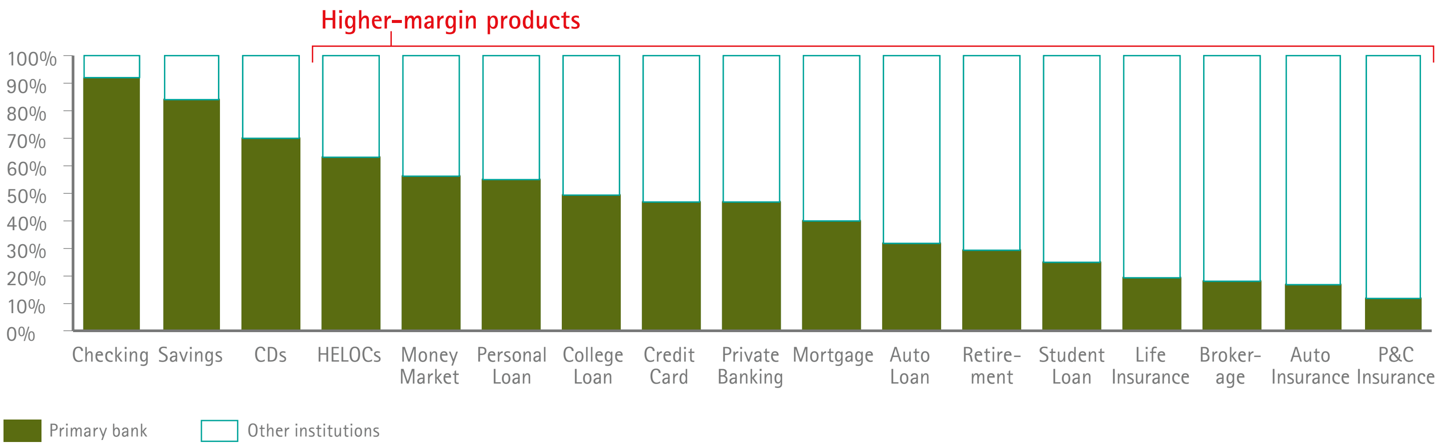

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FIGURE 6. Mobile Banking is Taking Flight

How often do you do mobile banking?

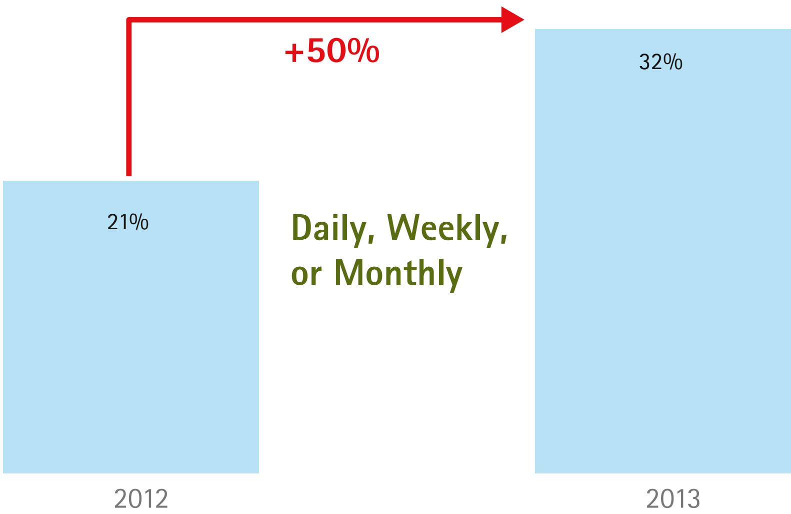

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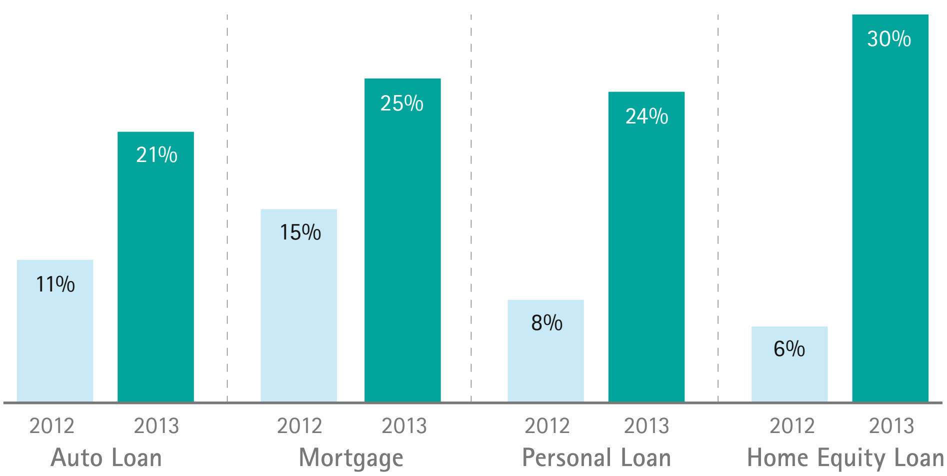
FIGURE 7. Rapid Jump in Online Sales

Where did you buy or sign up for the products that you purchased over the last year? **Online.**



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While branches saw a year-on-year decrease in sales of higher margin products—the Internet managed triple-digit growth across several such categories (Figure 7). Indeed, the Internet is now the most frequently accessed distribution channel on a monthly basis—well above the branch. And mobile use has soared in the past year, almost overtaking the ATM in its perceived importance to customers. More than a third (37 percent) of survey respondents also expect to use mobile banking more in future.

5

The potential of social media and video conferencing remains untapped

Most of the nearly three quarters (74 percent) of banking customers active on social networks still feel that financial activities should be kept separate. But some customers already see tangible benefits from blending the two. Well over a third (38 percent), for instance, say they would like to be able to locate branches via social media. And 30 percent would use it to access customer services. Furthermore, 29 percent are interested in finding financial education material via social media and 26 percent would be happy to receive bill pay reminders.

The story is similar for video conferencing. Only four percent have used video conferencing to conduct their banking activities—but a majority is satisfied with the experience. And 31 percent say they would be interested in using video conferencing in the future.

The Way Forward

The five key findings of our research not only underscore the need for a new approach to distribution. They also suggest a way forward.

Enable the digital model

More personalized service and faster problem resolution—the key reasons for switching banks cited by those that do so—are capabilities at which the digital leaders excel. Customer-centricity and empowerment are their mantra. And they are able to let the customer lead because thanks to their astute leveraging of Big Data and analytics, they know just what the customer wants—often before the customer does. They can anticipate customer needs and engage with them to fulfill those needs in real time.

In addition, their insights enable them to continually innovate compelling new digital offerings and experiences. Our research shows that it is largely inertia that keeps bank customers from switching right now; but as their interest in alternative product and service capabilities grows—and alternative providers continue to expand such offerings—inertia could soon give way to exodus.

Digital, in short, is critical to the more agile and innovative operating model that traditional providers now also require. They can invest in digital to transform their IT platforms, overcoming rigid legacy technology in the back office. They can also power an analytics-driven front office, equipped with deeper understanding of customer needs and thus able to develop a more compelling product set—especially for the high-margin products that customers currently seek from others.

Positioning more products in digital channels can also help make operating costs both lower and more flexible. And it can cut distribution costs, just as it has in the retail industry[2]. Digital banks will spend less on new account acquisition, and new, digital accounts will, in turn, generate more sales.

The digital model can also improve branch performance. Digital channels allow banks to track customer transaction experiences, for example, including at the branch. And the cost advantages of investing in digital channels can be re-invested in upgrading branches. Digital, furthermore, can complement the cross-selling opportunities that are currently being lost at the branch.

Revamp the branch

More branches close to where they live or work was a key reason to switch providers for 27 percent of our survey respondents. About half (48 percent) said they would be inconvenienced by the closure of nearby branches to such an extent that it would induce them to switch.

Yet, over the next five years, as technology advances and online services become increasingly available, branches will likely lose business—unless traditional banks leverage their strategic advantage more effectively by reimagining the branch concept.

Some of the largest US retail banks are already experimenting with more open and flexible branch formats that give customers multiple options, 24/7, and that could, in addition, lower the banks' own cost to build by 33 percent and their cost to operate by 25 percent.

We foresee greater diversity of branch types, tailored to the locations and functions they serve:

- "Light" branches—highly automated and focused on sales, but providing access to remote advisory specialists via video conferencing—a technology with the long-term potential, we believe, to bridge the service gap between channels
- Kiosks—geared to routine account services, featuring advanced ATMs with video, and located in malls and transport hubs. These, we believe, could account for up to half a bank's branch network
- Full-service "hubs"—like conventional branches but fewer in number, offering full sales and service support with extended hours and specialized providers for such products as mortgages and trading
- Flagships—a small number of strategically located centers of sales and service excellence to promote the bank's brand and introduce new offerings around simpler and seamless-to-use self-service tools

Pioneering banks are already investing in employee tablets, self-serve kiosks and instant-issue credit card machines. In the future some even plan to introduce video tellers and account opening facilities via mobile tablet, which could dramatically cut the cost of processing deposits, relative to the use of ATMs.

Digital channels could be leveraged to promote higher-value branch usage. Moreover, these developments will reinforce a holistic sales process since branch customers will be able to use such digital access points as video tellers and mobile tablet account opening while in the branch.

A Winning Combination

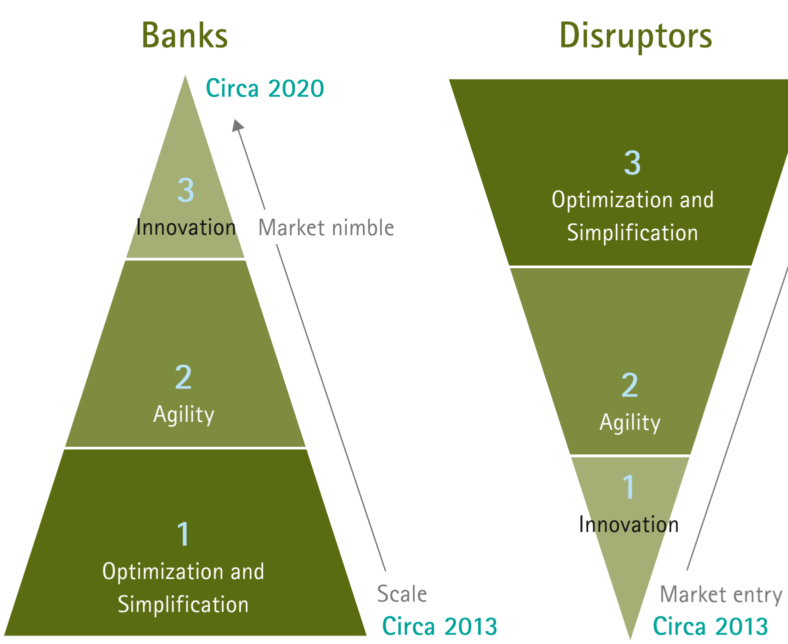
By simplifying the cost structure of their branches and optimizing their branch offerings, traditional providers can maximize the advantages of what is still a core strategic asset. But it is only by complementing the branch with digital, and continually innovating the customer's digital experience across channels, that they will develop a truly powerful, winning combination.

In this regard, traditional providers have much to learn from the digital disruptors—players that have taken their cues from the best practices of the most successful retailers: a customer-first approach that leverages "always on" analytics to deliver a seamless, cross-channel experience (Figure 8).

The digital disruptors lure customers with offers related to their ability to spend—new categories of highly utilitarian bank account, for example, that don't come freighted with checking or overdraft fees. They also market through multiple online channels, notably mobile and social—a channel with huge under-utilized potential that traditional banks could also use to gain valuable customer feedback and ideas, as well as information vital to serving customers better.

By infusing digital throughout the enterprise, getting smarter about data, and developing one look and feel across all channels, US retail banks can ensure that wherever their customers are, they are there too—becoming, integral to the everyday lives of a sustainable community of customers.

FIGURE 8. Emerging Disruptors



Common Characteristics of the Emerging Disruptors

Emphasize social responsibility

Focus on customer centricity and empowerment

Present simpler fee structure to customers

Provide personal financial management tools and access to other accounts

Embedded with social media, especially Facebook

Leverage Big Data and analytics

Offer mobile bill pay, P2P, remote-deposit, free ATM access

Moving up the Value Chain

Banks risk lower margins and, thus, shrinking market share, unless they can leverage digital to play a bigger role in their customers' commercial lives. We are, after all, witnessing a digital revolution that will transform US retail banking, impacting an estimated 40 percent of revenues and 55 to 60 percent of operational processes[3].

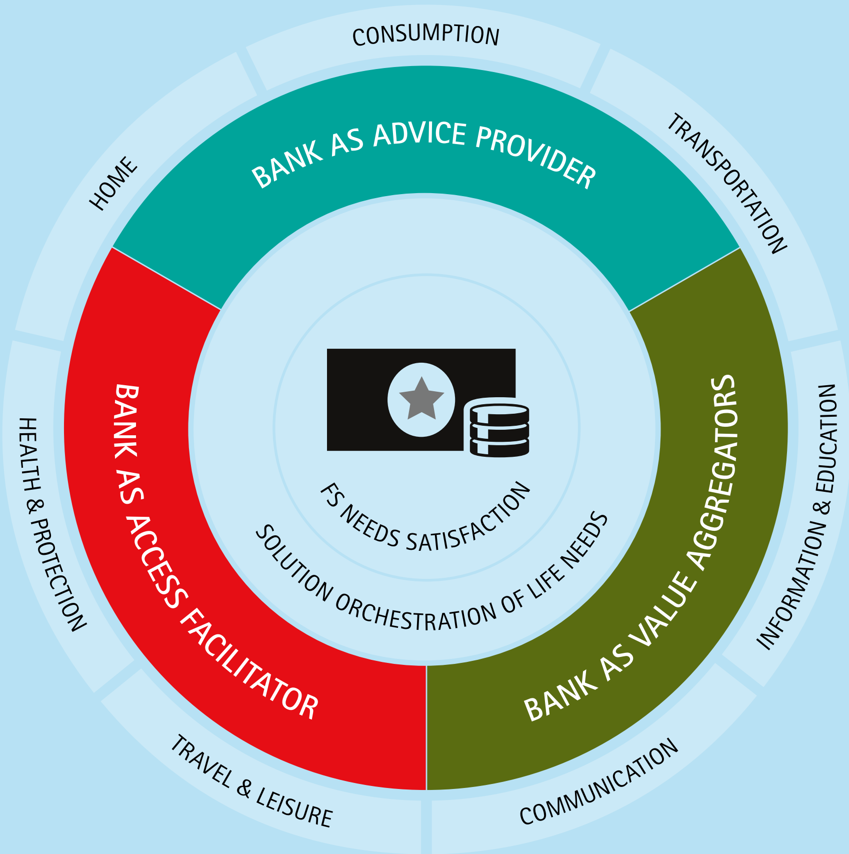
As banks come to appreciate the full significance of this digital revolution we anticipate a major rethink in the industry—and the eventual emergence of a new service model that will open up entirely new sources of growth.

The key to effectiveness in making this strategic shift will be continuous innovation to enter—and achieve a pivotal place in—other value chains. Becoming so central to a customer's life that when, for example, they buy a car, their bank is there not only to provide the loan, but also to negotiate the best price and help insure, service and maintain the vehicle.

To orchestrate the fulfilment of such needs throughout their customers' lives, dynamic banks should look to develop and manage three new roles:

- **Value Aggregators—**offering a distinctive portfolio of products and services through the bank, but within a broader ecosystem of services providers
- **Advisors—**continuously leveraging analytics engines/algorithms to gain the deep customer knowledge that will enable them to personalize their advice
- **Facilitators—**accessing cross-industry products and services through support experiences with "hidden" partners and leveraging tools like digital id and d-wallet

FIGURE 9. Banks Should Look to Develop/Manage Three New Roles



For more information

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About the research

Accenture conducted online interviews with 2,001 US retail banking customers of the 15 leading retail banks doing business in the US today—including the 10 largest US-based retail banks, three of the largest foreign banks with a branch network in the US and the two largest US virtual banks. The survey was conducted in May 2013. It has a statistical margin of error of 2.2 percent. Year-over-year comparisons are based on the results of the same survey fielded by Accenture in June 2012.

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3 *The Everyday Bank: How Digital is Revolutionizing Banking,* Accenture, September 2013

About Accenture

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