

GLOBAL RETAIL BANKING 2016

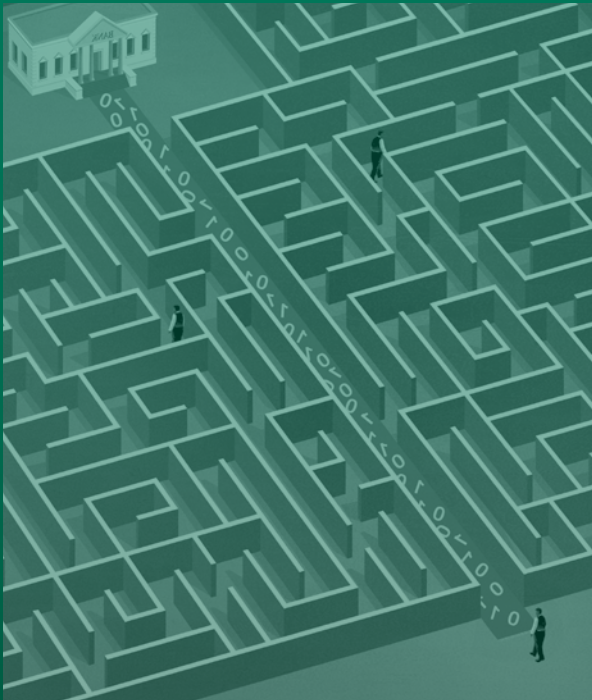
BANKING ON DIGITAL SIMPLICITY



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INTRODUCTION

DESPITE A TENTATIVE FINANCIAL recovery, the retail-banking industry faces unrelenting, disruptive challenges. Banks that hope to prevail must urgently pursue digital simplicity. That is, they must develop digital and data capabilities that radically simplify their businesses while dramatically improving the customer experience through greater efficiency, quality, and speed.

That mandate for digital simplicity is the central insight emerging from the research behind this sixth edition of BCG's annual review of the industry.

This year we have widened and deepened the perspective of our past research to provide a comprehensive and data-informed assessment of retail-banking excellence, or REBEX—the abbreviation referring to our report and its underlying benchmarks, surveys, databases, and tools. Our intent is to identify actionable insights into the leading global trends, the best practices of top-performing banks, and the key levers available for improving performance.

This year, our assessment of retail-banking excellence, or REBEX, features expanded benchmarks, surveys, databases, and tools.

We open with an overview of the industry's financial performance, based on BCG Banking Pools data, reporting that global retail-banking revenues rose 3% in 2015, to nearly \$1.6 trillion, with wide disparities among regions.¹

We then examine competitive trends and capabilities driving the industry. We analyze the customer-driven digital transformation of banking, drawing insights from BCG's proprietary Consumer Digital Banking Surveys of digital behavior and expectations in nine countries. In China, for example, the survey found that customers who use both human and digital channels are two to six times as likely as other customers to be affluent but are also more challenging to serve.

The report then examines the ramifications of the industry's weak performance in BCG's Brand Advocacy Index (BAI)—which ranks retail banking's brand advocacy lower than that of most other industries, sometimes by more than 30 percentage points.

A deep dive on financial-technology (fintech) competitors examines the impact of fintechs and other upstarts that are challenging—and sometimes partnering with—traditional banks.

Next, we report the results of BCG's annual benchmarking of the operational and digital excellence of leading retail banks, assessing the trends and capabilities that increasingly separate the top performers among the leading banks from the median. This year, once again, the best operational and digital performers reaped the lion's share of financial rewards—for example, 50% higher average pretax profit per customer than the median. Additional data from the benchmarking, as well as from BCG Banking Pools research and the BAI and Consumer Digital Banking Surveys, is provided in an appendix to the report.

As the world's top-performing retail banks continue to widen their lead over the rest, banks that aspire to join them at the top will need to jump-start their digital transformation. The report's final chapter discusses the specific steps that banks can take to achieve that goal.

Tentative Recovery, Disruptive Challenges

Banks will have to make that digital transformation amid a welter of challenges and risks. While they are experiencing a tentative recovery, banks face continued pressure on margins. Digital technologies increasingly disrupt the industry, and competition is intensifying. Regulatory oversight will continue to tighten. Return on equity (ROE) will remain constrained as fines and restructuring costs affect profit, while revenue growth will struggle to keep pace with increased capital requirements.

Additionally, digital innovators like Amazon, Airbnb, and Uber have raised the bar for consumer expectations regarding service, speed, and convenience and have created the expectation that banks will interact seamlessly with customers through digital channels while offering human interaction at moments that matter. At the same time, fintech upstarts are increasingly disrupting the industry, eroding the profitability of traditional business lines, from lending to personal finance, payments, and retail investments.

These and other players—from inside financial services and beyond—threaten to disintermediate banks' relationships with customers and transform the retail bank into little more than a utility in the eyes of consumers.

Banks need to act urgently to prevent this erosion of the customer relationship. Strategy and culture must be transformed. No longer can banks be product centric; instead, they must truly fulfill the evolving needs of digitally enabled customers. Distribution models should seamlessly blend digital and human interaction. The customer-led migration to digital channels is starving traditional banks of foot traffic in branches. Banks need to be more proactive and precise in targeting and engaging customers. To survive, they must reimagine every element of the customer experience—deepening, broadening, and customizing the customer relationship in a newly agile manner.

Banks Must Simplify—and Do So Radically

The best banks will learn from, and sometimes partner with, emerging fintech players to integrate new digital solutions and deliver exceptional customer experience. To cooperate and take advantage of fintechs, banks will require new partnering capabilities. To heighten their understanding of customers' needs and to deliver products and services that customers truly value, banks will need new capabilities in data management and analytics.

Most banks today have a considerable distance to travel on the journey to overcome the compromises and frictions that degrade the customer experience. To get started, banks must simplify. And they must do so radically. The technological revolution creates an opportunity to achieve digitally enabled simplicity—by moving beyond incremental change and instead fundamentally challenging complexity in every area of their business. Digital simplicity includes rightsizing product portfolios, redesigning customer journeys to create natural pathways across channels, and using digital technologies to industrialize core processes from end to end. The payoff can be measured in an improved experience for the customer and significantly increased efficiency for the bank.

Leading banks are making progress by both measures, as the results of BCG's sixth annual Global Retail-Banking Excellence benchmarking show. They are reducing cycle times for core processes, such as account opening, while achieving higher rates of straight-through-processing and improving productivity. At the same time, the REBEX leaders are reallocating resources from back- and middle-office functions to customer-facing advisory roles. Almost all banks in the benchmarking are making operational advances. But the gap between leading banks and the rest is significant and growing.

In short, the competitive standards for operational and digital excellence and radical simplicity are becoming more demanding, and the table stakes are rising, with opportunities for median players to reduce operating expenses by 15% to 25%, increase pretax profit by 20% to 30%, and boost pretax profit margins by 5 to 10 percentage points.

Embedding and sustaining such change requires transforming the entire organization. That is much easier said than done. Agile approaches to development are needed in order to design and adopt fresh ways of working. Cross-functional teams of personnel responsible for product development, marketing, operations, legal and compliance, IT, and testing must be deployed, working in short cycles, to reduce time to market. Scarce entrepreneurial talent must be attracted and retained, and a program of culture change must be implemented to embed a digital mind-set that supports organization-wide collaboration and risk taking.

The Four REBEX Requirements for Leadership

In the next few years, the disparity in performance between the leading banks and the laggards will widen further. To rank among the leaders, a bank will need to achieve four primary goals:

- **Understand, strengthen, and deepen customer relationships.**
Move from being product-centric to become customer-centric. Consider extending offerings to include nontraditional services through digital platforms.
- **Reimagine customer journeys from front to back using digital technologies.** Understand natural customer pathways across channels to overcome hidden customer compromises and frictions. Include middle and back offices in digital roadmaps.
- **Create agile, simple, and highly collaborative organizations.** Build a digital-ready culture. Deploy cross-functional teams that work in short cycles. Become more comfortable with making decisions amid uncertainty. Compete for scarce entrepreneurial talent.
- **Enhance digital capabilities.** Fail fast and fail cheap, and build digital capabilities through direct experience.

On the basis of BCG's global client experience, we believe that these goals represent the levers employed, and the practices followed, by leading retail banks in continuously improving their performance.

NOTE

1. BCG Banking Pools is a proprietary database that tracks the industry's global financial performance. It permits assessment by country, region, product, and banking segment, including corporate, retail, and private banking; asset management; and corporate investment banking. Retail-banking revenues in this report include banking receipts from small- and medium-size enterprises but exclude private banking. The global revenue total for 2015 is an estimate.

TOWARD FINANCIAL RECOVERY

AFTER A DIFFICULT PERIOD of variable growth, margin pressures, and intense and increasing regulatory intervention, global retail banking has entered a tentative recovery phase. Stability and growth are gradually, if unevenly, returning to markets and economies. Nevertheless, interest rates track decade-long historic lows, with no consensus about when they might rebound. (Other macroeconomic trends are discussed in the next chapter.)

Global Revenues Rise to \$1.6 Trillion

Global retail-banking revenues rose by an estimated 3% in 2015, from \$1.54 trillion to \$1.59 trillion, BCG Banking Pools research found. (See Exhibit 1.) The growth rate of global revenues is expected to show relative recovery during the second half of the decade, rising close to precrisis levels. (See Exhibit 2.)

In 2015, the Americas and Western Europe accounted for 62% of the global market—but less than 30% of its growth. Emerging markets, particularly those in Asia, were the engine of revenue growth, and that trend is likely to continue.

Revenue growth outpaced the rise in operating costs, producing a steady increase in operating profits. Although regulatory fines and restructuring costs continued to escalate,

overall risk costs fell because loan loss provisions shrunk.

Profit growth did not reduce pressure on ROE, however, as capital requirements continued to increase in tandem with profit.

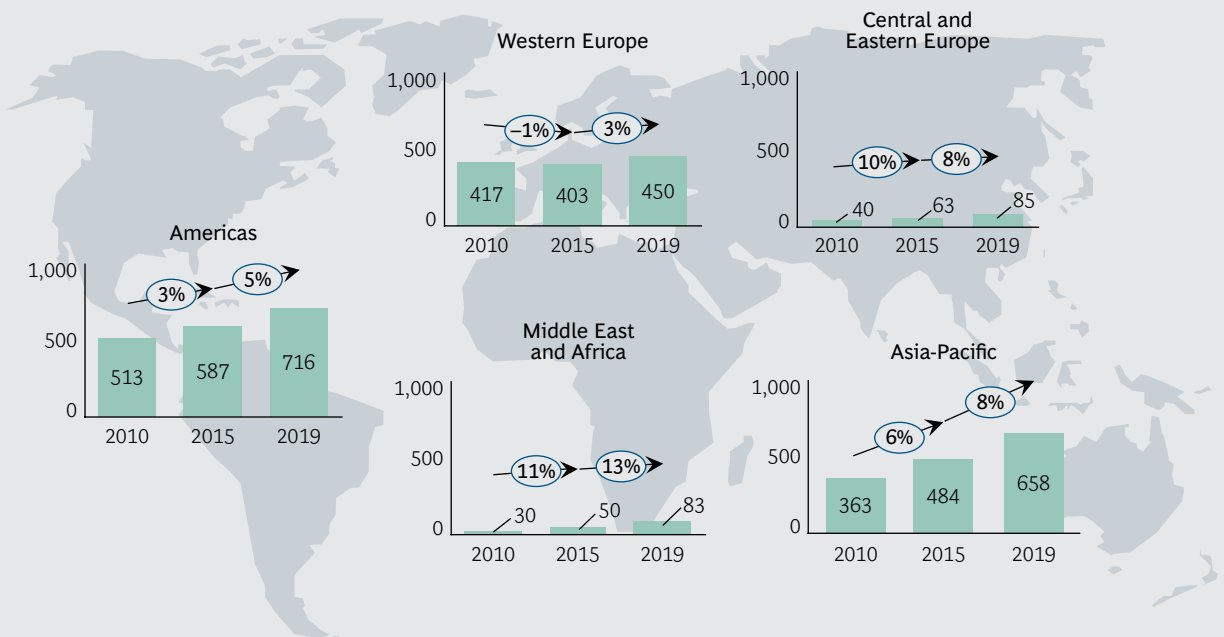
Regional Growth Trends and Outlook

The performance of retail banks continued to vary significantly by region in 2015, as did their near-term outlook. Asia retained its role as the industry's growth engine, and Western Europe remained sluggish. In North America, signs of growth appeared.

In December 2015, the US Federal Reserve inched rates higher for the first time in almost a decade, a move that was regarded as the potential start of a gradual tightening of monetary policy. Three months later, the European Central Bank (ECB) moved in the opposite direction. It cut its main interest rate and bank deposit rate, increased its “quantitative easing” bond-buying program, and reduced its economic-growth forecast for Europe. The contrasting moves—amid volatile markets and anxiety about financial stability—heightened concerns regarding whether the Fed, the ECB, and other leading central banks, including the Bank of England, the People's Bank of China, and the Bank of Japan, could coordinate monetary policies.

EXHIBIT 1 | Emerging Markets Drive Retail-Banking Revenue Growth

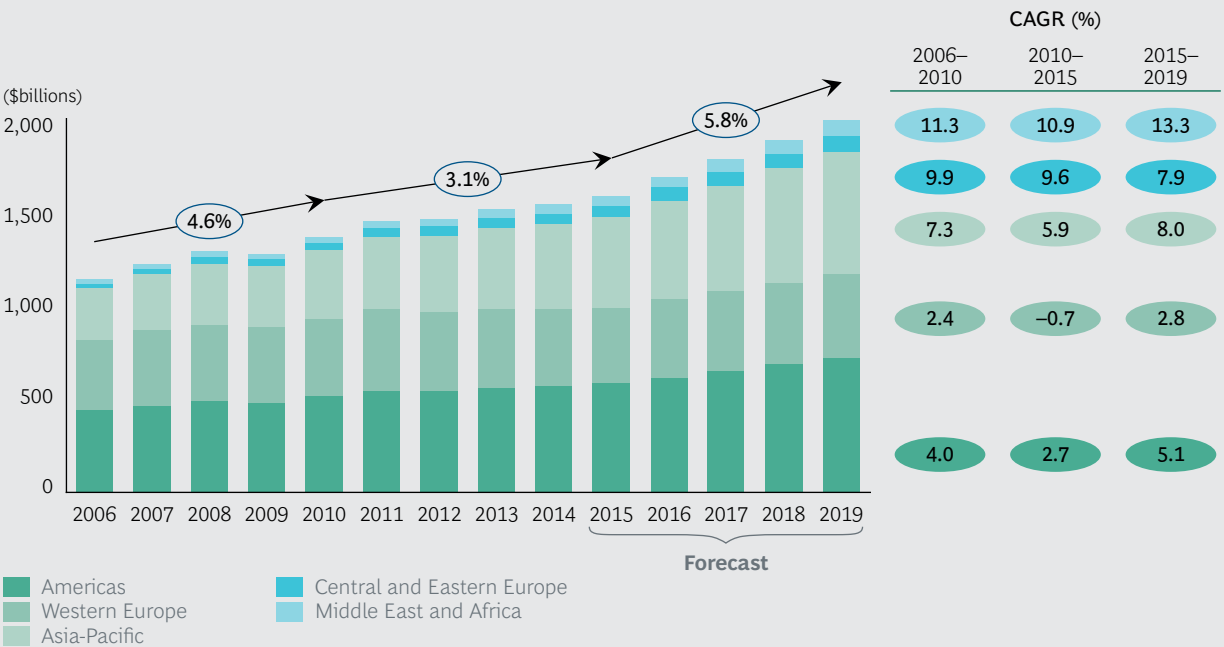
RISE OF REVENUES BY REGION (\$BILLIONS)



Sources: BCG Banking Pools 2015; BCG analysis.
Note: Estimated retail-banking revenues are for approximately 2,100 banks and are based on region-level financial and macroeconomic data. Data for 2015 and 2019 are forecasts; actual revenue estimates for 2015 will be available in spring 2016 following 2015/2016 annual-report publications. Growth rate calculations reflect rounding.

EXHIBIT 2 | Global Revenue Growth Is Expected to Return to Precrisis Rates by the End of the Decade

GLOBAL RISE OF RETAIL-BANKING REVENUES



Sources: BCG Banking Pools 2015; BCG analysis.
Note: Estimated retail-banking revenues are for approximately 2,100 banks and are based on region-level financial and macroeconomic data. Data for 2015 through 2019 are forecasts; actual revenue estimates for 2015 will be available in spring 2016 following 2015/2016 annual report publications. Growth rate calculations reflect rounding.

Americas (37% of Global Revenues). In North America, retail-banking revenues grew by approximately 1% in 2015. Many players saw flat or slightly declining growth. Deposits grew strongly and asset quality was robust, but profits grew slowly owing to continuing low base rates and modest consumer loan growth.

Regulations are pushing up North American banks' costs and complexity. Despite efforts, performance on operating efficiency has been flat at best. In this environment, banks are starting to decisively make major strategic investments in multichannel capabilities. These include new branch formats, digital sales and service, and advanced data and analytics. The best banks proactively identify near-term tactical initiatives to "fund the journey." These include pricing, simplifying the operating model, reengineering end-to-end processes, and sourcing. At the same time, these banks define a clear strategy and operating model for the medium term. They also identify critical enablers, such as more agile ways to deliver innovation and the development of talent in digital and analytics.

In Latin America, growth was sluggish in 2015, especially in US dollar terms. ROE decreased as a consequence of devaluations, a challenging interest rate environment, and higher costs of risk and regulation. However, average ROE remained in the 15% to 25% range. Despite cost-to-income ratios that were often below 50%, Latin American banks are still working to become more efficient. They are also looking to increase fees and commissions so that they will be less reliant on net-interest income. And Latin American banks are innovating, especially in electronic payments, to increase banking penetration from today's relatively low levels. Recent waves of regionalization-driven M&A in Latin American banks are subsiding; the number of deals will decline, and banks will shift their focus to postmerger integration to reap the benefits of past deals.

Western Europe (25% of Global Revenues). Income growth was sluggish, as interest rates remained at historically low levels in the Eurozone, the UK, and other Western European markets. Impairments returned to long-

term levels in many markets, as higher-quality lending displaced precrisis loan books, but in some markets, banks continued to work through the difficulties. Regulatory costs and fines rose considerably in many markets, while increased capital requirements placed further pressure on ROE. As a result of these trends, we see a widening disparity of financial performance across the region, with the best retail banks targeting cost-to-income ratios of 40% to 45% but many others struggling to get below 70%.

Regulations are pushing up North American banks' costs and complexity.

Many Western European retail banks have deleveraged their balance sheets, refocused on franchise customers, simplified their organizations, streamlined product ranges, and worked through their impairment legacy. This has left white space in the market for specialist players and fintechs to target specific customer niches. At the same time, Western European retail banks have experienced a fairly sizable migration of transactional flow out of the branches and into direct channels. This has created a dilemma for those banks: they seek to rationalize their branch networks (to reduce the cost to serve) yet to simultaneously retain their reach (to serve customers in key moments when human interaction is favored).

Looking forward, Western European banks will remain focused on income growth by serving as customers' main bank and providing multiple products, improving service through multichannel optimization, controlling costs through branch optimization and end-to-end digitization, improving operations and agility, and making compliance a way of doing business rather than an independent process.

Asia-Pacific (30% of Global Revenues). Asia continued to serve as the growth engine of retail banking, with profit increases in the high teens. Given the rapid expansion of many emerging markets in this region, sales

force effectiveness and branch network optimization have been important capabilities for capturing market share. Recognizing that end-to-end digitization is important as a way to drive efficiency, reduce costs, and enhance the customer experience, incumbents across the region launched innovative digital offerings at an accelerated pace. Developments at the national level helped spur growth, including interest rate liberalization and new differentiated bank licenses in India.

Australian banks continued their strong performance, with ROEs in the high teens.

Even though Asia's emerging markets are heterogeneous, the emergence of nonbank digital players has been a common theme, particularly in payments and consumer lending. Many of these players are designed to be "mobile first," an approach that may help the region make big strides in financial inclusion. In addition, inspired by innovation in China, leading retail banks across the region are enhancing ecosystem collaboration to expand their reach and encourage customer engagement.

Australian banks continued their strong performance, with ROEs in the high teens and low cost-to-income ratios. These results were supported by a relatively high interest income and a robust housing market. Australia has significantly outpaced its global peers in digital-channel usage. As a result, service is migrating out of branches at an accelerating pace; branch staff and size have fallen and total branch numbers have remained flat. Productivity improvement and cost reduction remain opportunities for Australian banks, especially compared with banks in other markets. Nonbank digital players are entering the market in Australia in increasing numbers but have yet to significantly erode traditional banks' market share. While the regulatory burden facing Australian banks is increasing, it lags that in other developed markets, such as the UK, by several years.

Central and Eastern Europe (4% of Global Revenues). In 2014, retail banking in Russia was negatively affected by financial turmoil. The swift devaluation of the ruble, market volatility, and a scarcity of funding as well as negative assessments by rating agencies led to stagnating revenues (compared with previous year-on-year growth of 25% to 30%).

Russian banks responded in 2015 by aggressively downsizing their branch networks and moving customers to remote servicing. In some cases, government authorities took over weak players. If the Russian economy improves in 2016, retail banks should record greater profits and lending volumes, driven by reduced risk and funding costs. The benefits of 2015's cost-reduction measures are also likely to be felt in 2016, easing the pressure on profitability.

In Poland, many retail banks sharpened their focus on segmenting customer bases using customer relationship management systems. They also sought to improve the customer experience through more effective onboarding, enhanced mobile-banking capabilities, and digitally driven simplification.

Elsewhere in the region, channel optimization and sales force effectiveness were strong themes. Banks also strengthened their consumer finance businesses to tap the growing spending power of consumers.

Middle East and Africa (3% of Global Revenues). In 2015, banks in the Middle East continued to see ROE in the midteens, thanks to the low cost of funding themselves from customer deposits and relatively low risk costs. Any rise in interest rates would be good news for the region's banks, as low-cost deposits would allow better margins. Especially in the Gulf Cooperation Council zone, banks generated solid asset growth of 8%. They also responded to tighter liquidity by running promotions and sales campaigns to gather more deposits. As in other markets, digital has been at the top of the agenda. Local banks have launched digital propositions to tap into high Internet and smartphone penetration. The first digital challenger bank in Saudi Arabia, Meem, the retail-banking arm of Gulf International Bank, was launched in 2016.

In 2016, Middle Eastern retail banks should expect continued pressure on margins and liquidity; the cost of funds is anticipated to rise by 50 basis points on average. Banks will continue to respond to increases in fund costs by pricing more keenly, revisiting their operating models to become lean, and investing in digital capabilities. They will also seek to address the challenge of acquiring new customers from among a relatively young and tech-savvy population that is confronting rising unemployment.

In North and sub-Saharan Africa, banks concerned themselves in 2015 with setting up the infrastructure and capabilities to succeed in the medium term. Their priorities included establishing clear strategy and value propositions, segmenting customer bases to offer differentiated propositions, and future-proofing their IT and sales organizations.

As in other regions, mobile financial services, particularly money transfer and payment offerings, continued to expand rapidly in Africa, providing many sub-Saharan Africans with their first formal banking experience. (See *Africa Blazes a Trail in Mobile Money: Time for Banks and Mobile Operators to Devise Strategies*, BCG report, February 2015.)

TRENDS DRIVING THE INDUSTRY

THE RETURN OF ECONOMIC growth to many markets, albeit at different rates, should help to boost the overall outlook for retail banking. At the same time, however, banks face a number of diverse challenges and uncertainties, including macroeconomic fluctuations, tighter regulations, customers' heightened digital expectations, a need for better brand advocacy, and new sources of competition.

Banks Face Macroeconomic and Regulatory Uncertainties

Any rise in interest rates will likely boost the economics of many banks—but not all banks and not equally. First, it is unclear how much banks can increase net-interest margins in an era of heightened regulatory scrutiny. Also, as rates rise, the increasing contingent of Internet-informed retail depositors, more aware than their predecessors of alternative opportunities for better returns, might abandon savings accounts—a potential “digital run on the bank.”

Competition and higher impairments could also erode the potential benefit of higher interest rates. Historically, in many markets, rising interest rates have moved income from assets to liabilities without materially changing the overall net-interest margin. Also, many banks would have to balance the political pressure to keep borrowing rates low,

while increasing deposit rates for long-suffering savers.

In some regions and for some market activities, the introduction of new regulations has slowed—for example, in anti-money-laundering compliance. But that has done little to reduce the uncertainties that banks face, especially since many banks have yet to develop effective ways to both manage regulatory requirements and rein in compliance costs.

One notable uncertainty concerns future capital requirements under Basel IV, which will likely have a significant impact on banks' economics and business models. Until banks are given more guidance, bank managers will remain strategically frozen. Banks should expect higher levels of risk-weighted assets to be the “new normal.” They should start scenario planning now on that basis to design their product mix and funding choices.

Consumer protection continues to be paramount for regulators in mature markets. That concern is evident from the relatively intrusive levels of intervention on matters related to retail customers, such as payment protection insurance and packaged accounts in the UK. Regulatory efforts to ensure that customers are treated fairly will persist. Pressure by regulators to implement ring-fencing arrangements—to insulate and protect depositors' assets, for example—is likewise increasing.

This poses particular challenges for European banks. In less mature markets such as those in Southeast Asia, however, regulators are currently much more concerned about system stability than about conduct and protection.

Until now, banks have generally bolted compliance activities onto existing processes, increasing organizational layers to address new regulations as they arise. This has led to over-size compliance functions—which are now a target that banks can take aim at. Banks have the opportunity to fully redesign and optimize their bloated compliance processes, embedding “smart compliance” in digitized customer journeys. (See “Enabling Sustainable Compliance at Banks,” BCG article, September 2015.)

Customers Are Driving Digital Transformation

Consumer expectations are increasingly influenced by the advances of digital pioneers in the retail sector, such as Amazon, Netflix, and Uber, whose users access services 24-7. Bank customers now expect quick and convenient service from their banks as well—through simple, intuitive interfaces. But they also expect human interaction when they need it. In other words, they want a “bionic” banking experience: one that combines digital and human elements. (See *The Bionic Bank*, BCG Focus, March 2015.)

The emergence of innovators like Apple Pay and Google Wallet is also changing the competitive landscape for banks. New products and payment methods are challenging the relevance of traditional banks’ offerings and threatening their customer relationships. Unless they act, banks face an increasing risk of commoditization: customers will begin to regard banks as public utility companies, a trend that will put downward pressure on margins and undermine pricing power.

One way for a bank to avoid that fate—to differentiate its offerings and value—is to provide a superior customer journey. But doing so is also a challenge. Increasingly, customer transactions are not only multichannel but also multistep. Users are often distracted, their attention fragmented. Often, they use

product applications and complete other banking tasks over several sessions, perhaps using more than one device. Mobile-device screens are small, and bank advisors aren’t present to guide the way. Any provider able to surmount these impediments and give the customer a smooth, painless, digitally simple experience will be ahead of the pack in winning the customer’s loyalty.

Consumers’ expectations are increasingly influenced by the advances of digital retailers.

Digital technologies and data analytics represent a significant opportunity for banks not only to better meet the needs of their customers but also to lower their costs and increase their efficiency. The best banks are now fully seizing these opportunities and capitalizing on them. Those that fail to act will be left behind.

In our experience, enhanced digital capabilities drive substantial and measurable improvements in banks’ financial and operational performance. These benefits can include boosting revenues per customer by 50%, increasing customer penetration by 30%, and reducing operating costs by as much as 20%. (See Exhibit 3.)

Digital channels, especially mobile, are growing rapidly worldwide. Customers increasingly prioritize digital functionality when choosing a bank, our Consumer Digital Banking Surveys found. But our research also revealed that consumers continue to demand personalized, face-to-face contact at key points in their banking relationship.¹ Further, our research shows that these multichannel customers—those who use both digital and face-to-face channels and thereby seek what we have called a bionic banking experience—are more valuable: they have higher income and more assets, and they hold more products.

Our findings also showed conclusively that multichannel customers have higher expectations than single-channel customers and

EXHIBIT 3 | Enhanced Digital Capabilities Improve Bank Performance

	KEY PERFORMANCE INDICATOR	IMPACT ¹	DETAILS OF IMPACT FROM CASE EXPERIENCE
GO-TO-MARKET ACTIVITIES, CUSTOMER EXPERIENCE	Revenues per customer	50%	Banks with superior lead management and customer intelligence have 50% greater revenues per customer than peers
	Lead management and cross-selling	4x–5x	Targeted cross-selling, based on sophisticated data mining of customer transaction history, raised redemption rates from approximately 5% to 20%–25%
	Customer targeting	75%–80%	Enhanced intelligence correctly classifies 75% to 80% of customer needs and preferences
	Customer penetration	+30%	Better targeting and superior customer satisfaction can result in an increase of 30% in products per customer
	Loyalty and advocacy	+20%–25%	Poor customer centricity is among the main reasons for switching banks, but steps such as making proactive calls to at-risk customers, based on predictive models, reduced attrition by 25% at one bank, for example, and helped boost customer advocacy by 20% at another
OPERATIONS	Operating costs	Up to 20% reduction	Digital-enabled customer centricity drives operational complexity down (to, for example, one-third fewer products)
	Full-time employees	30%–40% reduction	Depending on whether it is possible to partially or fully digitize the process, reduction of full-time employees varies; on average, expect a 30% to 40% reduction
RISK	Costs, including risk costs	20% reduction in clients in arrears	New predictive techniques to understand late payments and the probability of recovery; process differentiated by customer profile (quick recovery versus no action)

Source: BCG analysis.

¹Impact observed at various best-practice banks.

therefore are more challenging to serve. (See Exhibit 4.) They demand that their banks be simpler, quicker, more integrated, and more personal. Banks that get their offering right for this demanding group are more likely to get it right for the rest of their customer base.

Cybersecurity is also of increasing concern to customers amid a rising number of high-profile data thefts and account breaches. Customers require account security that offers gold-standard data protection but does not compromise the quality, speed, and ease of their banking experience. Questions remain regarding the extent of bank liability when a third-party provider, such as a retailer or a dating website, loses credit card data or fails to prevent the hacking of customer accounts.

Retail Banks Need to Improve Their Brand Advocacy

Banks looking to assess and improve their customers’ experience can do so through a sim-

ple yet powerful indicator that is also one of the best predictors of business performance: word-of-mouth recommendation, or brand advocacy. That’s the good news. The bad news is that most retail banks—and the industry as a whole—register weak brand advocacy compared with other industries.

BCG’s Brand Advocacy Index (BAI) measures word-of-mouth influence, including both recommendations and criticism, for 650 brands in more than 35 industries based on 120,000 surveys completed in eight countries worldwide. Responses are weighted to give an overall brand advocacy score by brand per country. The 2015 BAI study showed that retail banks rank significantly behind businesses in most other industries in brand advocacy, though direct banks fare slightly better. (See Exhibit 5.)

Globally, just 37% of customers positively recommended their retail banks. Direct banks—mostly small, upstart players that forgo

EXHIBIT 4 | Multichannel Customers Are More Demanding and More Challenging to Serve

RANKING OF SEGMENTS BASED ON THE PERCENTAGE OF RESPONDENTS WHO CONSIDER A PARTICULAR FEATURE “EXTREMELY IMPORTANT” (1), “VERY IMPORTANT” (2), OR “IMPORTANT” (3)

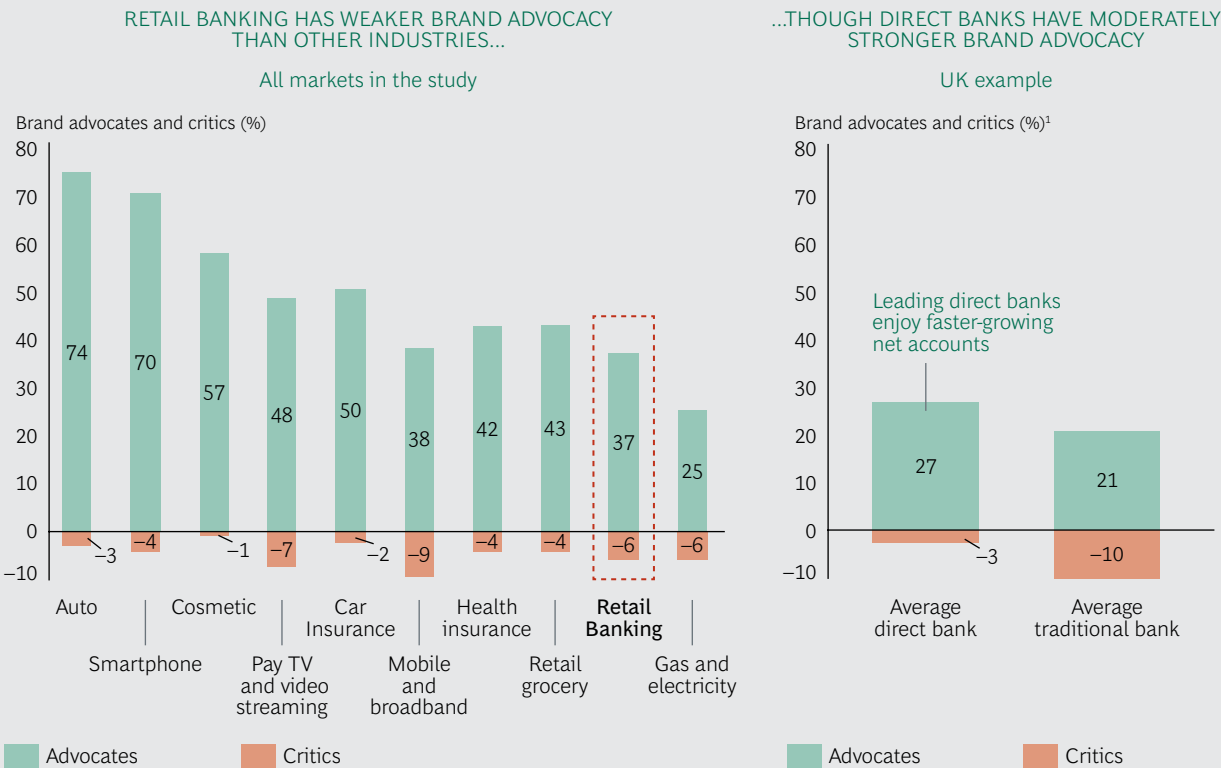
CUSTOMER PROFILE	MY BANK SHOULD HAVE SINGLE LOGIN FOR ALL CHANNELS								
	Digital	Face to face	Multichannel	Netherlands	Brazil	Belgium	Italy	France	China
Digital	2	2	2	2	2	2	2	1	1
Face to face	3	3	3	3	3	3	3	3	3
Multichannel	1	1	1	1	1	1	1	2	2

CUSTOMER PROFILE	I SHOULD BE ABLE TO OPEN A NEW PRODUCT WITH TWO OR THREE CLICKS								
	Digital	Face to face	Multichannel	Netherlands	Brazil	Belgium	Italy	France	China
Digital	2	2	2	2	2	2	2	2	1
Face to face	3	3	3	3	3	3	3	3	2
Multichannel	1	1	1	1	1	1	1	1	3

	Netherlands	Brazil	Belgium	Italy	France	China	Spain	UK	US
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Source: BCG Consumer Digital Banking Surveys, 2014/2015.
Note: Digital customers are those who perform an online banking transaction at least once every two to three months and visit branches no more than once a year. Face-to-face customers are those who use branches for transactions at least once every two to three months and perform online transactions no more than once a year. Multichannel customers are those who perform an online banking transaction at least once every two to three months and visit branches at least once a year. The average is weighted by the size of the segment.

EXHIBIT 5 | Retail Banks Are Weak in Brand Advocacy, Though Direct Banks Score Better



Sources: IntelliSurvey of approximately 123,000 respondents in the US, Canada, UK, France, Germany, Italy, Spain, and Japan; BCG analysis.
Note: A bank is a direct bank if it has no physical retail branches. BAI calculates advocacy by tallying recommendations from advocates and critics on a weighted basis. Respondents were asked whether they recommended [retail bank A, B, and so on] in the last 12 months:
• I've recommended it spontaneously (without being asked).
• I've recommended it when asked about it.
• I haven't recommended it or criticized it.
• I've criticized it when asked about it.
• I've criticized it spontaneously (without being asked).
¹Averaged across the category.

branches and tellers to offer fluid, no-waiting services often online or mobile only—fared better than traditional brick-and-mortar banks in all markets. They were recommended on average by 44% of customers and sometimes by more than 60%—a high level of advocacy that helped them to achieve stronger net account growth in 2015.

In Germany, the three most-recommended banks were direct. In fact, the three top banks in most markets were fairly small, focused players. Almost universally, customers of these winning banks told BCG that they preferred these banks for their better service, greater trustworthiness, and enhanced product range. It's likely that an ongoing backlash against large established banks has heightened customers' expectations for performance on these dimensions. There were a couple of exceptions: branch and ATM locations were important in Japan, and fees were an important consideration in Spain.

An excellent customer experience can support growth by breeding brand advocates.

Indeed, surveyed customers in 75% of countries cited “customer service” as the primary basis for word-of-mouth advocacy, and “trust in the institution” consistently ranked second. Offering an excellent customer experience can support sustainable growth, because it breeds brand advocates, who are less likely than customers in general to leave their bank and more likely to buy a greater number of products and to provide positive recommendations to friends and family. It is important to note that social media makes it easier than ever for customers to make their views known.

New Challengers Are Disrupting the Competitive Environment

Around the world, a host of small challengers—which have been, in many cases, encouraged and supported by regulators—are taking on established retail banks and presenting competition to the industry's traditional, core

offerings. While some of these upstarts operate little differently from established banks, they often claim to differentiate themselves through better service, lower or “fairer” fees, or offerings that purport to better resolve customers' problems. These claims remain to be proven in the long term, but they are creating plenty of disruption now—in both developing and developed markets. In India, for example, more than 20 licenses for new and specialized banks were issued in 2015, after several years when few or no licenses were granted.

Many of the niche players among these challengers are financially adept technology companies that specialize in market subsections that traditional banks have struggled to make profitable—such as near-prime lending. They thrive by offering targeted and innovative products and touting speedy, hassle-free service.

For example, Avant, a US-based consumer loan provider, has developed an automated credit-screening process—using machine learning to predict the likelihood of customer credit defaults—that allows it to provide loan approval within 15 minutes of a customer's application submission.

In recent years, fintech start-ups have increased dramatically in number and have harnessed new technologies to provide financial services while sidestepping the legacy cost structures and regulatory constraints of traditional banks. Collectively, fintechs now offer services covering many of the traditional business lines of retail and other banks, from credit cards and loans to payments, cross-border transfers, and digital currencies. Tradle, an early-stage, UK-based start-up, allows banks to perform know-your-customer assessments with a mobile app that also eases the path for customers applying for new accounts. Applicants complete all verification procedures and upload images of required documents on the app.

Fintech funding keeps accelerating: the \$11 billion in total funding of ten years ago grew to a cumulative \$46 billion by the end of 2015, according to BCG's fintech database.² Fintech offerings have focused in particular

on consumer- and corporate-banking activities. Categories receiving the strongest investments are lending and crowdfunding, data and analytics, and payments. (See Exhibit 6.)

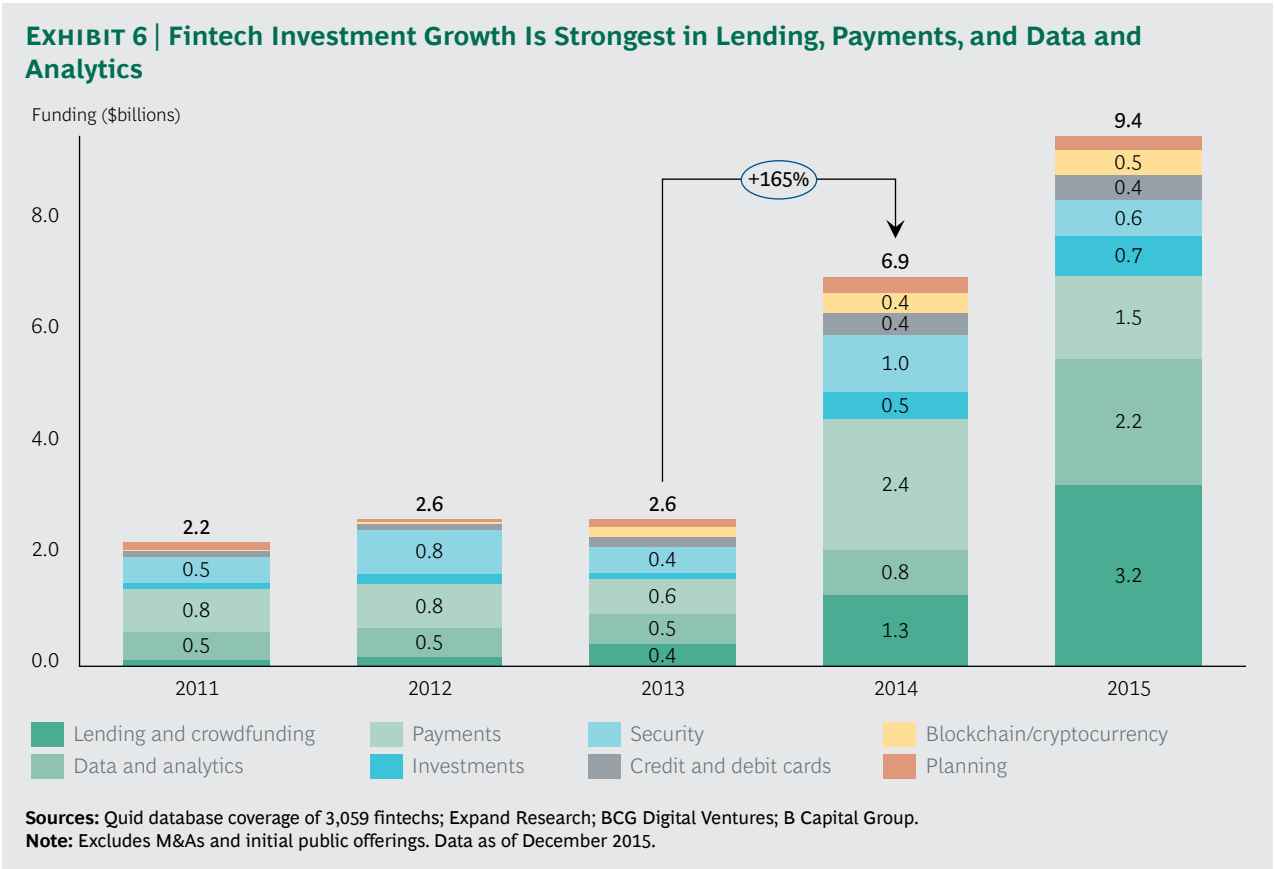
Several nonpublic firms have garnered more than \$500 million of cumulative investment: Social Finance (or SoFi), Alipay, Avant, One97 Communications, and Square. More than 15 unicorns—start-ups with valuations of \$1 billion or more—have emerged; their aggregate valuation is \$49 billion. North America accounts for almost 1,700 of the roughly 3,100 fintech firms worldwide.

Often, fintechs provide superior customer service as a means of taking market share, rebasing prices, and stealing margin from banks. For example, peer-to-peer lending has grown by more than 150% since 2010, typically filling a gap for consumers or small businesses seeking small finance when traditional options are either not suitable or not available.

Markets differ significantly, however: in China, estimates show, fintechs may have accounted for more than 10% of gross lending

volumes in 2015, compared with about 2% in the US and the UK and less than 1% in many European markets.³ The two biggest drivers of fintech growth are consumer adoption of mobile banking and penetration of unsecured lending. Increased banking regulation might also drive fintech growth by reducing the profitability of traditional lending activities. In the US, for example, the Credit CARD Act and the Fed’s Comprehensive Credit Analysis and Review (CCAR) stress tests are affecting, respectively, personal lending and small-business lending.

Some skeptics believe that the share of revenues and margin captured by fintechs will remain small in the long term. They may have to revise this prediction, however, if fintechs manage to increase their market share in more profitable niches than they currently occupy. For example, in UK peer-to-peer lending, vehicle purchases and debt consolidation already account for 46% and debt consolidation 25%, respectively. Both of these areas are more profitable than many other traditional banking activities, such as short-term and small-business lending.⁴ In the end, there will



be value at risk for banks owing to new players' competitive advantage in offering more compelling value propositions to borrowers and lenders, designing more efficient end-to-end processes, and driving new insights from data and analytics.

For leading retail banks, however, fintechs offer an opportunity to achieve a step change in performance: they can learn from and adapt fintechs' innovative methodologies, tools, and capabilities. In fact, many banks are investing heavily in fintechs through accelerator programs and competitions. Barclays' global accelerator program is one example; it is supported by Techstars, which offers office space, expertise, mentoring, and seed funding to start-ups in return for a 6% equity stake. Other banks, such as Santander, sponsor competitions to encourage fintech talent.

Meanwhile, some banks, including HSBC and Capital One, are setting up innovation labs that operate as independent entities with their own distinct cultures. The labs recruit start-up talent and collaborate with the wider tech industry.

In some instances, banks are buying or partnering with successful fintechs and then integrating them into their operations. One of

them is the Spanish multinational Banco Bilbao Vizcaya Argentaria, which has won multiple awards for its digital applications. BBVA made at least two significant digital purchases in 2014: Simple, a US digital-only bank, and Madiva, a company specializing in aggregation of publicly available big data. Also, BBVA is partnering with payment service provider Dwolla to offer customers rapid online and mobile payment and recently purchased a share of mobile-only Atom Bank, based in the UK.

NOTES

1. BCG conducted primary consumer research on digital retail banking in nine countries: the US, Spain, the Netherlands, UK, Italy, France, Belgium, China, and Brazil. We asked customers what they currently expect of banks' digital offerings, how they use various channels, and how they feel about more than a hundred innovative digital features, including their willingness to pay for specific offerings and their reasons for rejecting such offerings.

2. Fintech companies founded from 2000 through 2005 received cumulative funding of \$11 billion, as of December 2015. The cumulative funding received by companies founded from 2000 through 2015 was \$46 billion.

3. *Global Marketplace Lending: Disruptive Innovation in Financials*, Morgan Stanley Research, May 19, 2015.

4. *Understanding Alternative Finance: The UK Alternative Finance Industry Report 2014*, Nesta and the University of Cambridge, November 2014.

OPERATIONAL AND DIGITAL LEADERS REAP FINANCIAL REWARDS

BCG'S RETAIL-BANKING EXCELLENCE BENCHMARKING study profiles the operational and digital practices and performance of 20 of the world's leading retail banks, a group of 40 institutions chosen for their size and the strength of their capabilities. We refer to these banks as the "premier league." This edition of the REBEX benchmarking, conducted in 2015, assessed premier-league banks, which together represented approximately 220 million customers and 26,300 branches worldwide.

Top banks relied less heavily on net-interest income than those at the median.

This year's benchmarking showed, once again, that banks leading in measures of operational and digital excellence reaped the lion's share of financial rewards. They achieved 50% higher average pretax profit per customer than the median, while their operating expenses per customer were 30% less, a savings largely driven by lower personnel and IT costs.

At the heart of the benchmarking are core operational metrics. These include full-time employee (FTE) productivity by activity mix,

cycle time, and degree of automation as well as an assessment of the bank's digital maturity—for example, the functionalities available through various digital channels.

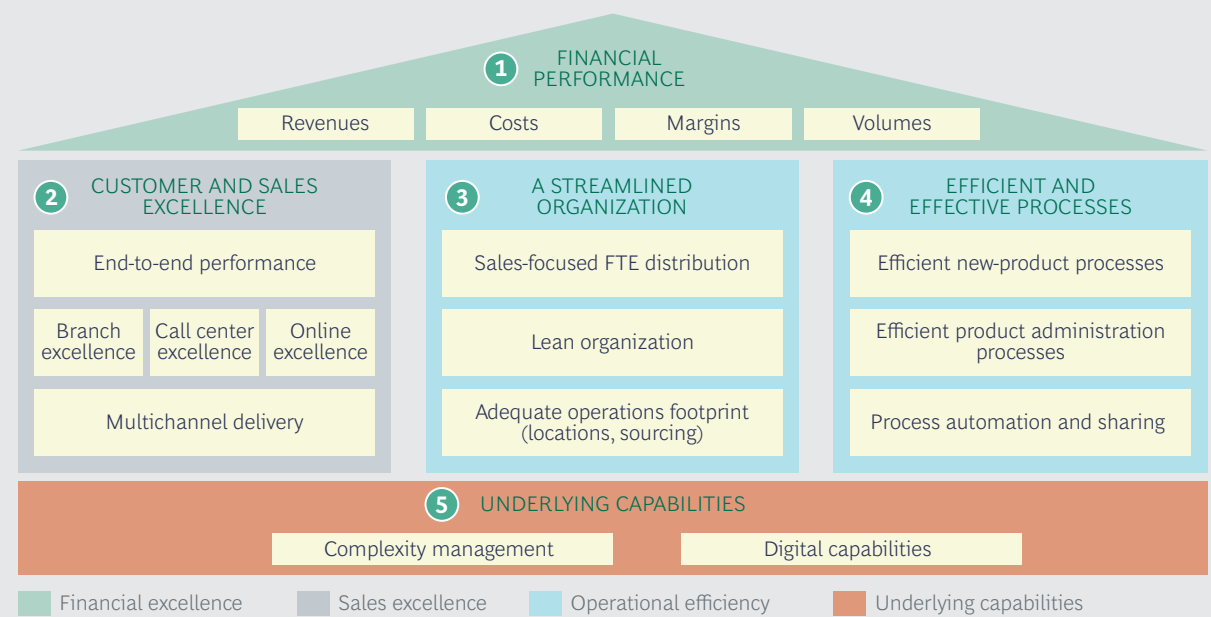
The scope of the benchmarking is broad, providing an end-to-end view that comprises five components of retail bank performance and operational and digital excellence: financial performance, customer and sales excellence, efficient and effective processes, a streamlined organization, and underlying capabilities. (See Exhibit 7 and the sidebar "The Five Levers of Operational and Digital Excellence.")

Financial Performance

Our benchmarking reveals a significant disparity in financial performance separating the leaders in operational and digital excellence from the rest. Average pretax profit per customer was \$367 for top-quartile banks, more than 50% higher than for the median, which came in at \$239.

Although differences in net-interest margins account for some of this gap, a distinguishing factor of leading banks was their ability to generate more income per customer that was not derived from interest. Top banks relied less heavily on net-interest income, which made up 70% of total income at top-quartile banks and 84% of total income at the median. At top-quartile banks, operating expenses per

EXHIBIT 7 | BCG’s Operational and Digital Excellence Benchmarking Measures Five Performance Components



Source: BCG Retail-Banking Excellence benchmarking.

THE FIVE LEVERS OF OPERATIONAL AND DIGITAL EXCELLENCE

Retail banks that aspire to improve and prevail must master the five levers of operational and digital excellence. The following, drawn from our annual benchmarking and our experience with clients, are among the best practices and success factors for each lever.

Financial Performance. Banks with the best financial performance show not only higher net-interest margins but also higher noninterest income per customer. Operating expenses per customer are another important variable, driven largely by lower personnel and IT costs.

Customer and Sales Excellence. Leading banks need to provide effective sales and service across all channels, seamless transition between channels, and easy-to-buy, easy-to-sell, easy-to-service products that are immediately functional.

Efficient and Effective Processes. Successful banks develop processes that are

simple and fast, using automation, paperless processes, workflow tools, and automated task management. The goal is not only to reduce costs but also to deliver an excellent experience for customers.

A Streamlined Organization. The strongest banks create an organization that is truly customer focused, with a high proportion of customer-facing roles, and that has lean back- and middle-office functions. These banks eliminate multiple layers of management, bringing executives closer to the front line.

Underlying Capabilities. Leading banks are reducing complexity and building capabilities in digital channels (for example, by offering a rich set of functions for mobile devices), using digital technologies to automate end-to-end processes, and building capabilities in data management and analytics to better serve customer needs.

customer were also 30% lower than at the median, driven largely by lower personnel and IT costs. The average cost-to-income ratio for top-quartile banks was 47%, compared with 54% at the median. We observed less variation, however, in risk costs among benchmark participants; the value was 16 basis points for top-quartile banks versus 19 basis points for the median.

Customer and Sales Excellence

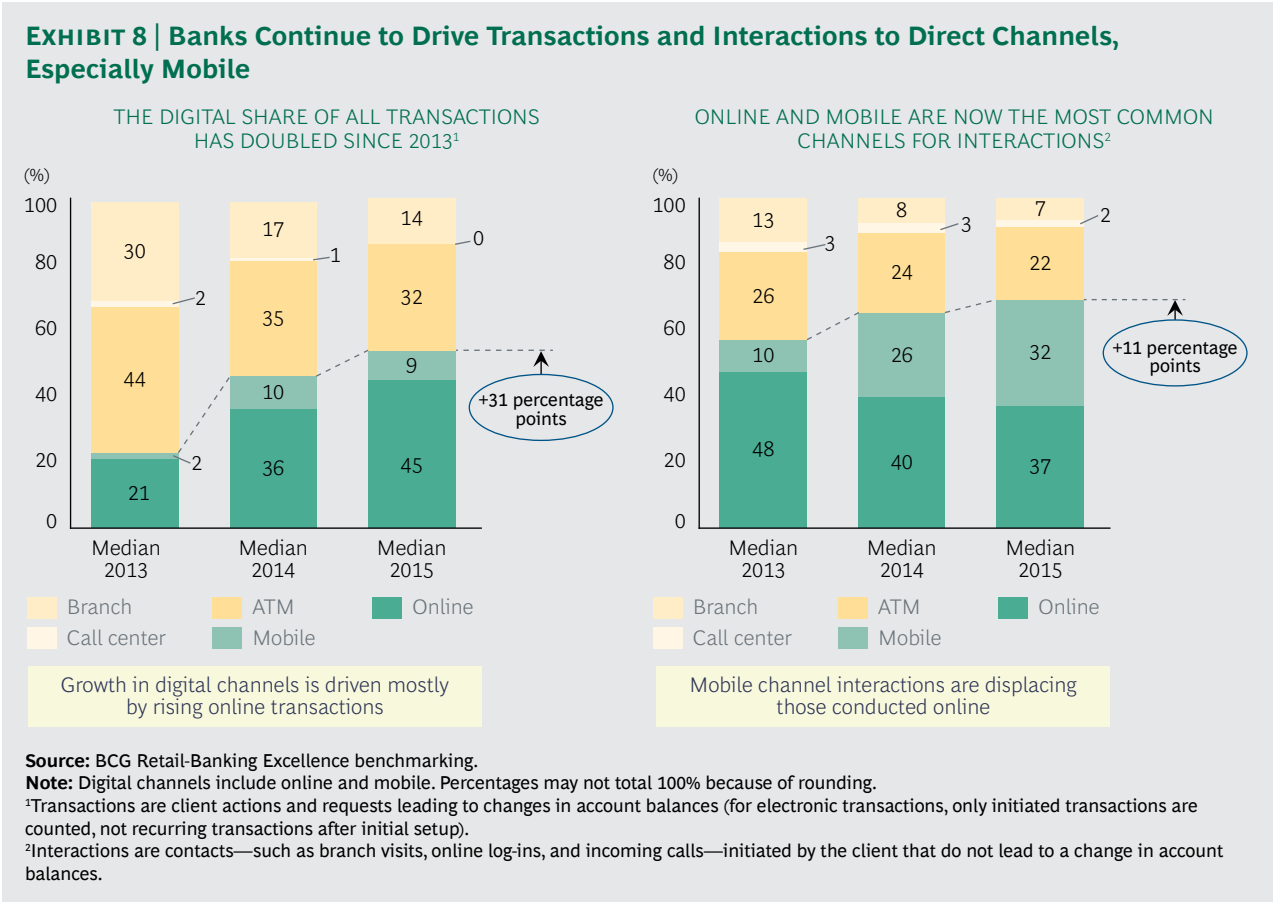
Banks continued to drive interactions and transactions away from branches and toward direct channels—that is, mobile and online transactions.¹ The share of direct transactions has doubled since 2013 for the median. (See Exhibit 8.)

Banks encouraged customers to self-serve through direct channels for basic needs, reserving other channels for more complex needs and relationship-based selling. This migration to digital is achieved more easily when banks make these channels demonstrably easier to use. In this year’s benchmarking,

two in five new accounts at leading banks were sold directly, outside of branches. The vast majority of customers at top-quartile banks, approximately 71%, are now enrolled online, representing 43% of all transactions. Mobile enrollment rates are similar, 66% at top-quartile banks. But just 15% of all transactions at top-quartile banks take place on mobile.

Many banks are providing positive incentives for using direct channels. More than 50% of banks participating in this year’s survey reported that they reward customers for using direct channels; for example, some provide higher interest rates for savings products that are set up and administered exclusively online. Likewise, approximately a third of participants said that they use negative incentives like charging a fee for a transaction that could have been conducted via a direct channel but instead was undertaken in a branch.

The best banks are also encouraging customers to use mobile by developing functional-



ities for that channel. However, despite the growing emphasis on direct channels, branches still constitute a critical component of banks’ interactions with customers.

While customers increasingly demand digital features as a basic requirement, they still want personalized, face-to-face contact at certain points in their banking relationship.

Thus, the role of branches as well as their network density and formats are evolving. Banks are trying to maintain their distribution reach while reducing their distribution cost. They are also reducing the density of their branch footprint, experimenting with lower-cost formats, developing video capabilities, and deploying hub-and-spoke models—with main-branch “hubs” that provide full services and smaller “spoke” offices focused on self-service. Going forward, we expect to see a wider variety of formats such as transaction-only, “light,” full-service, and flagship branches, as well as increased variation in hours of operation and staffing profiles. These new formats will require higher-level,

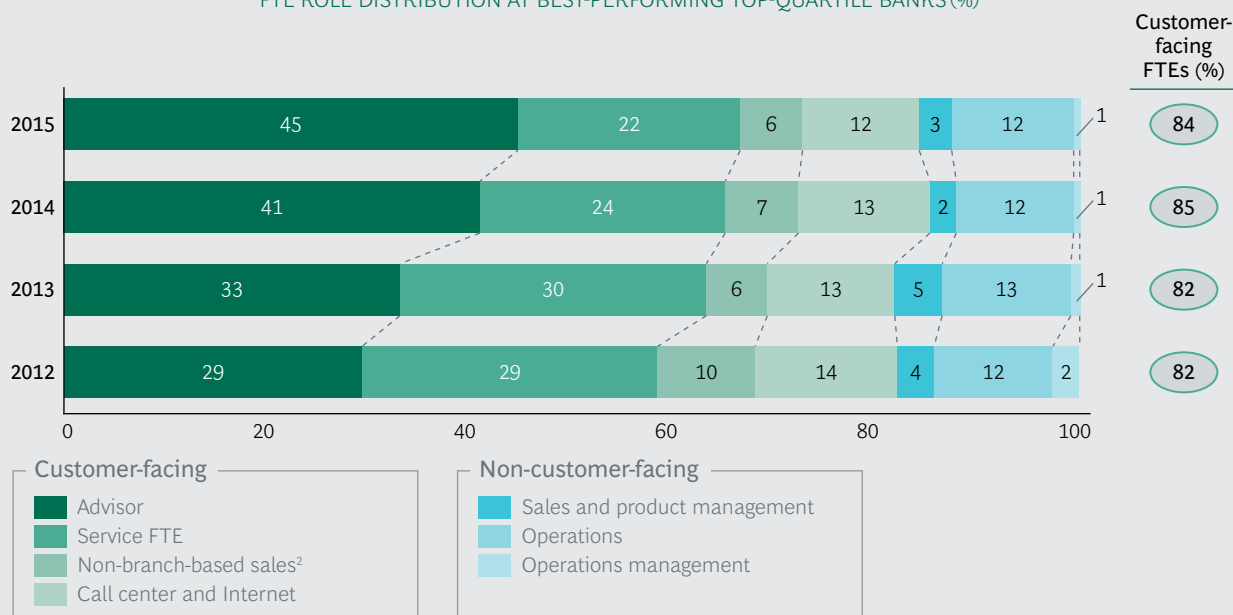
more differentiated support, such as paperless services, remote support from specialists through videoconferencing and mobile interfaces, and prebooked appointments.

Our Operational Excellence in Retail Banking 2015 report highlighted the trend toward banks becoming “bionic,” and this year’s study provided further evidence that the trend continues. Leading banks focused a greater share of their FTEs on advisory activities in branches; 45% of FTEs at top-quartile banks worked in advisory roles, compared with 41% in 2014. (See Exhibit 9.) Advisory roles for the median totaled 38% of FTEs, up from 31% the previous year.

As top-quartile banks focused more FTEs on customer-facing advisory activities, their advisors also spent more of their time preparing for and attending customer meetings. These appointment-related activities made up 60% of an advisor’s time at top-quartile banks, compared with 50% at the median. Optimizing the productivity of branch staff will remain a priority for leading banks.

EXHIBIT 9 | Customer-Facing Roles Continue to Dominate at Leading Banks, as Ranks of Advisors Grow

FTE ROLE DISTRIBUTION AT BEST-PERFORMING TOP-QUARTILE BANKS (%)¹



Source: BCG Retail-Banking Excellence benchmarking.

Note: Percentages may not total 100% because of rounding.

¹Percentages provide an aggregate view of best performers’ FTE role distribution, not an overall average for top-quartile banks. Calculations are based on the FTE distribution of just the best-performing top-quartile banks in each metric for each year. The resulting distribution represents a hypothetical bank achieving top-quartile ranking in all metrics every year.

²Includes agents, “hunters,” third-party sales personnel, and mobile sales force.

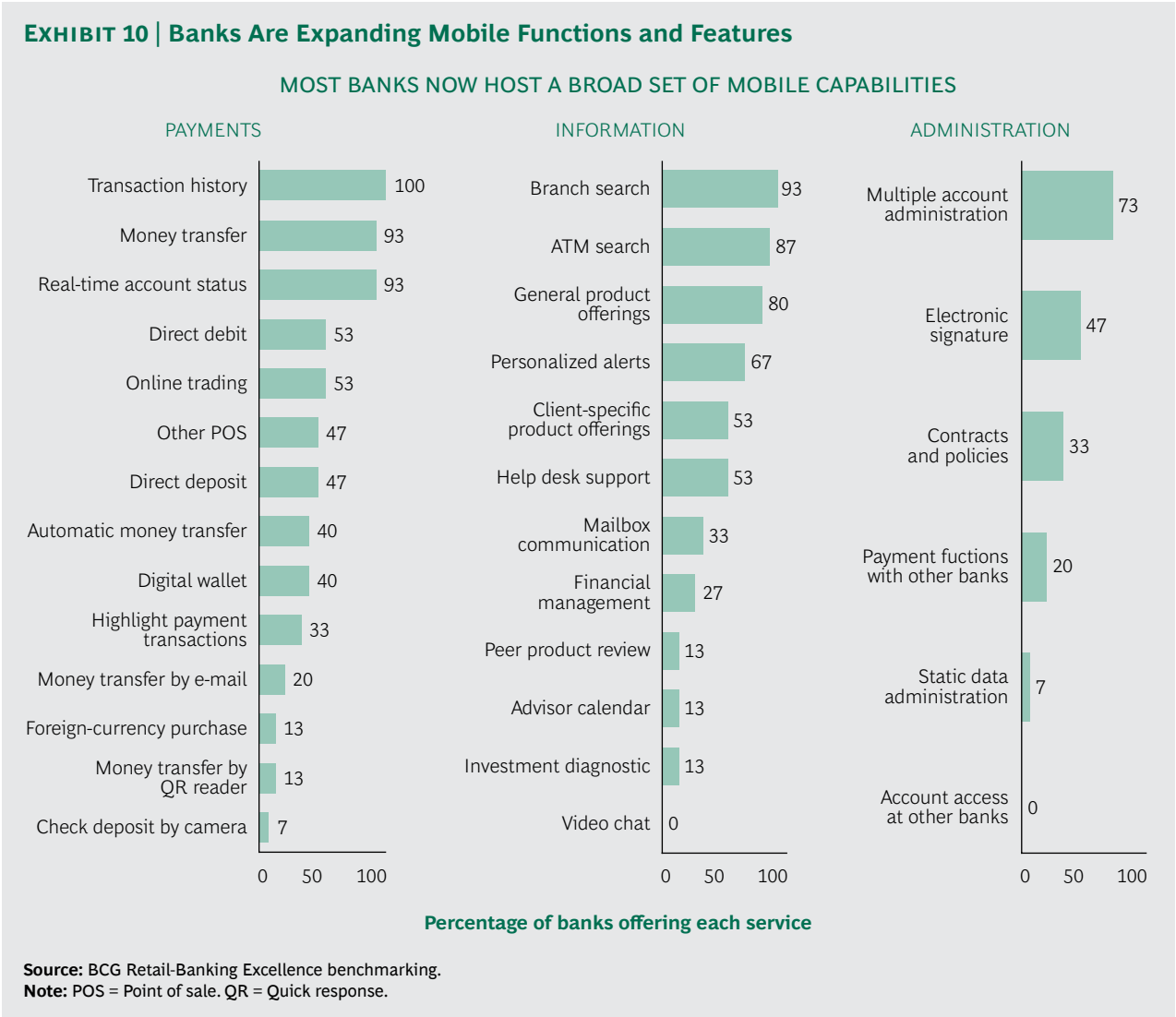
Responding to customer demand, banks continued to boost mobile functionality and add new mobile-app features. For instance, 93% of participating banks said they offered online money transfers and real-time account status functions, and 73% planned to add mobile payments with other banks; currently, just 20% offer this functionality. And 87% intend to provide check deposit by mobile camera, compared with just 7% currently. (See Exhibit 10.)

Leading banks are also increasing the number of products available through mobile. Today, most products once accessible only at branches or online are now available on mobile devices—including unsecured loans, mortgages, and investment accounts. In some countries, though, regulatory attitudes limit the remote interactions that banks can offer without face-to-face contact.

The objective of many banks is to create a seamless multichannel experience, facilitating natural customer pathways between channels without the need to repeat actions or enter the same data twice and with all the required information available regardless of channel. (See the sidebar “Poland’s mBank Puts Digital Tools in Customers’ Hands.”)

Efficient and Effective Processes and a Streamlined Organization

Banks continue to simplify and digitize end-to-end processes to reduce costs, increase efficiency, and improve the customer experience. However, only top-quartile banks have full straight-through processing for simple products such as credit cards and unsecured loans. For more complex products such as mortgages, even top-quartile banks



POLAND'S MBANK PUTS DIGITAL TOOLS IN CUSTOMERS' HANDS

With more than 5 million customers across Eastern Europe, mBank has become Poland's leading digital bank. In 2013, the bank revamped its online-banking platform, designing, testing, and implementing more than 200 new features in just 14 months.

The enhanced website gives customers an intuitive online interface for interacting with the bank through Google-like search and self-serve functions. Customers can review all account and product details on the same platform, along with tools to analyze their spending patterns, project account balances on the basis of upcoming bills, and transfer funds to social media and mobile contacts.

Customers receive product recommendations based on their activity and preferences, with access to human support by phone, Web, and online video chat.

The new digital tools are an important part of mBank's multichannel strategy across all of its markets.

In its home market of Poland, the bank has enhanced its branch network with differentiated branch formats. The bank's Light branches, for example, specialize in customer enrollment, using digital tools to highlight a commitment to easing the customer experience.

In the Czech Republic, mBank is adding to its distribution network to reach even more customers and increase convenience—for example, it is working with a Czech financial-planning firm to distribute mBank products in 70 of the Czech firm's branches, and it will open 20 to 30 of its own outlets in a new and modern format.

still use semimanual processes. (See the sidebar “PNC Bank Puts It All Online with the Tracker.”)

Although many banks have been successful in automating applications, fewer have achieved high levels of automation in middle- and back-office processes. As a result, productivity varies significantly. For example, in unsecured loans, account-opening FTEs at top-quartile banks opened approximately 10,000 accounts over the course of the year, while their counterparts at median banks managed just 4,000. Similar differences were observed for administration of existing accounts: at top-quartile banks, FTEs dedicated to postsales administration managed about 23,000 existing unsecured loans each, whereas their peers at the median managed just 10,000. (See Exhibit 11.)

Overall, lean operations processes at top-quartile banks resulted in a significant difference in the number of operations FTE required for a given number of customers: top-quartile banks have approximately 4,400

customers per operations FTE; at the median, the number is just 2,900.

As a result of banks' efforts to improve processes, cycle times have continued to fall across all products. For example, for unsecured loans, median cycle time has fallen from approximately two hours in 2012 to about 50 minutes in 2015.

To facilitate improvements in end-to-end processes, banks are reducing their outsourcing scope, bringing some activities back in-house. At top-quartile banks, 7% of all FTEs were outsourced in 2015, down from about 11% just two years before. Owning processes from end to end enables banks to optimize more extensively.

As banks focus on optimizing end-to-end processes, the proportion of FTEs in customer-facing roles is rising. At top-quartile banks, approximately 85% of FTEs were in customer-facing roles in 2014. At the median, 74% were in customer-facing roles, a slight increase from 71% in 2014.

PNC BANK PUTS IT ALL ONLINE WITH THE TRACKER

PNC Bank, a US-based bank, launched the Home Insight Tracker in December 2014. The Tracker enables customers to manage all aspects of their mortgage application from start to finish, using online and mobile channels exclusively.

Applicants can initiate their application online, submitting personal details and uploading relevant verification documents. They can view the status of their application online or within the mobile app, receiving e-mail updates and push notifications when their application reaches key milestones.

The messaging service gives applicants the ability to keep in touch with their account manager online, uploading any additional verification documents as required.

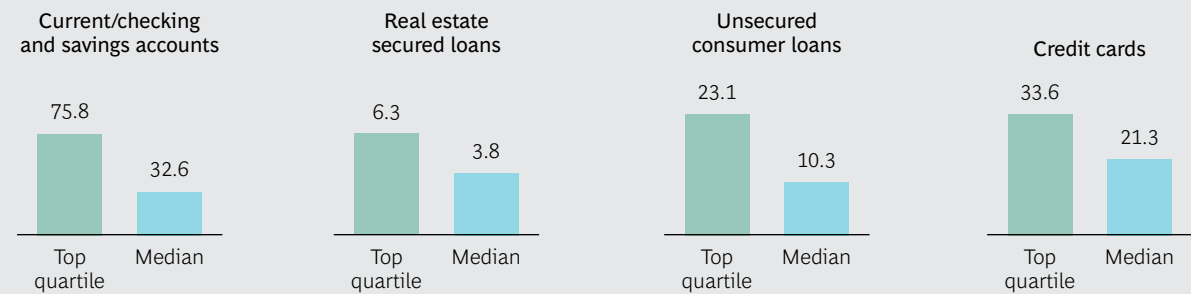
Applicants can even give restricted-view access of their application status to their real estate agent.

The tracker offers many benefits:

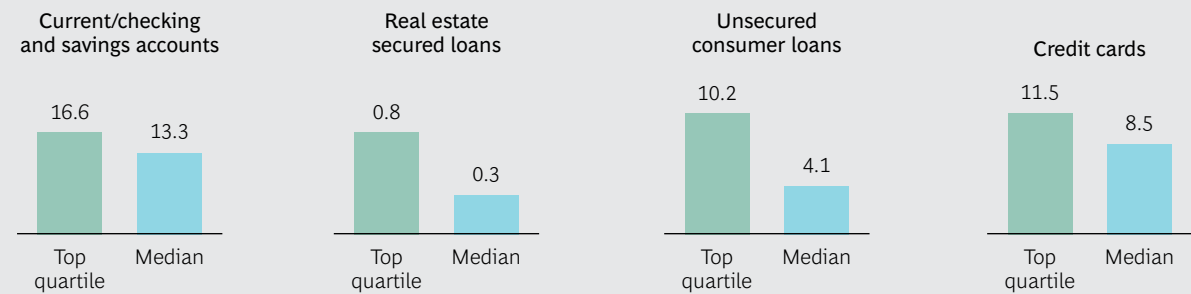
- It automates the end-to-end application process.
- It enhances the customer experience.
- It reduces cycle times.
- It allows applicants to monitor their application’s progress.
- It eliminates time-consuming branch visits.

EXHIBIT 11 | Median Banks Have Much Potential to Improve Administrative and Account-Opening Efficiency

EXISTING PRODUCTS PER POSTSALE ADMINISTRATIVE FTE¹ (THOUSANDS)



NEW PRODUCTS PER ACCOUNT-OPENING FTE² (THOUSANDS)



Source: BCG Retail-Banking Excellence benchmarking.

¹Includes operations FTEs for existing accounts.

²Includes operations FTEs for new accounts and account-opening risk-management FTEs.

However, as the percentage of customer-facing FTEs increased, sales productivity for top-quartile banks—such as new accounts per customer-facing FTE—fell by about 20% in this year’s study, after having steadily increased in recent years. Productivity at the median also fell, after having largely stagnated. A challenge for banks will be to resume gains in sales productivity while continuing to increase the ranks of sales employees.

Despite significant progress to date, substantial opportunity remains to industrialize and increase efficiency from end to end. Many banks have undertaken a first round of lean process redesign. But a second wave of efficiency is needed to embed practices in the business—paperless processes, workflow tools, and automated task management are only now being introduced in many institutions.

While all participants in our benchmarking survey claimed to have a digital roadmap, by far the biggest motivator was improving sales and enhancing the customer experience rather than enhancing the efficiency or quality of processes. Only 19% of respondents said that the main focus of their digital efforts was process automation.

Underlying Capabilities

Banks are reducing product complexity in order to lower costs and improve the customer experience. Less complexity improves back-office efficiency and also makes front-office processes simpler for sales staff and customers alike. Leading banks continued to reduce the number of inactive (administered only) legacy products: the average for top-quartile banks was 4; at the median, it was 18. Overall product sets for top-quartile banks continued to fall and were 35% lower in our survey than two years ago.

Leading banks are also simplifying their IT architecture to boost agility, flexibility, and efficiency. This may include rationalization of applications—decommissioning legacy applications, for example, and replacing or consolidating applications—which can drive IT cost reductions of 15% to 20% while significantly improving overall agility and speed. Reducing the number of technology patterns can real-

ize savings of up to 15% of IT costs and enhance agility.

Banks have focused on data management and analytical capabilities, both to increase sales and to improve the customer experience. But significant progress remains to be made.

Banks are seeking to future-proof themselves against decreased traffic to branches (which offers easy lead generation) by improving generation and conversion rates of other channels.

Substantial opportunities remain in lead generation; only 11% of banks consider 75% or more of their leads to be high quality. Data management and enhanced analytics are critical capabilities that banks should develop to increase the quantity and quality of leads. Banks that focused on lead quality in 2015 achieved nearly three times as many annual sales per customer as banks focusing on quantity, with more than 50% of their high-quality leads resulting in a sale. Today, only 31% of banks are using needs-based analytics to improve the quality of lead generation and boost sales. Instead, nearly half of all leads were the result of inbound customer inquiries. Only 33% of banks used transactional or behavioral data to generate leads, with 56% using internally generated static data and the remaining 11% using both internal and external data.

Improved data warehousing is critical for effectively managing multiple channels and providing a “single view” of the customer as well as improving the customer experience. Just one in three banks reported having a unique customer ID across all channels—a crucial capability for offering a seamless, multichannel customer experience.

NOTE

1. Interactions are defined as occasions of contact (for example, branch visits, logins, and incoming calls) between the customer and the bank that are initiated by the customer and that do not lead to a change in account balances. Transactions are defined as customer actions or requests leading to a change in an account balance. For electronic channels, only initial transactions, not recurring transactions, are counted.

WHAT DOES IT TAKE TO SUCCEED?

AS THE WORLD'S TOP-PERFORMING retail banks continue to widen their lead over the rest, banks that aspire to join them at the top will need to jump-start their digital transformation. This is true no matter how much or how little disruption a bank has encountered to date, or how far along the path of digital development it has progressed.

Digital development cycles are extremely rapid—far faster than traditional product and service cycles. The overly deliberate and cautious approach that many banks take is already outdated, leaving them fighting yesterday's battles and shrinking in today's markets.

Achieving the REBEX Leadership Goals

Given the pervasiveness, lower cost of entry, and potential impact of digital technology, it is imperative that banks act today to launch new digital products and services and to digitize internal processes. A committed, full-scale digital implementation will be the only way for banks to achieve the four REBEX leadership goals that will allow them to rise above the median and lead the pack:

- Understand, strengthen, and deepen customer relationships.
- Reimagine customer journeys from front to back using digital technologies.

- Create agile, simple, and highly collaborative organizations.
- Enhance digital capabilities.

Understand, strengthen, and deepen customer relationships. With the proliferation of fintech competitors and the evolution of customer attitudes and behaviors, banks face the danger of becoming increasingly commoditized over the next five years. To prevent this, they must focus on customers' needs and priorities. They must become customer centric, not product centric.

Banks should seek to increase their interactions with customers and to consistently deliver a positive experience—perhaps extending offerings to include nontraditional banking products and services, through online and mobile channels. Banks should consider engaging customers in life events rather than simply offering products—they could, for example, design offerings that support a customer's move to a new home in its entirety, rather than just financing the purchase.

They should also continue to push for fresh and innovative means of developing deeper relationships with customers, including multi-product and multichannel relationships. Deeper relationships are more profitable and offer a lower cost to serve. Banks should seek to push customers up the relationship hierarchy; cur-

rent accounts alone are no longer the benchmark of a customer's main banking relationship. Instead, banks should aim for customers to have at least two high-quality cross-holdings and to make active use of online functionality.

Banks must develop capabilities in digitally based data and analytics and embed them at the heart of the business. Advanced data analytics greatly increases value creation through improved customer understanding and higher-quality lead generation. More efficient and effective use of information also reduces costs. The very best banks will buy or partner with fintechs to learn from their methodologies, tools, and capabilities, thereby achieving a step change in performance.

Reimagine customer journeys from front to back using digital technologies. Banks should redesign customer journeys to focus on customers' needs and simplify the customer experience by overcoming both visible and hidden customer compromises and frictions. This should be based on a deep understanding of natural customer pathways across channels and should allow customers to move seamlessly among channels.

Retail banks need to attract and retain scarce entrepreneurial talent.

Digital roadmaps should include middle- and back-office processes, allowing full automation of certain functions while focusing on the front-end customer experience. Digital advances made to date, even at the front end, have primarily focused on sales. Even the most advanced banks need to do more to digitize and improve service.

Banks should embed compliance activities within core processes, streamlining compliance as a function rather than bolting it onto existing processes. Compliance should be integrated into the customer journey, ensuring rather than hindering an excellent end-to-end experience. Banks that achieve this transformation can earn 50% more revenue per cus-

tomers than their peers and reduce costs by as much as 20%, among other financial gains.

Create agile, simple, and highly collaborative organizations. Banks need to adapt their working styles and incorporate agile approaches to development. Deploying cross-functional teams that focus on individual product features and working in short cycles will increase product ownership, decrease errors, and speed time to market. This means that banks must implement far more nimble development processes and become more comfortable with decision making amid uncertainty.

In the front office, for example, banks should reduce their product portfolios and complexity, simplify account-opening processes, and make straightforward transactions as simple and hassle-free as possible for the customer. Greater opportunities await in middle- and back-office functions, however, where digital technologies offer enormous potential to simplify, remove activities that can be automated or are unnecessary, eliminate unnecessary bureaucracy and management layers, and industrialize core processes.

Retail banks need to attract and retain scarce entrepreneurial talent to rapidly drive ambitious plans. This requires identifying new roles and skills to be recruited, a clear strategy for acquiring new talent (build, borrow, or buy), and a compelling value proposition that will allow banks to compete with technology companies to attract employees with digital talent. Generally, these individuals will be hired from outside the organization or even "acqui-hired"—through the acquisition of digital studios. Digital expertise should not be restricted to expert teams in charge of innovation; it should also be embedded in the leadership team.

Banks must develop a digital culture to disrupt their own business before rivals do it to them. They should implement a cultural program that clearly supports cross-functional work, collaboration, customer centricity, and risk taking.

Our experience with clients shows that success with this kind of trial-and-error approach

requires a structured transformation built on three steps: securing quick wins at the outset, scaling up successful initiatives, and leading and sustaining change through a renewed and agile operating model.

Fresh organizational models are likely to evolve for banks during this transformation. Whatever the model, however, we believe that digital strategy must be embedded within the business to ignite and fan successful innovation at the core. In contrast, a truly disruptive business model reinvention is generally conducted more effectively from outside the core business.

Agile transformation at ING Netherlands broke down silos, accelerating software deployment.

In recent years, ING Netherlands felt growing pressure from digital innovators that were relentlessly raising consumer expectations for service, speed, and connectivity. The bank responded by undertaking an agile transformation that involved—and empowered—employees throughout the organization by breaking down traditional silos. The transformation enabled the bank's customer proposition teams to accelerate the pace of software deployments from a few per year to one every few weeks. (See *The Power of People in Digital Banking Transformation*, BCG Focus, November 2015.)

Enhance digital capabilities. Rather than use the top-down, strategy-driven approach of the past, banks need to innovate to enhance their digital capabilities using build, assess, and learn cycles, even when they are not entirely sure of the outcome. Banks should focus on pilot tests and prototypes that can be developed and rolled out quickly, assessed for performance, and scaled up (or shut down) accordingly. They need to embrace the concept of “fail fast and fail cheap” and build digital capabilities through direct experience. And rather than making a single big, strategic bet, they need to manage multiple initiatives,

trying out new business models with low sunk costs, killing off the losers, and scaling up the winners.

IT architecture can also be heavily simplified to boost agility, flexibility, and efficiency. This may include rationalization of applications—for example, decommissioning legacy applications—or simplification of the IT infrastructure by eliminating redundant technologies. Beyond IT simplification, there is also a need to address how the behavior and activities of individuals affect an organization's structures, processes, and layers. This requires understanding how people behave—and why—in order to change the context and encourage desired behavior while removing restrictions that create complexity.

Simplification and digitization are two sides of the same coin: simplification helps accelerate digitization, and digitization forces a bank to simplify. Transformations should therefore entail both elements.

The Path to Measurable Results

Our research and case experience show that banks focusing on the four key goals can achieve significant, measurable results.

One bank in Western Europe strengthened customer relations by improving data sources and adopting new analytical models. As a result, it increased its marketing up-sell rates by 500%. Another bank boosted its offer conversion rate sixfold by employing advanced analytics to implement dynamic segmentation.

Banks moving from a median to a top-quartile position on each of the four key goals can reduce operating expenses by 15% to 25%, depending on the initial position of the bank. For the median premier-league bank in our benchmarking study, this translates to a pretax profit increase of 20% to 30%, and a 5- to 10-percentage-point increase in pretax profit margin.

Indeed, our experience confirms that for banks willing to undertake the transformation to digital simplicity, using tested toolkits and methodologies, these benefits are entirely achievable.

APPENDIX

RESEARCH AND SURVEY DATA

This appendix provides highlights of REBEX 2016 research data, including regional revenue totals, key performance indicators from our operational- and digital-excellence bench- marking, Brand Advocacy Index results for eight countries, and social, demographic, and banking-behavior findings from Consumer Digital Banking Surveys in nine countries.

TABLE 1 | 2015 GLOBAL REVENUE POOLS

Region	Revenue pool (\$billions)	Change from 2014 (%)
Americas ¹	587	2.9
Western Europe ²	403	−1.8
Eastern Europe ³	63	9.1
Middle East and Africa ⁴	50	−0.5
Asia-Pacific ⁵	484	6.4

Source: BCG Banking Pools 2015.

¹The Americas include Argentina, Bolivia, Brazil, Canada, Chile, Colombia, Costa Rica, Ecuador, Guatemala, Honduras, Mexico, Panama, Peru, Uruguay, the US, and Venezuela.

²Western Europe comprises Andorra, Austria, Belgium, Denmark, Finland, France, Germany, Greece, Iceland, Ireland, Israel, Italy, Liechtenstein, Luxembourg, Malta, the Netherlands, Norway, Portugal, San Marino, Spain, Sweden, Switzerland, Turkey, and the UK.

³Eastern Europe comprises Albania, Armenia, Azerbaijan, Belarus, Bosnia and Herzegovina, Bulgaria, Croatia, Czech Republic, Estonia, Georgia, Hungary, Latvia, Lithuania, Macedonia, Moldova, Montenegro, Poland, Romania, Russia, Serbia, Slovakia, Slovenia, and Ukraine.

⁴Middle East and Africa comprise Algeria, Angola, Bahrain, Benin, Botswana, Burkina Faso, Burundi, Cameroon, Cape Verde, Central African Republic, Chad, Comoros, Democratic Republic of the Congo, Republic of the Congo, Côte d'Ivoire, Djibouti, Egypt, Equatorial Guinea, Eritrea, Ethiopia, Gabon, the Gambia, Guinea, Guinea-Bissau, Iraq, Jordan, Kenya, Kuwait, Lebanon, Lesotho, Liberia, Libya, Madagascar, Malawi, Mali, Mauritania, Mauritius, Morocco, Mozambique, Namibia, Niger, Nigeria, Oman, Qatar, Rwanda, São Tomé and Príncipe, Saudi Arabia, Senegal, Seychelles, Sierra Leone, Somalia, South Africa, Sudan, Swaziland, Syria, Tanzania, Togo, Tunisia, Uganda, United Arab Emirates, Yemen, and Zambia.

⁵Asia-Pacific includes Australia, Bangladesh, China, Hong Kong, India, Indonesia, Iran, Japan, Malaysia, New Zealand, Pakistan, the Philippines, Singapore, South Korea, Taiwan, Thailand, and Vietnam.

TABLE 2 | RETAIL BANKING EXCELLENCE BENCHMARKING 2015

	FTE key performance indicators	2014		2015		Difference	
		Top quartile	Median	Top quartile	Median	Top quartile	Median
CUSTOMER AND SALES EXCELLENCE	Number of customers per customer-facing FTE	1,093	963	984	933	−108	−30
	Number of new accounts per customer-facing FTE per week	10	6	8	6	−2	−0.2
	Transactions in direct channels as a share of the total (%)	91	87	91	86	0	1
	Interactions in direct channels as a share of the total (%)	96	92	93	90	−2	−2
	Customer attrition rate (%)	4	5	4	5	0	0
A ORGANIZATION	Number of accounts per total FTE	1,748	1,140	1,621	1,138	−127	−2
	Number of customers per total FTE	839	550	805	610	−35	60
	Number of customers per operations FTE	4,673	2,578	4,391	2,878	−283	300
EFFICIENT AND EFFECTIVE PROCESS	Number of new accounts per operations FTE (000)	4.0	2.5	4.5	2.8	0.5	0.3K
	Number of existing accounts per operations FTE	18.1	12.2	22.7	10.4	4.6	−2.2
UNDERLYING CAPABILITIES	Share of new accounts generated in direct channels (%)	37	21	41	27	3	6
	Share of mobile customers (%)	63	33	66	48	3	15
	Share of active mobile customers (%)	39	26	41	29	2	3
	Share of online customers (%)	64	62	71	63	7	3
	Share of active online customers (%)	50	48	69	48	19	0

Source: BCG Retail-Banking Excellence benchmarking.

Note: FTE ratio calculations are based on activity allocations, not department affiliation. Branch operations activities have been allocated to “operations.”

TABLE 3 | 2015 BRAND ADVOCACY INDEX RESULTS FOR RETAIL BANKS

Country	Average weighted BAI
US	21
Canada	22
UK	13
France	15
Germany	16
Spain	11
Italy	35
Japan	13

Source: BCG Brand Advocacy Index 2015.

Note: BAI calculates advocacy by tallying recommendations from advocates and critics on a weighted basis. Respondents were asked whether they recommended [retail bank A, B, and so on] in the last 12 months:

- I've recommended it spontaneously (without being asked).
- I've recommended it when asked about it.
- I haven't recommended it or criticized it.
- I've criticized it when asked about it.
- I've criticized it spontaneously (without being asked).

TABLE 4 | CONSUMER DIGITAL BANKING SURVEY

		US	Brazil	UK	France	Spain	Italy	Belgium	Nether-lands	China
SOCIAL DEMOGRAPHICS										
Segment weight in population (%)	Digital	15	12	25	32	12	14	44	75	7
	F2F	26	62	23	33	46	54	27	12	57
	Multichannel	59	26	52	35	42	31	29	14	36
Probability of being affluent (top three income segments) ¹	Digital	1.5 X	1.8 X	1.5 X	1.4 X	1.3 X	2.3 X	1.3 X	2.6 X	1.6 X
	F2F									
	Multichannel	1.4 X	1.9 X	1.7 X	2.1 X	2.2 X	3.9 X	1.4 X	2.3 X	2.7 X
Probability of being affluent (top three asset segments) ¹	Digital	1 X	0.9 X	1.2 X	2.1 X	1 X	1.9 X	1.3 X	2 X	2 X
	F2F									
	Multichannel	1.2 X	1.2 X	1.4 X	3.2 X	1.8 X	4 X	1.8 X	3.3 X	6.6 X
BANKING BEHAVIOR										
Average number of products per customer	Digital	3.8	4.1	3.0	3.4	3.4	2.7	3.3	3.3	3.2
	F2F	3.5	3.4	2.8	3.1	2.9	2.4	3.1	3.1	2.9
	Multichannel	4.0	4.0	3.5	3.7	3.6	3.4	3.6	3.8	4.0
	Average	3.8	3.6	3.2	3.4	3.3	2.8	3.3	3.3	3.3
Share of customers visiting bank to make a transaction at least once every two to three months (%)	Digital	—	—	—	—	—	—	—	—	—
	F2F	67	47	67	34	69	63	45	8	42
	Multichannel	100	97	98	93	100	95	90	88	97
	Average	76	54	66	44	74	64	38	13	58
Share of customers who transact online at least once every two to three months (%)	Digital	100	96	97	96	100	97	97	96	93
	F2F	—	—	—	—	—	—	—	—	—
	Multichannel	100	98	97	96	100	98	98	96	97
	Average	74	37	75	64	54	45	71	85	41
Share of customers who transact through a mobile device at least once every two to three months (%)	Digital		68	45	35		39	32	55	81
	F2F		—	—	—		—	—	—	—
	Multichannel		86	60	59		61	44	77	91
	Average		31	42	32		25	27	52	38
% of customers who researched and subscribed to a banking product online	Digital		23	13	6		16	8	5	19
	F2F		6	6	3		4	7	4	14
	Multichannel		60	36	33		47	28	49	65
	Average		22	23	14		19	14	11	33

Source: BCG Consumer Digital Banking Surveys 2015.

Note: Digital customers are those who perform an online banking transaction at least once every two to three months and visit branches no more than once a year. Face-to-face (F2F) customers are those who use branches for transactions at least once every two to three months and perform online transactions no more than once a year. Multichannel customers are those who perform an online banking transaction at least once every two to three months and visit branches at least once a year. The average is weighted by the size of the segment.

¹Using F2F as the basis for comparison.

FOR FURTHER READING

The Boston Consulting Group has published other reports and articles that may be of interest to senior financial executives. Recent examples include those listed here.

How to Reap a Pricing Windfall in Retail Banking

An article by The Boston Consulting Group, February 2016

Making Big Data Work in Retail Banking,

A Focus by The Boston Consulting Group, November 2015

Operational Excellence in Retail Banking 2015: Creating Digital Banks with a Human Touch

A Focus by The Boston Consulting Group, April 2015

The Bionic Bank

A Focus by The Boston Consulting Group, March 2015

The Digital Financial Institution: The Power of People in Digital Banking Transformation

A Focus by The Boston Consulting Group, November 2015

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