

GLOBAL RETAIL BANKING 2018

THE POWER OF PERSONALIZATION



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INTRODUCTION

YOU COULD MORE EASILY find a yachtsman willing to sail into a sustained 40-mile-an-hour headwind than a retail bank trying to stick with a nondigital strategy.

Banks know where the prevailing economic and technological forces are pushing them these days. But they are moving at very different speeds and focusing on different milestones.

BCG's latest bank study shows that the economic benefits are increasing for traditional retail banks that have implemented the most effective digital strategies. Between their more developed digital strategies and (in many cases) regional advantages, the top-performing banks now have cost-income ratios that are 19% better than those of median banks. That differential has been growing for the past two years.

On the other hand, the pressure to embrace a more digital mode of operation has eliminated the differences in certain service areas. For instance, most banks have implemented online and mobile self-service capabilities. Likewise, most banks have added enough automation to their call centers to enable them to provide acceptable customer service with a smaller operations staff and at a lower cost. Once big advantages, these capabilities now represent mere table stakes.

This year's data, part of BCG's annual benchmarking of banks across more than 100 key performance indicators, underscores the extent to which banking is a local business affected by each market's regulations, competitive dynamics, and consumer behaviors. For instance, retail banks in North America have structural advantages—including high fee and commission ratios—that give them profit margins that wouldn't be possible elsewhere. Banks in the Netherlands, Belgium, and Australia—countries where most customers interact with their banks primarily through digital channels and rarely set foot in a physical bank—can embrace digital delivery more aggressively than banks in less-connected countries can.

But BCG's Retail Banking Excellence Benchmark (REBEX) also uncovers sizable differences between local banks. Against local competitors, banks are in a position to control their own destinies.

Looking at the universe of banks in six major geographic regions—North America, Asia-Pacific, Western Europe, Latin America, Eastern Europe, and the Middle East/Africa—we observe that banks are about midway through their transformation journeys. Many banks have made progress in digitizing for cost, although they still need to move

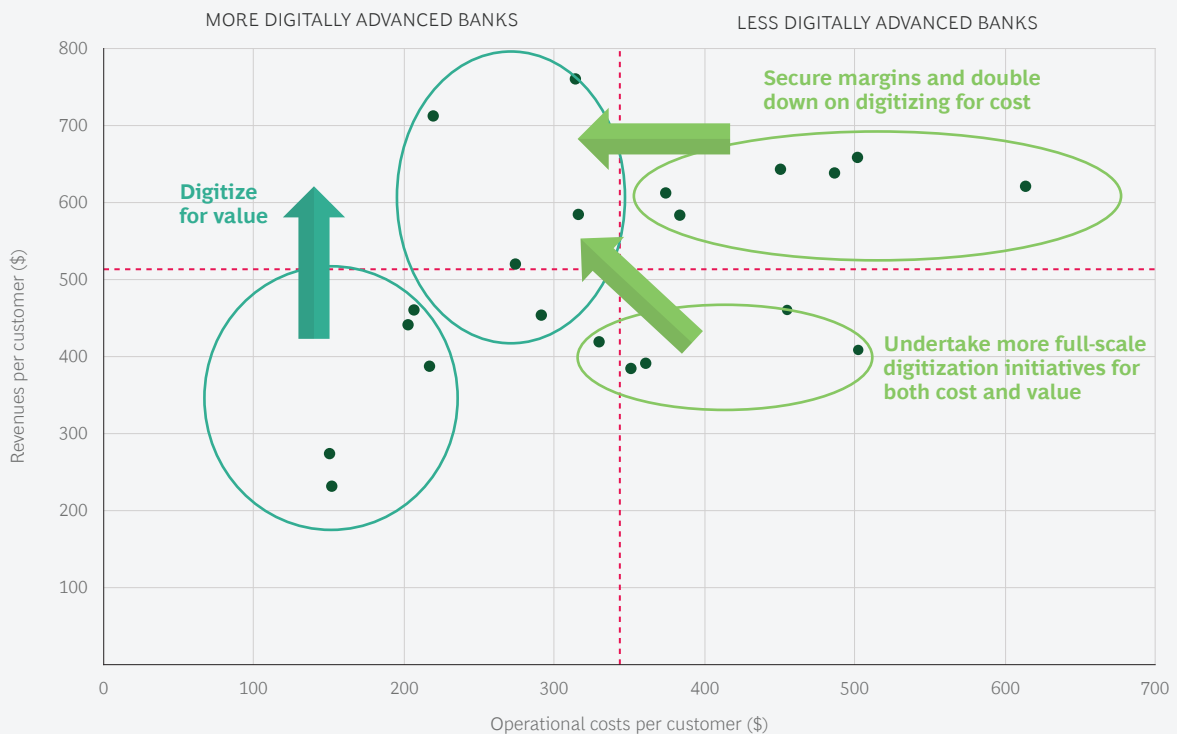
from pilots to large-scale initiatives to reap the benefits of their digital investments. Banks are less far along in digitizing for value. (See Exhibit 1.) The goal of this more ambitious phase is to find ways to serve the customer better—and in doing so, to earn more revenue per customer and increase retention. The best route to success is through a reinvention of the customer engagement model.

To make further progress in digitizing for value, retail banks around the world must address two emerging imperatives: personalization and continuous delivery.

The personalization imperative has several dimensions:

- Personalization is quickly becoming a primary mechanism for increasing both customer satisfaction and economic value in banking. Customer retention is higher at banks that understand customers’ financial needs and interact with customers in ways that reflect their preferences.
- Improved data and rapidly improving digital technologies enable banks to meet customers’ heightened expectations of personalization. Banks should use these tools to get a clear sense of each customer’s financial and behavioral DNA and to develop individualized offers on that basis.

EXHIBIT 1 | What the Biggest Banks Must Do to Improve Their Performance



Sources: BCG Retail Banking Excellence Benchmark 2017 (REBEX); BCG analysis.

Note: The 21 banks represented here are the biggest banks in large banking markets in BCG’s REBEX database. The “more digitally advanced banks,” in the two left-hand quadrants, have higher levels of digital interactions, transactions, and sales than the “less digitally advanced banks,” in the two right-hand quadrants. The positioning of the quadrants is defined by the median revenues per customer (x-axis) and the median operational costs per customer (y-axis).

- Banks that succeed with personalization will become better at acquiring, engaging, and retaining customers. This improvement will add appreciably to their growth and profits.

The issue of continuous delivery, meanwhile, involves two key points:

- Bank convenience used to be a function of the number of physical retail outlets that a bank had in a given city or town. In the future, convenience will increasingly revolve around the concept of always-on banking. Payment services will be embedded in every aspect of the online shopping experience and will be available for peer-to-peer transactions in social networks.
- The number, type, and timing of these interactions are evolving quickly. To remain flexible, banks will have to build sophisticated routing platforms that ensure continuous delivery of the personalized experience, through digitally empowered relationship managers, automated customer care centers, and self-service technologies.

In most parts of the world, the bank transformation imperative (or as we called it last year, the imperative for *bionic transformation*) is coming at a time of improving conditions in the sector. (See *Global Retail Banking 2017: Accelerating Bionic Transformation*, BCG report, July 2017.) BCG Banking Pools, our forecasting unit, forecasts an annual rise of 5.3% in global retail bank revenues between now and the end of 2021, exceeding the fastest growth recorded in the past decade. The gains will be greater in some regions than in others, however:

- Asian bank revenue will grow by about 8% annually for the next few years, helped by financial inclusion and the rollout of digital banking services. By 2021, BCG predicts, Asia will surpass North America as the region with the highest retail banking revenues.
- Two other young banking regions, Latin America and the Middle East and Africa, will also experience above-average revenue growth. In Latin America, the key growth catalyst will be Brazil's renewed economic vitality. In Africa, the catalyst will be financial inclusion.
- Revenues will grow at a considerably slower pace in the mature North American banking market than in these still-developing markets. But North American banks will likely get a lift from higher interest rates, which will help them improve their margins. The banks will also benefit from their customers' growing interest in investment products.
- At the bottom, in terms of growth, will be European banks. Western European banks are facing some unfavorable regulations just as they start to recover from an environment of punishingly low interest rates. Their revenues, on average, will grow by only 2.2% on a compound annual basis over the next few years. Eastern European banks will fare better, except in Russia, the region's largest market, where we expect the banking sector to continue to struggle with nonperforming loans and other challenges and to grow more slowly than nominal GDP.

RETAIL BANKING GROWTH AND CHALLENGES, BY REGION

RETAIL BANKING IS RESPONSIBLE for about half of all banking revenues worldwide; the rest comes from corporate banking and other sources, including asset management, investment banking, proprietary trading, and bancassurance. These proportions are not likely to change dramatically between now and 2021, a period during which BCG expects retail banking revenues to rise by 5.3% annually. A compound annual growth rate of 5% would represent the fastest increase in the sector in at least a decade.

Although some trends in banking are relevant across all regions, retail banking is inherently a local business.

Although some trends in banking—most obviously, digitization—are relevant across all regions and markets, retail banking is inherently a local business, inextricably bound up with each country’s economic fundamentals, regulatory landscape, and competitive dynamics.

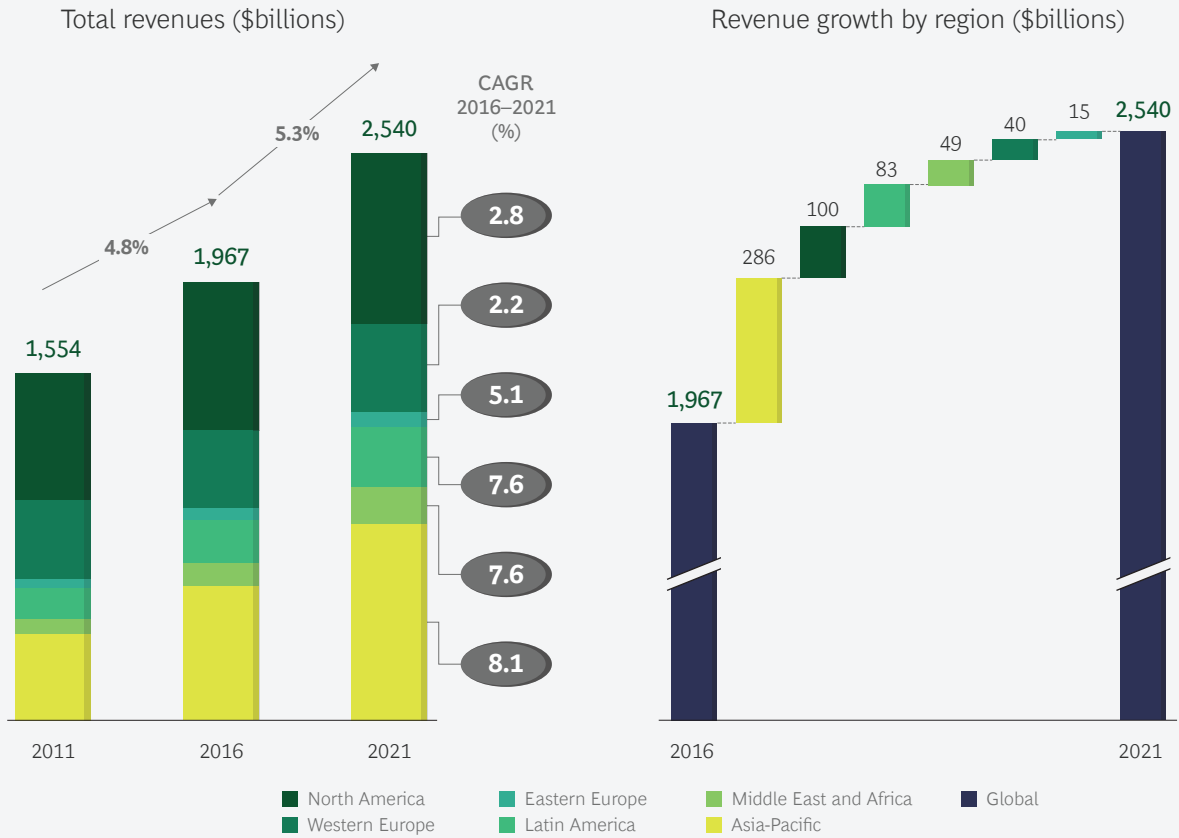
Geographically, the greatest growth in retail banking is occurring in the Asia-Pacific region. By 2021, Asia-Pacific will have a larger retail banking pool than North America, bolstered

by the trend toward financial inclusion in the region’s most populous countries. According to BCG’s forecast, revenue growth in Asia-Pacific will exceed that in the rest of the world over the next three years. North American banks will produce the second-highest volume of new revenues, and Latin American banks the third-highest volume. Western European and Eastern European banks will be at the low end of the list, with banks in the Middle East and Africa sandwiched in between. (See Exhibit 2.) Economies in both the Middle East and Africa are developing rapidly, and African banks, like those in Asia, are benefiting from a rapid increase in the banked population.

Aside from each region’s top-line growth prospects, there are differences in revenues by product type, with some product types poised to grow faster, in percentage terms, than the economy they’re a part of and others likely to grow slower. (See Exhibit 3.)

The biggest boost to Asian banks’ revenues will come from their savings lines. This is a result of two developments: regulations that are spurring financial inclusion in Asia, and digital adoption levels that have lowered the cost of serving the region’s unbanked people. Double-digit revenue growth in savings is likely in China, Indonesia, the Philippines, and India, among other Asian countries, over the next few years.

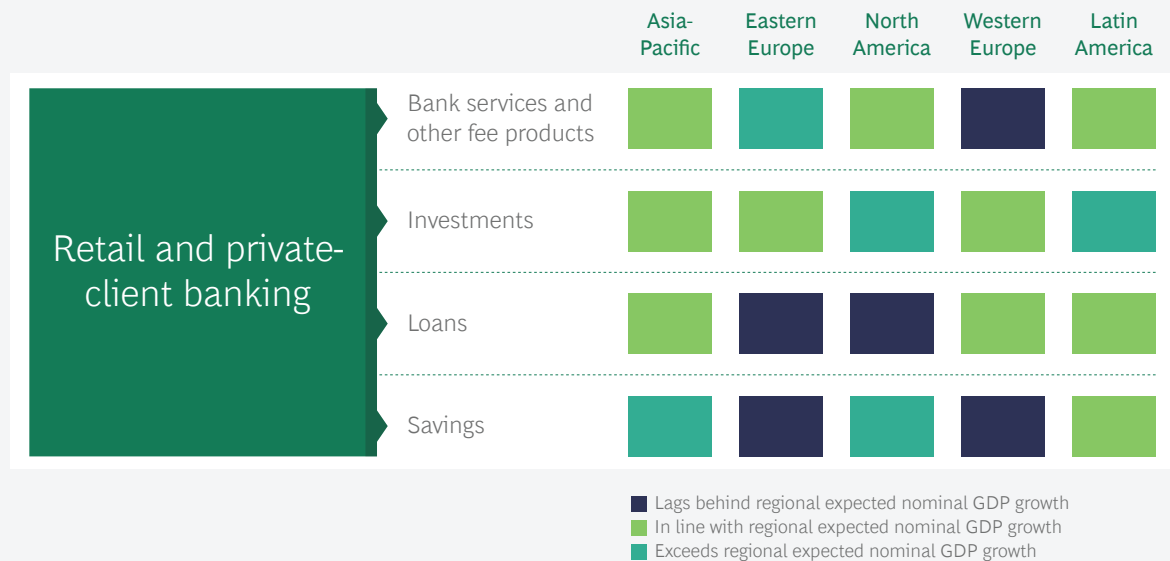
EXHIBIT 2 | Global Retail Banking Revenue Growth Through 2021



Source: BCG Banking Pools 2017.

Note: Revenues exclude insurance and asset management products. All other banking revenues are included. Growth estimates are based on constant 2016 FX rates.

EXHIBIT 3 | Growth Rate of Product Lines by Region, 2016-2021



Source: BCG Banking Pools 2017.

Note: Growth rate projections are based on extensive coverage of various banking markets, representing over 90% of global GDP.

Interest rates are likely to rise in North America, as a result of its rapidly improving employment picture. Higher interest rates should have a twofold impact—increasing banks’ margins on their savings products but restraining the demand for loans in a region where competition for loan customers is already high. North American banks are poised to benefit from growing use of their investment products, which many customers prefer to the banks’ more traditional deposit and savings products. Political uncertainty or a stock-market correction in the US could diminish some of this upside, however.

North American banks are poised to benefit from customers’ growing use of their investment products.

Latin America’s fastest growth will occur in a product area that has until now been woefully underused: investments. The demand for investment products will come largely from South America’s largest country, Brazil, where the economic outlook is improving and where households have, in the past, feasted at the banquet of high equity-market returns. Especially promising for bank investment products in Brazil are the country’s many mass-market customers, who are currently underserved and represent a huge opportunity.

Retail banks in Western Europe face the greatest risk of growing more slowly than the local economy. On the plus side, thanks to an improved economic outlook and to rebounding consumer confidence, which is at its highest level in 15 years, loan volume growth in Western Europe will likely double from the meager 1% annual increase that prevailed between 2011 and 2016. On the downside, uncertainty over rate normalization— for years, interest rates have been near or below zero— still hampers Western European banks, which can pass only so much of this problem on to their customers. The banks’ transaction revenues will also remain under pressure because of increased competition from digital attackers and because of the caps that regulators

have imposed on interchange fees. The possibility of a recession within the next three years, though unlikely, can’t be dismissed; if a recession were to materialize, it would create new impediments to this group’s rebound.

Eastern European banks are in the middle of the pack, with an expected expansion in banking revenues of 5.1% annually, close to the global average. Russian banks will see significant growth in their services and fees products, as the country increasingly moves toward noncash payments and as the Russian government pushes for increased financial inclusion. In other respects, though, Russian banks don’t have a lot working in their favor. Their loan performance is expected to be sluggish, with low margins. (This is true of Polish banks, too.) And in contrast to their East European peers, Russian banks are likely to face margin pressure in the savings area. Unfortunately, because Russia accounts for more than 70% of the region’s savings revenue, the underperformance of its banks will substantially lower the whole region’s performance in this area.

The Impact of Regulation

The broad outlines of most top-level regulatory reform packages are now in place, and the regulations address three areas: financial stability, prudent operations, and resolution (which refers to a bank’s responsibility to put forward a plan in the event of its own failure). The challenge for banks is to remain efficient as they start to implement the regulations, whose number has tripled since 2011.

Regulations will have a bigger near-term impact in some regions than in others. In Europe, which continues to pay a stiff price for its slow response to nonperforming loans, and where the European Central Bank is bringing different national regulations together, bankers face the heaviest burden of compliance. The burden will be lower in the US, where some degree of banking deregulation is likely. The regulatory approaches taken outside Europe and the US in various smaller markets—some of them regional or developing markets—will generally track the initiatives of the regulators in the mature markets. (See *Future-Proofing the Bank Risk Agenda*, BCG report, February 2018).

European retail banks also face two EU regulations whose impact goes beyond strict compliance and implementation:

- The Payment Services Directive II (PSD2) requires banks to enable third-party access to customer account information through more open and standardized application programming interfaces (APIs). In other industries, portals such as Google and Facebook have long used open APIs so that third parties can integrate their products and services. Today, entire ecosystems exist around those tech giants' core platforms. The move toward open banking could give others access to areas that banks have long controlled, threatening banks' customer relationships and their control over data. A field that has already seen one wave of disruption—fintech—could see another if tech giants regard PSD2 as an entry point.

One thing is indisputable:
The customer can never be
an afterthought.

- The General Data Protection Regulation (GDPR), which banks are now implementing, requires banks in the EU to establish robust processes to safeguard customer and employee data, and to disclose any data breach. The burden that GDPR imposes on banks will grow as digitization accelerates, necessitating comprehensive measures to protect expanding volumes of client and internal transaction information. The good news is that banks rank among the most trusted corporate holders of personal financial information. A 2017 BCG survey showed that, in every country except China, consumers are reluctant to share their personal financial information with any nonbank entity.

Low interest rates, increased competition, and tighter regulation are significant near-term challenges in many of the most developed banking markets. Retail banks need to grapple with these challenges while still in-

vesting in capabilities and services to remain relevant in the future. Short- and long-term goals will occasionally conflict in the coming years, and each bank will have to figure out the tradeoffs it must make. One thing is indisputable, however: The customer can never be an afterthought.

Greater Dispersion of Performance

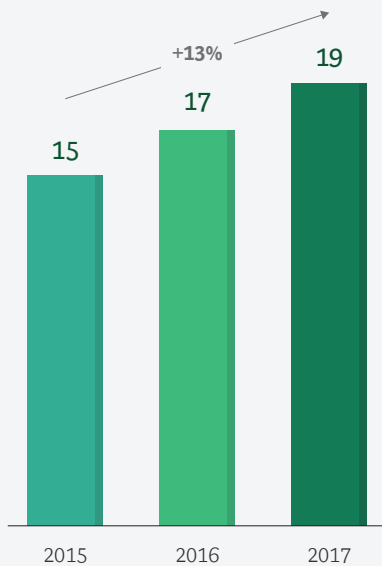
BCG's Retail Banking Excellence Benchmark (REBEX)—a yearly analysis that allows us to compare banks across hundreds of metrics—shows that not all retail banks are responding to the current challenges with equal success. In fact, the gap between the cost-income ratio of top or Quartile 1 (Q1) banks and of median banks has been increasing at a compound annual growth rate of 13% over the past three years. (See Exhibit 4.) The gap between top-quartile and bottom-quartile players in cost-income ratio grew to 41% last year, up from 38% in 2016. (See the sidebar, "REBEX Quartiles: What They Mean.")

The performance dispersion is due in part to circumstances specific to different regions. For instance, the average margins of median banks are roughly 50% higher in North America than in the rest of the world, according to key performance indicators in REBEX. This reflects the different structure of revenues in North American banks, which have a higher fee and commission ratio, as well as higher interest margins and different funds transfer pricing mechanisms. In addition, interest rate increases are starting to lift the retail fortunes of those banks, adding between 3% and 5% to their reported retail revenues. This, in combination with enactment of business-friendly tax legislation in the US, sent US bank stocks soaring in 2017.

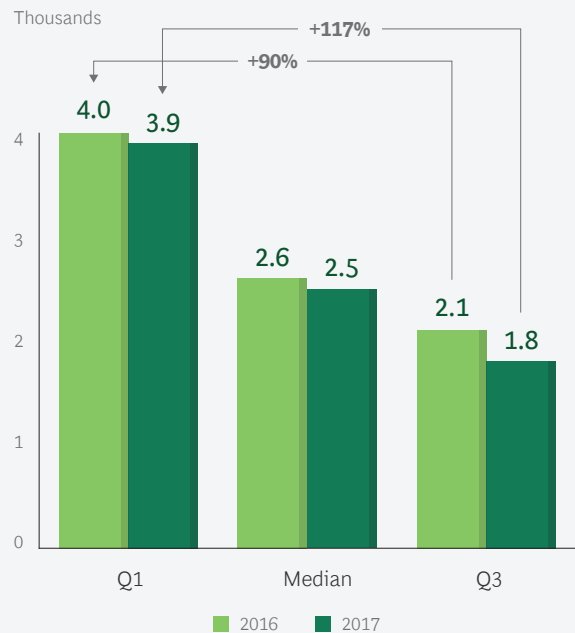
Cost structures and efficiency levels have some regional components as well. For example, in their battle to counter low interest rates and manage the threat posed by a high number of at-risk loans, some European banks have invested heavily in cost-reduction programs. This has given them a higher average operational efficiency level than banks in other regions of the world: approximately 2,500 customers per back-office full-time em-

EXHIBIT 4 | Top Banks Have a Big Efficiency Advantage

Gap in cost income ratio between Q1 banks and median banks (%)



Customers for each full-time operations employee



Source: BCG Retail Banking Excellence Benchmark 2017 (REBEX).

Note: Figures for Q1 banks reflect the data for the single bank in the 25th percentile. Figures for Q3 banks reflect the data for the single bank in the 75th percentile.

ployee. But despite those cost-reduction programs, global operational costs remain high at banks in certain parts of Europe, owing to the difficulty of decommissioning legacy IT systems as well as the need to maintain employment in response to local labor laws or as a commitment to social responsibility.

Another regional difference relates to variations in bank customers' digital readiness. A REBEX survey of customers in 16 countries

found considerable variation on this measure: more than three-quarters of respondents fit into the "primarily digital interactions" category in the most technologically advanced banking regions, while only 10% of respondents fit into that category in the least advanced banking regions.

The Netherlands ranked at the top of the countries surveyed, as 76% of Dutch respondents considered themselves to be primarily

REBEX QUARTILES What They Mean

REBEX assesses the first-, second-, and third-quartile banks for each key performance indicator (KPI).

Quartile 1 (Q1) reflects the data of the single bank that is in the 25th percentile; Quartile 2 (Q2), the median, reflects the data of the single bank in the 50th percentile; and Quartile 3 (Q3) reflects the data of

the single bank in the 75th percentile. Many banks rank differently across REBEX's 100-plus KPIs, qualifying as top performers in some of them and as median or bottom performers in others.

digital banking customers. Belgium and Australia were next (with 56% and 55%, respectively), followed by Austria (51%), Germany (50%), the UK (47%), and France (46%). Canada and the US came next, with 41% and 34% of respondents in those countries describing themselves as primarily digital banking customers. Toward the bottom of the list were China (15%) and Colombia (11%), where most customers define themselves as hybrid.

These regional differences are important to keep in mind in evaluating banks' performance and the distance they've come in realizing their digital transformation strategies. The differences *within* regions, however, indicate that there is a local dimension to the story and suggest that a lot depends on how companies respond to the macroeconomic conditions they face and on the level of technical literacy in their customer bases.

MIDWAY THROUGH THE DIGITAL TRANSFORMATION

FOR MANY RETAIL BANK executives, the key question is how efficient and digitally advanced their organization is compared with their immediate competitors—the banks that pursue the same customers, have branches on the same streets, and operate under the same regulatory constraints. The REBEX data shows considerable variation in within-region performance, and much of that variation reflects the different stages that banks have reached in their digital transformations.

At the most advanced banks, three-fifths of all transactions are now conducted digitally, via smartphone or computer.

In talking about where different banks are in their transformation journeys, it's useful to consider two objectives. The first objective is *digitizing for cost*, which refers to the use of digital technologies to create operational efficiencies, including pushing routine business activities to low-cost channels such as a bank's mobile apps, websites, and interactive voice response systems. The second objective, *digitizing for value*, refers to the use of digital technologies to create a fundamentally better experience for customers. That should also translate into an increase in each customer's

lifetime revenue potential through higher average sales per customer and a higher retention rate across the whole customer base.

As we noted a year ago, it's a rare bank that hasn't thrown off its bowlines and set sail into the digital future. In some areas, indeed, digitization is a necessity. Four of every five customer interactions are now digital, and REBEX data shows that all banks have made progress in the past year, including some bottom-quartile banks that are catching up with top-quartile banks. Likewise, more than three of every five transactions—deposits, transfers, or payments on loans—are now digital at Q1 banks, done via smartphones or computers. This trend permits banks to operate with fewer branch employees and leaner back-office staffs. They've made considerable progress in digitizing for cost.

The story on the revenue side is different. Banks are still struggling to convert their new touch points (including smartphone apps) into digital sales. About 34% of Q1 banks' sales are digital, virtually unchanged from the figure noted in the prior year's REBEX study. At bottom-quartile banks, digital sales represent a paltry 10% of revenues.

As part of their effort to attract more sales through digital channels, incumbent banks are increasingly adopting an ecosystem approach and investing in fintechs, seeing these

companies as a path to innovation and customer acquisition. Last year, for instance, incumbents participated in 71% of the funding rounds for retail bank startups, according to the BCG FinTech Control Tower, our database of fintech information. Back in 2013, when banks still primarily viewed fintechs as a threat, fewer than one in five of those funding rounds included an incumbent.

Some retail banks have entered into distribution partnerships with fintechs, seeing it as a way to gain market share in fast-growing areas such as consumer lending. This has certainly been the case in the US. But there is also a more strategic side to the banks' fintech investments, in the US and elsewhere. Banks see their investments in fintechs as helping them stay ahead of their traditional brick-and-mortar competitors. They also see their fintech relationships as accelerating their capacity to innovate and as helping them prepare for a second wave of disruption. The disruption could come from digital natives such as Amazon, Apple, and Google, which have already rolled out some early banking services and could be working on more.

These platform businesses—so called because of their ability to continually build on what they have done previously and to add new services—could disintermediate bank brands and reset the industry's competitive dynamics. But there is an opportunity here as well

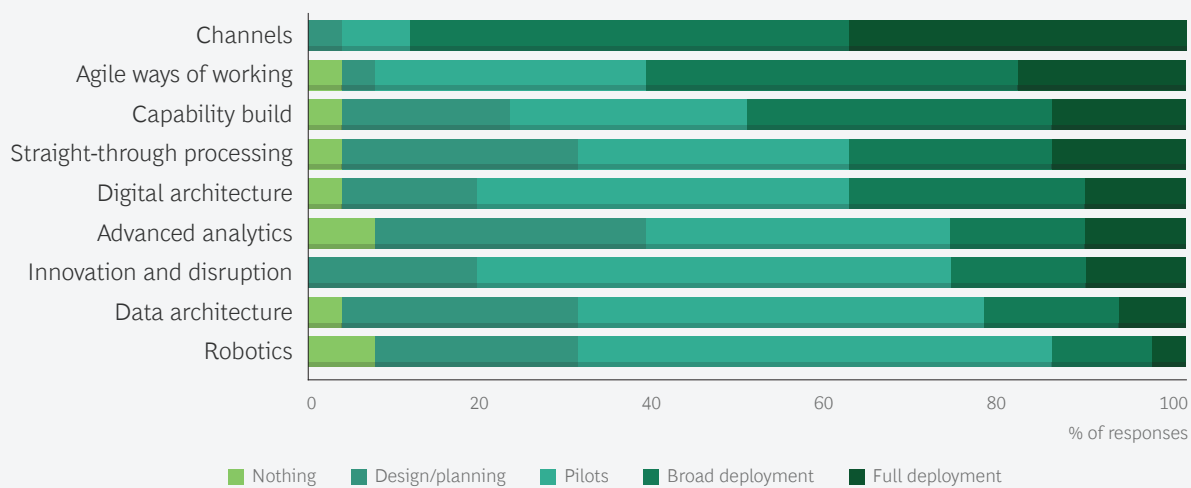
as a threat. Like platform companies, banks can become ecosystem orchestrators, applying data and analytics to enrich their offerings, learn faster, and engage more effectively with customers. Many banks want to do this but have struggled to move from theory to practice and to introduce large-scale digital innovations. To overcome these limitations, banks must redouble their efforts to evolve and must build digital learning systems of their own.

Signs of Progress

The REBEX metrics, our conversations with banks, and the survey work we've done lead us to believe that banks are about halfway through their digital transformation efforts. Yes, banks are broadly deploying digital channels, and they are testing ecosystem models and starting to use agile software development methodologies, thus positioning themselves to release high-quality digital services more quickly. But most of their other digital efforts—in areas such as advanced analytics, data architecture, and robotics—remain at the pilot stage. (See Exhibit 5.)

In short, investors are still waiting for retail banks to capture the transformative impact of their move to digital. There are signs of progress, however. As recently as 2016, REBEX showed no obvious correlation between digital front-office capabilities and back-office efficiency. That is starting to change. REBEX's

EXHIBIT 5 | Most Banks' Digital Initiatives Are Still at the Pilot Stage



Source: BCG survey of bank executives, 2017.

digitally advanced peer group—the traditional banks in our database that have the highest level of digital interactions, transactions, and sales—now have a cost-income ratio that is 10 percentage points below that of the least digitally advanced banks. The digitally advanced peer group also demonstrates higher productivity in many areas related to selling. (See Exhibit 6.)

With so many digital initiatives still in the pilot stage, the impact of implementing them on a larger scale is impossible to predict. But our digitally advanced peer group provides a glimpse of the potential benefits, as do the purely digital banks in our sample. Purely digital banks—newer banks that do business entirely online and on mobile devices—are roughly 50% more efficient than traditional banks, in terms of customers per full-time employee. The simpler products that digital-only banks sell don't require any handholding from relationship managers, which partly explains this huge edge. Even so, it's an eye-opening statistic.

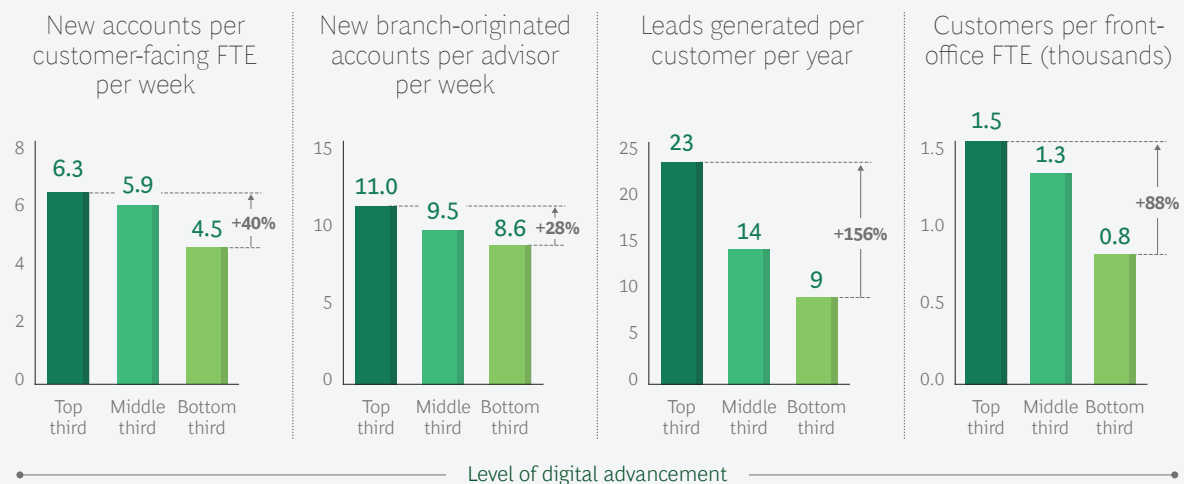
personal and education loans, and retirement plans. Banks should make these and all of their other products more engaging and easier to use, and they should become more efficient in selling and supporting the products. New capabilities, including in the areas of agile work methods, data management, and analytics, can help banks do this. Scaling up these capabilities will enable banks to reap the full benefits of digitizing for cost and will allow them to become more ambitious about digitizing for value.

Banks have two fundamental ways to reinvent their customer engagement models and position themselves to generate new revenues. The first is to move to a more personalized type of banking and do a better job of bringing value to customers. The second—which will unfold over a longer period of time—is to develop a distribution model that leaves the idea of mere channels far behind. Only with personalization and ubiquitous distribution can banks become a bigger part of their customers' lives.

What's Next?

As we have been saying for a while now, all banks should take a fresh look at the end-to-end journeys that their customers must take to access their products, including mortgages,

EXHIBIT 6 | Impact of a Bank's Level of Digital Advancement on Sales Productivity



Source: BCG Retail Banking Excellence Benchmark 2017 (REBEX).

Note: FTE (full-time equivalent) can refer to an employee of the bank or to a person hired to work temporarily full-time. Level of digital advancement is determined by a bank's percentages of digital interactions, digital transactions, and digital sales. Only traditional banks are included in this analysis; purely digital banks are excluded.

PERSONALIZED BANKING

WHAT PASSES FOR PERSONALIZED service in banking has changed dramatically over the years. The relationship used to involve face-to-face meetings with branch managers who knew their customers' financial situations and considered it their job to help them. George Bailey in *It's a Wonderful Life* may have been an idealized Hollywood portrait of a community banker, but he was certainly personal.

Personalization today still involves understanding customers' financial situations—including their family circumstances and their tolerance for risk—but it is also about helping individual customers in more immediate, tactical ways. For instance, in an earlier era of banking, regardless of how personal the relationship was, customers wouldn't have expected their bank to recognize the moment when they qualified for a lower-fee checking account, let alone to upgrade them and lower their monthly fees without their having to bring this possibility to the bank's attention. Nor would customers have expected their bank to spot a recurring transaction and offer them the option of automating it.

Today the best banks aim to understand and serve customers in this more personal, immediate way. The trick, of course, is to do so on a large scale—not through the efforts of one conscientious relationship manager, but through digital systems that constantly refine

and customize the experiences that are available to the bank's entire customer base.

Bank personalization is about delivering the right one-to-one experience in the right channel at the right time to every customer, in a contextually relevant manner. The right experience might entail advising a customer to transfer money from another account with ample reserves, when the customer is about to make a checking-account payment that will result in an overdraft. Or it might involve using a text message to steer a customer to a short video about how home-equity financing works, when the customer is considering a home renovation project.

For example, a bank prospect in San Francisco might click on a social media advertisement and find herself on a bank landing page customized with a San Francisco theme, family-oriented content (information available from the banks' targeting via Facebook), and a chatbot inviting her to share more information about herself. Or on her next interaction with the bank's website, mobile app, or call center, a customer might find that the bank has a savings plan tailored to her spending pattern and financial goals, and offering her an appointment with an advisor to review it.

A recent BCG survey brought home how important personalized experiences are to bank customers. A majority (54%) of people

who had become customers of a new bank in the past said that something their new bank did to personalize their experience was either the most important or a very important factor in their decision to move to that bank. (See Exhibit 7.) And 68% of respondents said that they had deepened ties with their existing bank—by purchasing additional products or services—because of the bank’s personalized approach. Among customers who had left a bank, 41% said that insufficiently personalized treatment was a factor in their decision.

The importance accorded to personalization was similar across all regions, and it was an especially common join-or-leave factor among the youngest bank customers and among the wealthiest bank customers (those in the 18-to-34-year-olds cohort and those with the highest level of bank assets).

Indeed, the willingness of millennials to share information in return for something that addresses their individual needs is prompting banks to focus more intensely on personalization. A second factor in banks’ push for personalization is competition from digital banks and digital natives, which banks see as infringing on their customer relationships. A third factor is banks’ own improving organi-

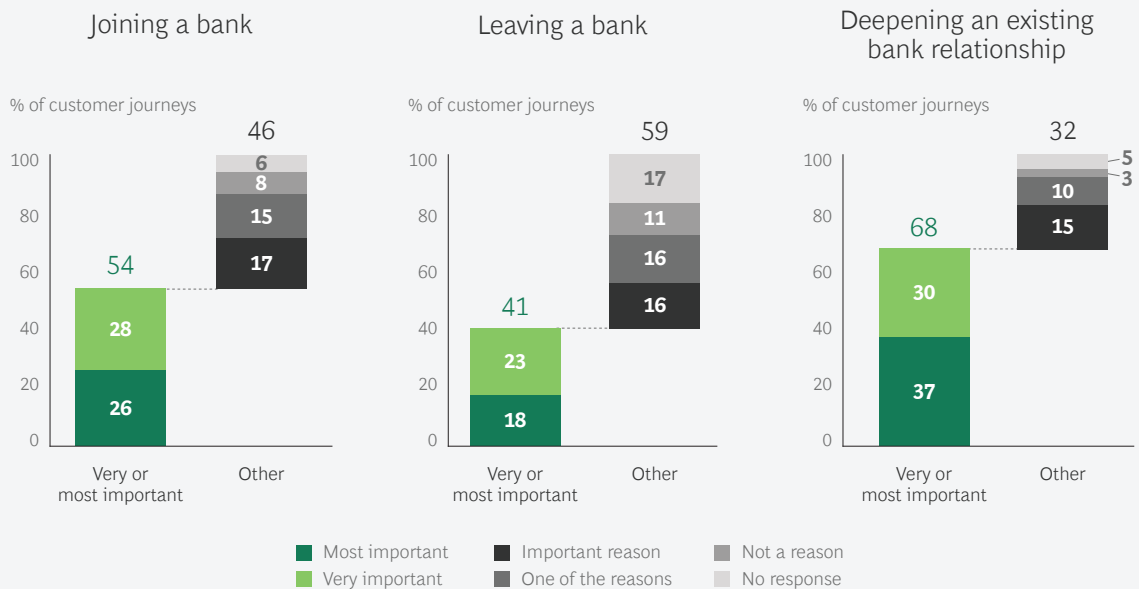
zational and data capabilities—the many technical, process, and human adaptations that have made it easier for them to look at, market to, and service customers in more personalized ways.

A Fundamental Shift in How Banks Operate

Personalization requires changes throughout a bank’s value chain. Such changes have the potential to increase customer engagement and create significant economic benefits for the bank over time. Here are the most important areas of change:

- **Prospecting.** Today, banks use credit risk and basic demographic segmentation in performing most prospecting assessments. With additional data and analytical capabilities in place, the mechanisms for reaching prospects and pulling them into the right bank channels will become more powerful and much more precise.
- **The customer experience.** Personalized web pages must reflect a customer’s individual situation and context, and suppress irrelevant product offers (such as balance consolidation offers to a customer

EXHIBIT 7 | Impact of Personalization on Key Customer Decisions



Source: REBEX consumer survey 2017.

Note: Some percentages do not sum to 100 because of rounding. Customer journeys considered: joiners, 56,351; leavers, 13,768; deepening, 18,221.

who isn't currently a borrower). Each customer's landing page should include the person's name and have dynamically updated shortcuts that reflect the most likely actions at a given time. For example, it might include an option to transfer money from checking to savings at the beginning of the month, if that's when the customer's paycheck usually shows up as a credit, or an option to check her teenage child's balance, if the customer often does that during the week or on Friday nights.

- **Products and pricing.** The current approach to products and pricing relies on segmentation and marketing calendars (Week 1 is the credit card campaign, Week 2 is financial planning, and so on). But these allow only a limited number of offer combinations and provide little flexibility. In the personalized bank, insights about the customer determine “next-best actions” across all products and channels, and can accommodate a virtually unlimited number of sales propositions.
- **Financial planning.** In the past, banks have not had a holistic picture of their customers' financial health. This is changing as customers (especially millennials) provide more information about their financial situations and aspirations, allowing banks to play a larger role in personal financial health and planning. Several banks are using highly personalized customer data to successfully create financial health planning experiences through branch appointments.
- **Customer retention.** Retail banks have long used predictive models to figure out which customers are at risk of leaving or might be on the verge of giving some of their banking business to other parties. We see dramatic improvements in this capability today, thanks to machine learning and personalized libraries of treatments, all leading to fewer false positives and less use of discounts and incentives. Artificial intelligence software identifies the approaches that work best for each customer, often triggering overtures from branch employees that can be surprisingly effective.

A Structured and Recursive Three-Step Approach

In a bank's efforts to personalize the customer experience, the first step should be to *capture customer DNA*. This is our term for bringing together many data points, including basic profile information, responses to marketing, types of products the customer holds, transaction history, credit and risk actions, and external data such as that available from credit bureaus and other agencies. This analysis yields a unique DNA profile of each bank customer, reflecting the person's household composition, wallet size, financial behavior, offer sensitivity (value versus premium), and channel preference.

Banks need to define a customer curriculum—a set of offers and interactions to encourage certain behaviors.

The next step is to *define a customer curriculum*, which is basically a set of offers and interactions to encourage certain behaviors. For instance, the desirable behaviors might be for a customer to increase the assets he has under management at the bank and to use his debit account for more everyday spending. The interactions that the bank initiates should likewise reflect the customer's preferences: maybe an email to a primary household earner in one case, and a video chat in another.

The third step is to *use recursive learning*. This involves applying machine learning, algorithms, and analytics systems to see how the customer has responded to different offers, and then adjusting future offers accordingly. The goal is to increase the bank's marketing efficiency and add to its top-line growth.

Economic Payoff

We believe the impact of personalization in retail banking will be dramatic, generating a 30% to 40% sales lift in some product areas, reducing customer churn rates by 10% to 30%, and lifting customer engagement scores by a factor of 2X to 3X.

To illustrate the potential of personalization, we modeled its impact on a hypothetical bank with \$100 billion in assets. (See Exhibit 8.) By personalizing its pricing and product offers, such a bank could increase its everyday banking revenue by as much as \$50 million. The bank could generate up to \$135 million in additional new sales by connecting the different channels that customers might use (such as smartphone apps, website information, and

in-branch consultations), creating a frictionless experience for customers who are researching new products. Through improved personalization, the bank could identify and intervene in situations where customers were on the verge of leaving, lowering attrition costs by \$90 million.

EXHIBIT 8 | Financial Potential of Personalization at a \$100 Billion Bank

	Use case	Goal	Baseline (\$millions)	Revenue impact range (\$millions)
Smart prospecting	Dynamic, targeted engagement with potential customers	New sales increase	450	15–25
Smart engagement	Personalized pricing and product offers	Increase in everyday banking revenue	2,555	25–50
	Improved marketing efficiency	Higher ROI	45	5–10
Personalized journeys	Optimized multichannel journey and delivery	Incremental sales increase	450	45–135
Smart retention	Reduced customer churn through earlier identification and intervention	Lower attrition cost	300	30–90
Smart collections	Improved collections strategy with regard to timing, offer, and contact channel	Recovery of write-offs	90	25–35

Source: BCG analysis.

UBIQUITOUS DISTRIBUTION

LONG GONE ARE THE days when a bank's physical presence in a town or city was its primary means of raising awareness—and de facto evidence of the bank's quality. We may walk or drive past a bank branch multiple times a week, but the bank's presence in our neighborhood doesn't make us think that it will necessarily be the best place to handle our personal financial needs.

Instead, when we need a bank product—a mortgage, a consumer loan, a savings account, or car insurance—we do an online search. In the US, the UK, and Australia, 83% of people looking for a financial service or insurance product begin their research on the web or on their mobile phones, according to a study that BCG conducted a few years ago.

The fact that we start online in our journeys for banking products does not mean that bank branches or bank relationship managers lag behind digital channels in securing new business. On the contrary, it is the digital channels that disappoint in capturing sales. BCG casework shows that visitors to bank websites don't usually follow through and deepen their relationships with those banks, whereas people who take the time to come to a bank branch with a product in mind often end up buying it. (See Exhibit 9.)

The continuing importance of human-to-human interactions, coupled with the knowl-

edge that most retail bank customers carry out parts of their journeys online, poses a transformation challenge for retail banks. They must figure out how to redeploy their assets—including offline and online channels, data, workforce, and partnerships—to meet the challenge of personalization, build remote human proximity, and remain relevant in the future.

Moving Beyond Channels

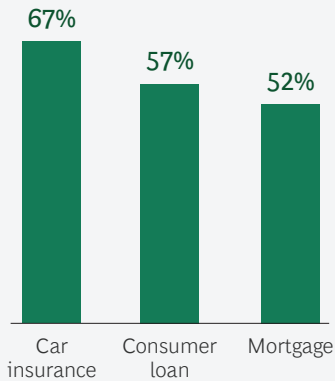
Today, most banks take a multichannel approach to distribution. Multichannel banking allows customers to access bank services through a discrete set of proprietary channels, which may differ from day to day depending on the customers' needs. The banks' mobile apps and websites are effectively one channel, good for self-care activities such as checking a savings account balance and making payments. Call centers or paper correspondence is another channel, allowing customers to pose routine inquiries and complete applications. Physical bank branches are yet another channel, providing a bank's full range of services, including critical support in resolving nonstandard customer inquiries and selling complex products.

But multichannel distribution, in its current form, has significant limitations. The first is the lack of data-sharing between, say, the bank's website and its call center, or between

EXHIBIT 9 | In-Person Crushes Online in Selling Bank Products

Most customers make their decisions long before contacting the bank...

Percentage of customers who have already made a decision to buy before entering a branch

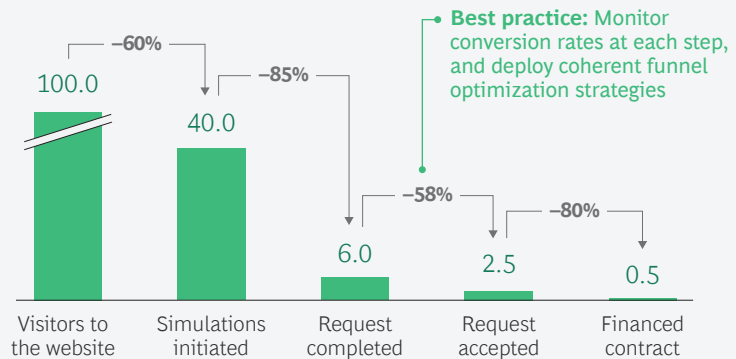


...requiring banks to monitor them across their funnel and implement catch-up strategies to relaunch interrupted journeys

Best practice: Build the ability to track customers along their journeys, whatever the channel



Illustration from a French retail bank



Sources: Google France (2017); BCG case experience.

its smartphone app and its branches. It's still uncommon for a bank customer to start a transaction in one channel and complete it in another. The inconvenience of this system is not lost on anyone, and the risk to the bank is especially great if the interrupted journey represents a customer's first impression of the bank. The lack of channel integration may well contribute to the extremely high drop-off rate that we have observed among prospects who come to banks' websites to research products, never to be heard from again.

In addition to the problem that data is not sharable among channels, the multichannel approach at banks—with its emphasis on the same experience for all—lays the wrong foundation for operating in the emerging world of continuously delivered bank services. As part of continuous delivery, banks must be able to accommodate customers who want to execute bank transactions through Internet of Things devices such as voice-activated personal assistants on smartphones or in connected cars. Banks will have to offer video chats to customers who don't wish to come in to branches, and will have to support peer-to-peer payments within social networks. Banks' services must be embedded within merchants' commerce platforms, an imperative that necessitates embracing the concepts of open banking and shared APIs.

Banks that fail to make these changes and respond slowly to customers' other expectations as they emerge will be pushing their customers into the arms of rivals with more advanced digital capabilities.

The Challenge Between Now and 2025

To become more responsive to customer preferences and to meet the larger personalization imperative, banks must develop dynamic channels orchestration, which involves the integration of four processes. The first is omnichannel tracking and data collection, whose goal is to dissolve the information barrier between different bank channels. The second process is automatic customer recognition, to enable the bank to know who is contacting it and how the person would prefer to interact. The third process is request qualification, to help the bank understand the different ways in which it might address an inquiry. And the fourth process is optimized routing, to ensure that the bank can complete the interaction quickly and efficiently.

For all of this to happen in an economically viable way, bank channels must evolve. In last year's version of this report, we discussed in detail the need for banks to optimize their physical footprints and to be more creative in

their branch formats. Bank branches aren't going away, if only because some bank products are too complicated for people to buy without the support of a relationship manager. But the nature of bank branches will change: some branches will offer only investment advice, for instance, and others will become self-service locations with remote advisors.

Another channel that needs to evolve is the bank call center. In its current incarnation as a phone response function, the call center will become obsolete. In its place will be what we call a remote customer care platform. This platform will consist of robots, artificial intelligence software, and human experts. It will handle not just phone calls, but emailed and texted inquiries, chat sessions, and video

chats, whether the query comes from an external customer or from a manager at a bank branch. Digital technology will enhance the operators' performance.

Ultimately, the challenge for every bank in the early years of the digital era is conversion: persuading people who come to the bank's website to open a tool that simulates one of the bank's products and to fill out an application for the product; and then persuading the people whose applications meet the bank's requirements to interact with a real or virtual (in the form of a digital assistant) relationship manager.

What will it take? That, in 2018 and beyond, is the question every bank should be asking.

CONCLUSION

A DIFFERENT PATH FOR EACH BANK

IF YOU COULD GET an aerial view of the retail bank industry, the way you might look down from the cockpit of a plane and see how different travelers were progressing across a mountainside, you would see that there are many different paths and that some banks are in a more advantageous position than others.

Like travelers on a mountain, banks are in demonstrably different places, using their own particular strengths to overcome obstacles. Some banks, in 2018, still have room to gain a

competitive advantage by digitizing for cost. Others have done most of what they can do in that area and have progressed to the trickier part of the journey, which is digitizing for value. Each bank must consider the imperatives of personalization and continuous delivery and decide how to get to where it needs to go. The destination is becoming clearer with each passing day.

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.

Global Capital Markets 2018: Embracing the Digital Migration

A report by The Boston Consulting Group, May 2018

Global Corporate Banking 2018: Unlocking Success Through Digital

A report by The Boston Consulting Group, March 2018

Global Risk 2018: Future-Proofing the Bank Risk Agenda

A report by The Boston Consulting Group, February 2018

How Pricing Can Solve European Banking's Earnings Crisis

An article by The Boston Consulting Group, February 2018

How Banks Can Thrive as Digital Payments Grow

An article by The Boston Consulting Group, December 2017

The Power of Digital in Commercial Banking

An article by The Boston Consulting Group, December 2017

Why Aren't Banks Getting More from Digital?

A Focus by The Boston Consulting Group, December 2017

Global Payments 2017: Deepening the Customer Relationship

A report by The Boston Consulting Group, October 2017

Getting Bank Automation Beyond the Pilot Phase

An article by The Boston Consulting Group, August 2017

The Seven Rules of Cost Excellence in Banking

An article by The Boston Consulting Group, August 2017

Global Asset Management 2017: The Innovator's Advantage

A report by The Boston Consulting Group, July 2017

Global Retail Banking 2017: Accelerating Bionic Transformation

A report by The Boston Consulting Group, July 2017

How Banks Can Close the Back Door on Attrition

An article by The Boston Consulting Group, July 2017

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