

VOLUME IV – WINTER 2014

# RETAIL BANKING

AMERICAS DIGEST



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# FOREWORD

This Digest offers a wide-ranging mix of articles: some topical, some tactical and others fundamental.

For topicality there is a review of digital currencies that compares and contrasts the better-known “cryptography-based protocol” world of Bitcoin with the less-well-known “consensus-based protocol” world of Ripple. Among other things, it argues that despite the far broader current awareness of Bitcoin, the eventual winner is more likely to be based on an offering from the consensus-based protocol world.

Tactically, there is a treatise on what it means to become a decision-centric bank. Given the renewed interest in all things “data & analytical”, and the related interest in “big data”, this is also fairly topical. Despite the advanced use of data in decision support processes in the credit card and auto P&C businesses, we believe that there are opportunities to deploy analytics more effectively in the rest of the industry; this article sets out a general approach to becoming broadly effective in the deployment of data as a decision-centric bank.

Tactical proficiency is also central to separate articles on transforming small business banking, improving the customer experience and upgrading mortgage cross-selling.

Some articles deal with fundamental banking issues. The article on reinventing affluent banking tackles head on the dilemma of affluent consumers: they have more money but they are costly to serve and special units set up to serve them often end up losing money. This article describes how to approach and capture this customer segment in the digital age.

Similarly fundamental is the schematic illustration “Making the Switch” in banking. Our recent in-depth research reveals some important basic facts about the purchase decision in banking and lays them out in an appealing visual format.

As always, I hope you find them stimulating. Please let us know what you think.

**Michael Zeltkevic**

On behalf of the  
Retail and Business Banking Practice

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### Shaping Results by Deciding How to Approach and Treat Each Customer

It is the frequent decisions we make in the course of running a business that, to a large extent, determine how profitable it will be. Some decisions are 'strategic' and frame the overall field of battle. But increasingly, it is the myriad 'micro-decisions' – the ones controlling how we approach and treat each customer – that shape results. This is how the world of 'data & analytics' can really have a powerful effect.

## 6. MORTGAGE CROSS-SELL 39

### The Elusive Opportunity

Many banks are re-evaluating their commitment to residential mortgage lending in the face of the significant investments required to meet regulatory and customer expectations. These investments would have a higher return if mortgage could have a role in establishing and deepening customer relationships. Unfortunately, recent Oliver Wyman research indicates that mortgage is not effective as a relationship-deepening platform outside of a few niche areas. Banks should consider cross-sell tactics focused on these niches where returns justify the costs to effectively pursue attractive pockets of opportunity.

## 7. LAYING THE FOUNDATIONS FOR RECOVERY 45

### Transforming Small Business Banking & Delivering Impact through Improved Customer Experience

Thematic Perspectives from Oliver Wyman's 2014 European Retail and Business Banking Report: views on emerging best practices in two of the major challenges facing European retail banks in the next 3-5 years:

- Transforming small business banking
- Delivering impact via improved customer experience

# 1. DIGITAL CURRENCIES

## THE PATH FORWARD

By Vanni Parmeggiani

Digital currencies, loosely defined as electronic mediums of exchange not subject to the control of a central authority, have been one of the hottest topics of 2014. Despite skepticism and legal concerns, they have been gaining an increasingly solid footing among consumers, merchants and financial institutions. But what will it take to achieve mainstream acceptance?

To answer this question we looked at digital currencies beyond the current market leader, Bitcoin, and identified two broad types of digital currency protocols: cryptography-based (e.g. Bitcoin) and consensus-based (e.g. Ripple). We believe consensus-based protocols hold more potential than their cryptographic counterparts, as they promise lower long-term transaction fees and support real-time transactions in any currency, whether *fiat* or digital. There are at least three use cases for which customer costs and experience could improve from Ripple or a similar solution in the near term: international remittances, peer-to-peer transfers and business-to-business payments.

Given the potential, banks, networks, merchants and other relevant stakeholder should educate themselves on these solutions, without necessarily plunging into implementation. Constant monitoring of the landscape, engaging in conversations with start-ups and even pilots should be on the radar screen of companies that stand to gain from digital currencies – lest they end up scrambling to catch up later.

Digital currencies have transitioned from a relatively unknown “geek preserve” to a multi-billion dollar market

under the banner of Bitcoin. En route, they have sent central banks, financial institutions, payment service providers, merchants, and consumers worldwide into rounds of wild speculation:

- Will digital currencies become the norm for everyday purchases?
- Will payment costs shrink to near-zero?
- Is this the end of transaction fraud as we know it?

Bitcoin, the most successful digital currency, at one point approached a \$14 BN market value. Scores of “alt-coins” jumped on the bandwagon trying to emulate its success – over 500 to date. Some tried to legitimately improve on the Bitcoin value proposition, others were more questionable. Icelanders will certainly have fond memories of Auroracoin, the alt-coin that was freely distributed to the island-nation’s population in February. At the time, Auroracoin’s market value surpassed \$400 MM, now it has all but vanished from existence. At the time of writing, Bitcoin itself has been beaten down to half its peak value.

On one hand, misinformation and speculation plague the industry, which has become a target for law enforcement and regulators. On the other, forward-looking parties are increasingly seeing value in digital currencies, and are moving fast to reap the benefits. What better time to offer our perspective on the path forward for digital currencies?

We will do so first by recapping what the year had in store for digital currencies and the current state of the

market. Then we will explain the difference between the two main types of digital currencies as we see it, focusing on pros and cons. Finally, we will discuss where we see the greatest opportunities for digital currencies – and the challenges that need to be overcome.

## A YEAR IN REVIEW

Many high-profile economists and bankers have dismissed digital currencies as a passing fad. Despite all the skepticism and semi-serious alt-coin attempts, digital currencies do not seem to be going away.

By Q3 2014, the industry had attracted over \$300 MM in venture capital investment; for comparison, the investment in internet start-ups in 1995 was 20% lower. Well-known technology investors like Andreessen Horowitz are supporting various digital currency start-ups. Google itself backs Ripple, a leading digital payments protocol and currency.

Some notable merchants and payment service providers have started accepting bitcoins. Overstock.com, one of Bitcoin’s early champions, claims bitcoin sales approached \$8 MM in its first year as a Bitcoin merchant. Most recently, PayPal has declared it will start processing bitcoin payments through its Braintree subsidiary.

Several sizeable hacks shook the industry throughout the year, but companies seem to have learned from them. After Mt. Gox, the largest digital currency exchange in the world, lost nearly half a billion of customer funds to cyber-attacks, audits and enterprise-grade security have become increasingly prevalent.

However, aside from a cadre of enthusiasts, digital currencies still raise more questions than acceptance.

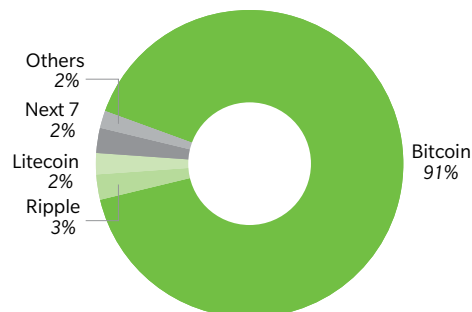
Bitcoin, far and away the largest digital currency worldwide with around 90% market share, persists in being extremely volatile. The price of a bitcoin in the past year ranged from a high of over \$1,000 to a low of less than \$350. Volatility has made bitcoin more of a speculative investment asset than a robust medium of exchange: over the past year, bitcoin exchange-traded volumes have been 10-15 times higher than transaction volumes<sup>1</sup> (Exhibit 1).

Digital wallet solutions are simply too many and too confusing for mainstream adoption by consumers or merchants. Ease of use is a particularly significant concern: the mechanics behind digital currencies already resemble black magic, so the lack of user-friendly offerings does not help.

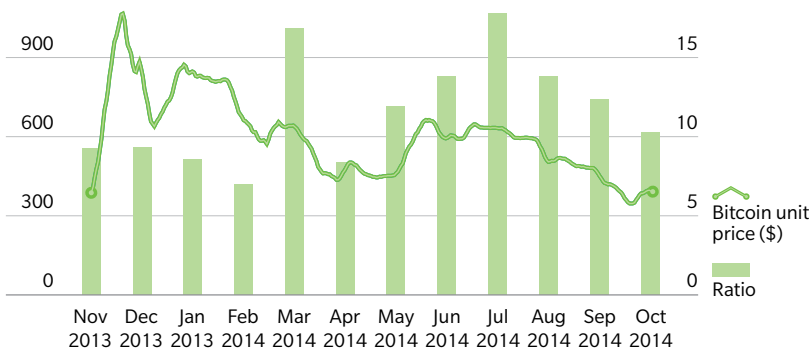
The use of digital currency for illicit purposes is still a concern. Bitcoin is the currency of choice for online drug and weapon marketplaces like Silk Road, even though

Exhibit 1: Digital currency market snapshot

DIGITAL CURRENCY MARKET SHARE BREAKDOWN  
TOTAL = \$5.7 BN



BITCOIN PRICE VOLATILITY  
NOVEMBER 2013 – OCTOBER 2014  
1,200



BITCOIN TRADE-TO-TRANSACTION RATIO  
20

Source coinmarketcap.com, blockchain.info, Oliver Wyman analysis

<sup>1</sup> Transaction volumes include C2C, B2C, and B2B bitcoin transfers.

law enforcement agencies have stepped up capabilities to identify transactions on these networks. Digital currencies offer a high degree of transparency – fund flows can be tracked since their inception on publicly available ledgers – but institutions willing to provide digital currency services need to set up AML controls that go beyond established practices to pinpoint suspicious activity.

Regulators are going through the five stages of grief in dealing with digital currencies (denial, anger, bargaining, depression, acceptance). Some countries, like China and Russia, are enforcing outright bans; others, like the UK and Australia, are treating digital currencies just like any other foreign currency; most countries, though, are still trying to figure out the best regulatory framework. In the US, the IRS has announced that digital currencies will be treated as an investment asset rather than a currency, and be subject to capital gains taxation. The New York Department of Financial Services is spear-heading the first effort at regulating digital currency businesses under its much-awaited “BitLicense”. Early drafts laid out requirements in terms of AML, capital, cyber-security and consumer protection – and drew outcries of stifling innovation from start-ups operating in the space. Undeniably though, balanced regulations that guarantee system stability are necessary to boost user confidence.

Established financial institutions and payment service providers, notoriously wary of any innovation that might carry additional regulatory risk, have been unwilling to get involved with digital currencies thus far – although interest is increasing.

What will it take to get digital currencies to the next level? To answer that question, we have assessed the two main types of digital currencies to indicate where we believe the market will head.

## COMPETING SOLUTIONS

Although Bitcoin has been grabbing most of the headlines and has essentially monopolistic market share so far, digital currencies are more than just Bitcoin. There are two main types of digital currency protocols, where by protocol we mean the set of rules that govern a digital currency:

- Cryptography-based protocols
- Consensus-based protocols

Both protocols are decentralized in nature, as they rely on computers operated by individual users to provide the power necessary to process transactions. The rationale is that decentralized processing is more cost-effective than centralized processing (e.g. operated by a corporate or governmental entity) because it works on free-market principles – transaction costs are determined by demand rather than fixed. However, beyond this similarity, there are fundamental differences in how the two protocols work (Exhibit 2).

Cryptography-based protocols like Bitcoin rely on sheer network computing power to operate efficiently and remain secure. Transactions are broadcast to all computers in the network, called “miners”. Miners compete to confirm transactions by finding a key to a cryptographic problem in exchange for a monetary reward. Every 10 minutes, confirmed transactions are stored in a publicly accessible ledger called a “block chain”, which contains details of all transactions that have ever occurred on the protocol. Once stored, funds cannot be reversed or re-spent unless a malicious user somehow manages to take control of more than 50% of network computing power and undo the block chain – something out of reach for hackers and even for most sovereign nations.<sup>2</sup>

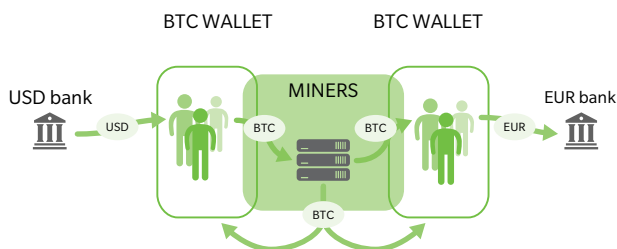
Consensus-based protocols, of which Ripple is the most prominent example, rely on the “network of trust” principle. In order to validate a transaction between users who do not know each other, the protocol attempts to find a path in which each node is between two users that have a trusted relationship. Once 80% of the network reaches a consensus on a set of trusted transactions (every 2-3 seconds), they are confirmed and stored in a public ledger. As the network grows so does the amount of trusted relationships, making the system more efficient. “Gateways” (e.g. banks) facilitate network-building by providing access for a multitude of users, similar to the way payments service providers allow access to existing payment rails.

We believe consensus-based protocols hold more potential than their cryptographic counterparts, as they promise lower long-term transaction fees and support real-time transactions in any *fiat* or digital currency.

<sup>2</sup> See Appendix for detailed description of Bitcoin mining process.

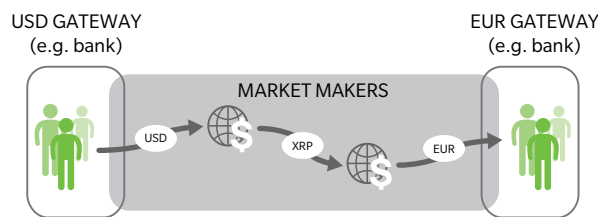
Exhibit 2: Bitcoin-Ripple comparison

BITCOIN



- Open source cryptography-based digital currency and payment protocol
- Transactions only in bitcoins (native currency)
- New bitcoins (BTC) issued as incentive for processing transactions until maximum amount of 21 MM reached
- Optional transaction fees
- Transactions processed every ~10 minutes

RIPPLE



- Open source consensus-based digital currency and payment protocol
- Currency-agnostic (transactions in any fiat or digital currency)
- 100 BN ripples (XRP) available as bridge currency to facilitate illiquid transactions
- Optional transaction fees
- Transactions processed in 2-3 seconds

The cryptographic transaction confirmation process, commonly known as “mining”, is not conducive to maintaining low transaction fees in the long term. Each computer participating in the network is currently motivated to mine via incentives: new bitcoins and transaction fees are assigned to the miner that confirms a transaction batch. Since incentives are assigned only to one miner at a time, whoever has the most computing power also has the highest likelihood of winning the incentive. But what happens when new bitcoins are exhausted? New bitcoin issuance is only meant to encourage network diffusion; no new bitcoins will be assigned once the maximum amount of 21 MM has been reached. At that point, the system needs to self-sustain through transaction fees, which are close to zero now but will inevitably rise to pay for mining costs. Unfortunately, most miners already struggle to break even given the skyrocketing computing power required to have even a remote chance of winning incentives, so transaction fees may rise quite a bit. Hence the main selling point for the ecosystem to adopt Bitcoin – low transaction fees – comes under question. Ultimately, centralized processing may be more cost-effective for a system based on raw computing power.

Consensus-based protocols, on the other hand, do not rely on incentives in a winner-takes-all mining system. Instead, the system relies on “access” fees charged by the protocol operator (e.g. Ripple) and transaction fees charged by service providers operating on the network

(e.g. gateways). The protocol operator is responsible for maintaining and updating the rules that govern the system, and enabling access to service providers; we expect these activities to command a small portion of overall end user fees. In parallel, any number of service providers can flourish as long as they provide services that customers want and are willing to pay for. Failing that, customers are free to switch to a competitor that offers better service or a better price. There is also an indirect incentive for service providers to host computing power to process network transactions, so they can become vertically integrated with transaction fees reflecting the full cost of network operations. We believe this system represents a more sustainable demand-based solution than one highly dependent on computing power costs.

There are other advantages to Ripple over Bitcoin, and to consensus- over cryptography-based protocols generally: Ripple is currency-agnostic and real-time. In other words, Ripple can be leveraged to transfer any currency that can be digitized, as long as there is a market maker willing to facilitate the transaction. Since essentially all relevant currencies can be digitized, the opportunity is vast and Ripple can be implemented on top of existing payments infrastructure with relative ease. In a more futuristic scenario, the system could also be used to transfer any kind of asset that can be digitized, from car ownership titles to equities. All this would be available essentially in real-time, as transactions are processed in 2-3 seconds.



In the Bitcoin world, on the other hand, transactions need to occur in bitcoins. Normal payment rails, like credit or debit, need to be used to move funds in and out of Bitcoin wallets, and currency conversion fees and FX risk may apply. This raises the problem of currency acceptance, above and beyond payment system acceptance: not only must you be connected to a Bitcoin wallet or processor, you must also be willing to store and be paid in bitcoins. Given bitcoin volatility, even the most supportive merchants convert bitcoins back to fiat currencies as soon as they receive them. Furthermore, Bitcoin transactions process in 10 minutes on average – the time required for miners to reach consensus on a new transaction batch. While this may not matter much for e-commerce, it poses issues for in-person transactions.

Bitcoin derivatives and protocol enhancements are in the works, but in the meantime a solution like Ripple is already available on the market – making it, or something similar to it, a frontrunner for mainstream adoption.

## THE FUTURE IS NOW(ISH)

By the end of 2014, three banks have announced adoption of Ripple as a payments protocol: Fidor Bank in Germany has been followed by Cross River Bank and CBW Bank in the US. All banks were particularly enthusiastic about

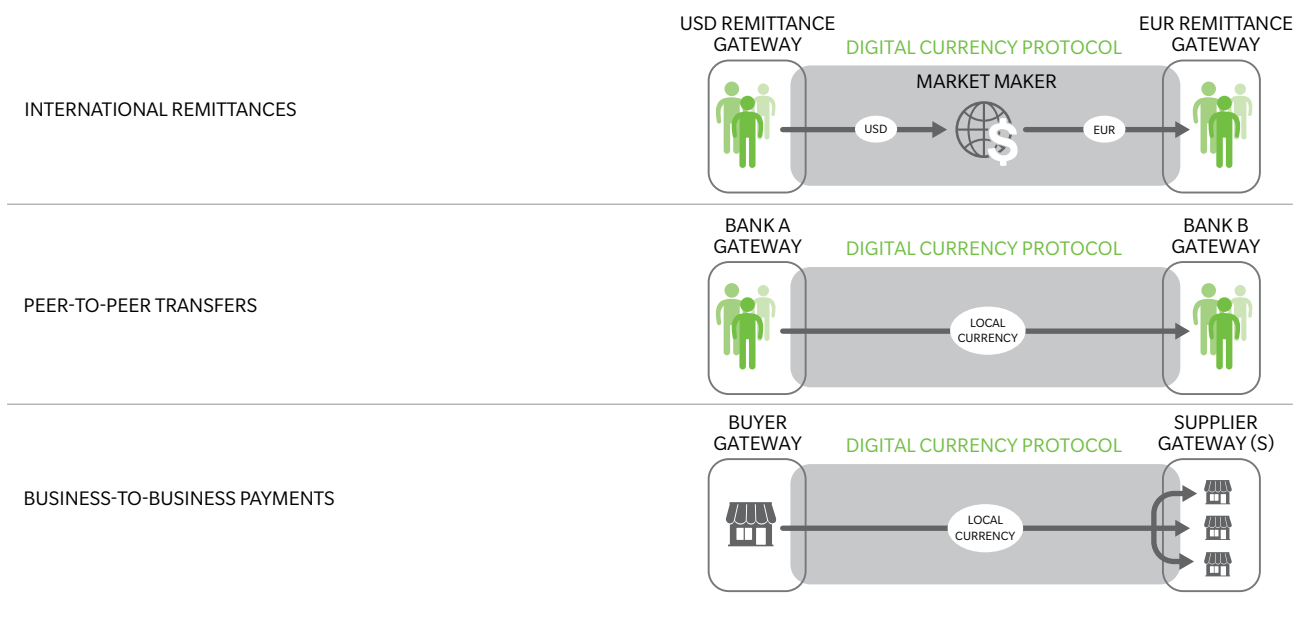
the opportunity to reduce customer costs for electronic payments. Most recently Earthport, a global provider of white-label cross-border payment services, announced a partnership with Ripple.

We believe there are at least three prominent use cases that could benefit from Ripple or one of its cousins in the near term (Exhibit 3):

- International remittances
- Peer-to-peer (P2P) transfers
- Business-to-business (B2B) payments

International remittance volumes are huge: in 2014 close to \$500 BN was sent overseas. Remittances are also one of the most expensive payment ecosystems for consumers worldwide: prices range from \$10 to \$20 per transaction, while the average ticket size hovers around \$200. Considering the added costs and risks of having to use physical locations and cash or checks to conduct transactions, the market is ripe for disruption. Digital currencies promise to support remittances at a fraction of the cost, and allow users to leverage self-service transaction solutions such as mobile phones or ATMs alongside traditional physical locations. Notably, SMS-based mobile solutions are being developed alongside smartphone solutions, in order to effectively target emerging markets. We have yet to see a substantially successful service in this space, but the amount of venture capital interest would definitely suggest 2015

Exhibit 3: High-potential digital currency use cases



might bring disruption to one or more remittance corridors in the form of new entrants or incumbents adopting new technologies. Some new entrants have been hinting at consumer prices around 1% of the remitted amount – if that were the case, consumer savings could range between \$20-50 BN annually.

Compared to remittances, P2P funds transfers are more sporadic and typically occur within a single country's borders. P2P transfers have already been the target of disruption in certain sizeable markets – most notably, in the US PayPal's subsidiary Venmo grew to over \$1 BN in P2P payments in 2014. While most US banks allow free transfers within the bank, inter-bank transfers are relatively inefficient as they rely on ACH or wire rails. ACH is inexpensive, but takes 1-2 business days to process and can be revoked within up to 60 days; wire transfers do not suffer these shortcomings, but they come with a \$10-20 price tag. Solutions like Venmo can make things easier, but require consumer to open separate accounts outside of their bank and link their cards or checking accounts as funding mechanisms. If banks were to become digital currency gateways, on the other hand, they could facilitate real-time, nearly cost-free transfers with minimal disruption to their existing infrastructure and core systems. This could be even more appealing to banks that have an established presence in multiple countries (e.g. Citi, HSBC, BBVA), given the high transfer time and costs for cross-border transfers, even if they effectively occur within the walls of the same institution.

B2B payments are typically large in nature and can be recurring, especially in buyer-supplier relationships. In Europe SEPA has established shared standards and direct debit is essentially free, but in the US and elsewhere the system is not as seamless. In the US for example businesses use checks for around half of all B2B transactions – even though by some accounts this generates a staggering \$50 BN annual processing cost and high fraud risk. Converting to electronic payments means incurring the aforementioned ACH or wire issues, or facing card fees of 2-3% – sizeable for payments of several thousands of dollars. So why not leverage a digital payment protocol that is real-time and extremely

low-cost? Businesses could use a bank gateway or even set up their own gateway and connect their suppliers to it. Based on our understanding of the Ripple protocol, participating in the network appears to be fairly straightforward from an implementation perspective.

If Ripple or an alternative solution gains traction for these use cases, it could pave the way for mainstream consumer adoption for purchase of goods and services as well, where merchants are faced with steep card acceptance fees. Presumably the first applications would be in e-commerce and m-commerce, to be followed by in-store transactions. However, complexities increase: merchant acquirers and device manufacturers would have to adapt their processes and technology, and the response of card issuers and networks is yet to be seen. Given all the "ifs" influencing this scenario and the need to first build critical mass, it is difficult to foresee the time frames and modalities in which it will play out – but billions of dollars are at stake.

## CONCLUSIONS

Digital currencies are one of the most disruptive innovations in the payments world since the invention of credit cards over half a century ago. The amount of interest by both the private and the public sector signals how potentially far-reaching and game-changing the implications are. Increasingly robust solutions are emerging from the Wild West days of the Bitcoin gold rush – and established merchants and financial institutions are taking notice.

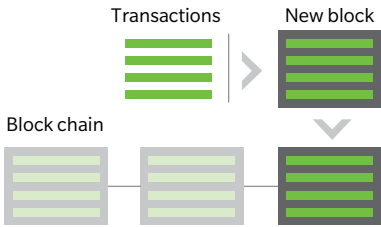
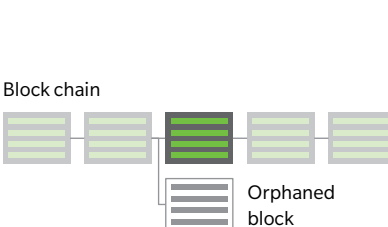
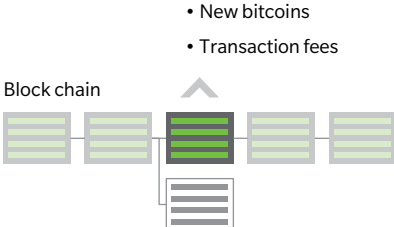
We believe it would be a mistake for companies not to educate themselves on how these solutions could improve their business, even if an implementable solution may be years away. Network effects are critical to reap benefits, so being a fast follower is probably a good strategy; but being a fast follower requires that companies understand solution pros and cons, implementation complexities, investment requirements and key success factors.

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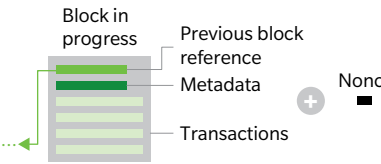
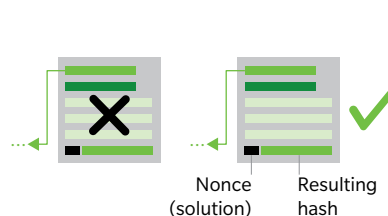
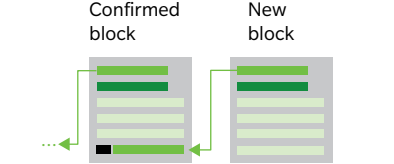
# APPENDIX: BITCOIN MINING PROCESS

## TRANSACTION PROCESSING

1) TRANSACTION CONFIRMATION	2) BLOCK CHAIN RECORDING	3) MINER INCENTIVE DISTRIBUTION
		
<ul style="list-style-type: none"> <li>• Transactions are broadcast to all miner nodes in the network for confirmation</li> <li>• Each miner node bundles transactions into a block and competes to confirm the block by solving a cryptographic proof-of-work problem (details on following figure)</li> <li>• When a node finds a proof-of-work, it broadcasts the block to the whole network by adding it to the block chain</li> </ul>	<ul style="list-style-type: none"> <li>• Other nodes confirm the block by re-running the winning node's solution to the proof-of-work problem</li> <li>• Confirmed blocks are time-stamped in the block chain, creating a public and sequential database of all bitcoin transactions</li> <li>• Nodes express their acceptance of the block by working on creating the next block in the chain, using the identifier of the confirmed block as a starting point</li> </ul>	<ul style="list-style-type: none"> <li>• New bitcoins and transaction fees are collected by the node which found the proof-of-work confirmed by the network ("winner takes all")</li> <li>• As long as the incentive to mine for new blocks is higher than the incentive to disrupt the block chain, the majority of network computing power will be non-malicious and Bitcoin will be secure</li> </ul>



## CRYPTOGRAPHIC PROOF-OF-WORK PROBLEM-SOLVING

1) INPUTS	2) HASH FUNCTION RESOLUTION	3) OUTPUT
		
<ul style="list-style-type: none"> <li>• Inputs to the hash function for a new block always include:             <ul style="list-style-type: none"> <li>- Hash reference to the previous block</li> <li>- Metadata (e.g. a timestamp)</li> <li>- All transactions included in the new block</li> <li>- A random number called a nonce</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>• Miners repeatedly increase the nonce until the hash function yields an output with a certain number of leading zeroes             <ul style="list-style-type: none"> <li>- More leading zeroes mean fewer possible solutions/more time required to solve the problem</li> <li>- Every 2,016 blocks (~2 weeks), proof-of-work difficulty is reset so that miners employ ~10 minutes to confirm a block on average</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>• When a nonce that works is identified, it is appended to the end of the block with the resulting hash reference</li> <li>• Every other miner in the network can run the hash function with the winner's nonce to verify the solution</li> <li>• If the solution is accepted by a majority of miners the winner gets the reward and a new block is started, using the previous block's hash as a reference</li> </ul>

# 2. REINVENTING AFFLUENT BANKING

## THE DIGITAL OPPORTUNITY

By Ashley Cunnington, Paul Mee and Mike Harding

Affluent customers represent a conundrum for most providers. While their revenue potential should be much better than a mass customer's, profit is typically compromised by high cost to serve, driven by the perceived need to respond to demands for higher service levels utilizing expensive personal advisors. However, new ways to exploit readily-available technologies offer the opportunity for forward-looking competitors to break the linkage between high service and high cost. The competitive landscape of the Affluent segment will be redrawn over the next few years as leaders adopt better and cheaper ways to serve these clients and disrupt the businesses of laggards, leaving them with leadership only in the high cost, low profit segment.

To grow or even maintain share in this segment, competitors need to address three issues:

1. How and where to substitute digital offerings for personal service, both face-to-face and voice-based.
2. How to develop effective mechanisms to drive sales through digital channels, shifting from "push" to "pull".
3. How to align the organization around this new, digitally-enabled model, embracing new opportunities and letting go of legacy approaches that will compromise the new business.

In this article, we look primarily at a subset of the first issue – how to introduce digital offerings into the investment product and service arena. We provide examples of ten potentially game-changing digital innovations in this space that are live or about to appear in the market – they are not theoretical concepts, but competitive offers that providers are likely to face soon if they are not already.

As a starting point, we begin by describing the economic challenges of affluent banking and how a customer-oriented digital approach may become a game changer by reviewing the digital trends in affluent banking. We then present ten digital innovations across the investment product value chain and discuss three steps that all banks should take to develop a successful digital strategy. We conclude by considering why banks have been slow to adopt these innovations and how different choices will influence the future winners and losers.

Digital is now moving from a relatively simple problem of adding new channels and features – what we call "Digital Featurism" – to the more complex issue of becoming a core part of financial services business models. Managing substitution is the new challenge and will define who wins and who loses in both Affluent and beyond.

## 1. SERVING THE AFFLUENT

The affluent banking segment traditionally presents a quandary for retail banks. On the one hand, affluent customers are attractive for a number of reasons – they represent a large and growing segment, hold more products than the average retail customer and hold a greater nominal value within these products. On the other hand, it is a difficult segment to serve effectively in order to differentiate and win. Affluent customers typically have their financial holdings spread across a number of different providers, in order to find the best price, the best experience, or the best advice. Being the main transactional bank does not necessarily correlate with securing the customer's total value, but does carry much of the cost-to-serve.

Digital technology has transformed many large industries over the last decade, leading to new business models and new dominant market players. In comparison, the pace of change and broad impact of digital technology on the banking industry has thus far been limited. Whilst we have seen rapid developments in some areas (e.g. adoption of online and mobile banking for simple transactions and sales), digital has thus far failed to deliver the long-promised improvements in customer experience and cost efficiency. This is, currently, no less true in affluent banking. But things are changing.

Traditional FS providers face a difficult future. Since the crisis, the banking industry suffers from a poor image and unhappy customers are increasingly looking for and offered more attractive alternatives. We observe a strong influence of non-banking sectors on customers' expectations and behaviors. Banks and others need to "raise their game" to reflect their weakened positions and higher customer expectations. Despite growth in the segment, there will be downward pressure on pricing and revenue as customers become less willing to pay for "inferior" service and as price comparison platforms erode the potential to charge premium prices.

At the same time, the scale and nature of investment needed in the digital space can be substantial, and will

affect the overall cost base and banks' already squeezed profitability. Providers must face this double threat of declining revenue and higher costs not just by adding new digital services, but by using them in a smart way to replace higher cost assets and services. In so doing, they need to learn new skills rapidly including addressing such difficult questions as:

- How to recruit customers through digital channels?
- How to use digital to cross-sell and up-sell products amongst affluent customers?
- How to build "stickiness" into the offering to counter the threat of attrition and tendency to multi-bank?

By way of example, consider the total economics of a "typical" affluent customer, as shown in Exhibit 1. In this simplified case we break the financial holdings into three parts:

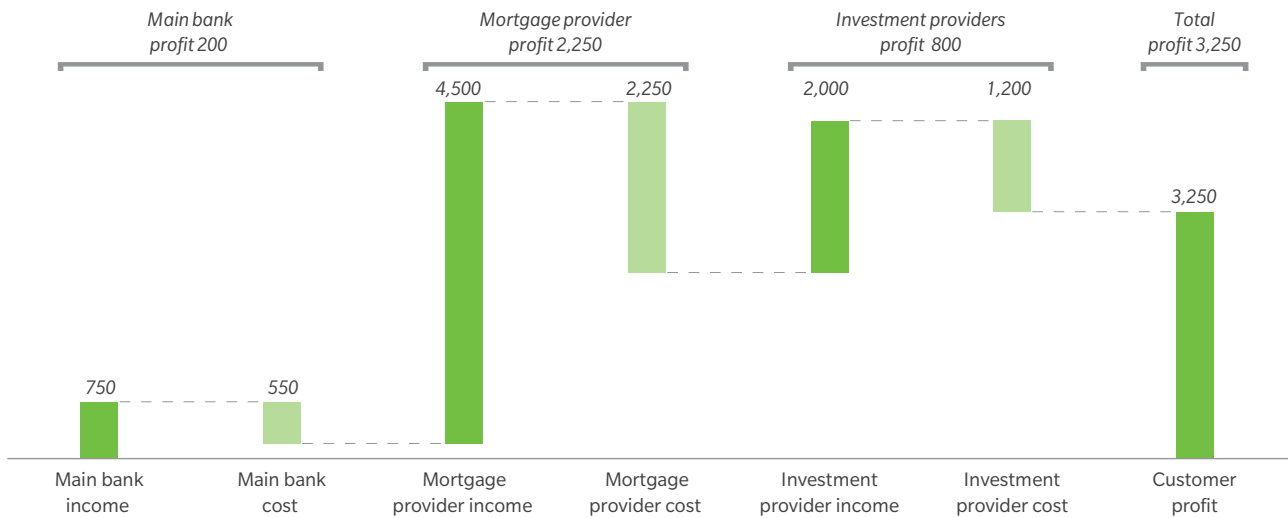
- The primary banking relationship – €25,000 deposits at 2% NIM<sup>1</sup>, fee income of €250, cost-to-serve of €550 based on an RM-based model.
- The residential mortgage – €300,000 mortgage with 1.5% NIM and fees, 0.5% opex and 0.25% cost of credit (losses and capital).
- Investments – €200,000 AuM with 1% income, 0.3% distribution cost and 0.3% platform cost.

This simple example highlights three areas where digital investments can help to enhance overall customer value:

1. Capturing a larger share of the customer's wallet through a better understanding of the client and more targeted, more relevant and more proactive contacts. All this to increase service quality and expand the offering, as well as develop platforms that aggregate all of customer's assets in one place and provide the benefit of a single view.
2. Reducing servicing costs by replacing low-value Relationship Manager contacts with online, self-service tools, and opening up a full range of new advisory models.
3. Providing new ways to acquire customers online, often at significantly lower costs compared to today.

<sup>1</sup> Including benefits of term and liquidity premia in transfer pricing.

Exhibit 1: Affluent customer value across providers



Source Oliver Wyman analysis

## 2. DIGITAL TRENDS

While much remains uncertain, with banks adopting different approaches to digital technology in affluent banking, four key trends are clear:

1. **Digital channel presence is non-negotiable.** All customer segments increasingly rely on online and mobile access to banking services. Experience in the US suggests that demand for digital services will be particularly strong among mass affluent and high-net worth customers. This trend will strengthen with the increasing importance of Generation Y, characterized by greater uptake of smartphones and reliance on digital technologies. Hence, some competitors are already positioning their products and services to attract future affluent clients at an early stage by expanding their use of the digital servicing channel.
2. **Digital clients are concentrating banking and wealth management services onto single platforms.** This is reflected by a proliferation of aggregated portal solutions in this space, such as Mint.com or Personal Capital. Traditional banks are reacting by expanding their product offerings and redesigning their platforms to meet the clients' need for a "one-stop shop". The aim is to provide a single customer view both internally and to the customer. Market leaders in this respect, such as Chase in the US, operate one portal integrating standard banking functionality (person-to-person transfers, bill payments, etc.) and wealth management functionality (asset allocation data, financial planning, etc.) with uniform navigation, branding and user experience across all areas.
3. **The digital channel is becoming an integral part of getting advice.** This trend has three facets. Firstly, digital tools are increasingly used to improve the quality of interaction between customers and Relationship Managers (RMs). For example, Groupe Generali France developed a mobile advisor tool for RMs, which allows them to show clients portfolio summaries, analytics and charts on the go. Secondly, in the aftermath of the crisis, clients believe more in getting advice from their peers – who are considered more credible than Relationship Managers commissioned on sales – and are more and more looking for "People like you" approaches to see how real people similar to them behave or invest. Thirdly, more banks are leveraging digital solutions in the background to enable RMs to use their time more efficiently.

4. Banks are increasingly deploying cutting-edge advances in digital technology to better serve customers across a range of areas. For example, new security features, such as retinal scanning or voice recognition are used to simplify customer

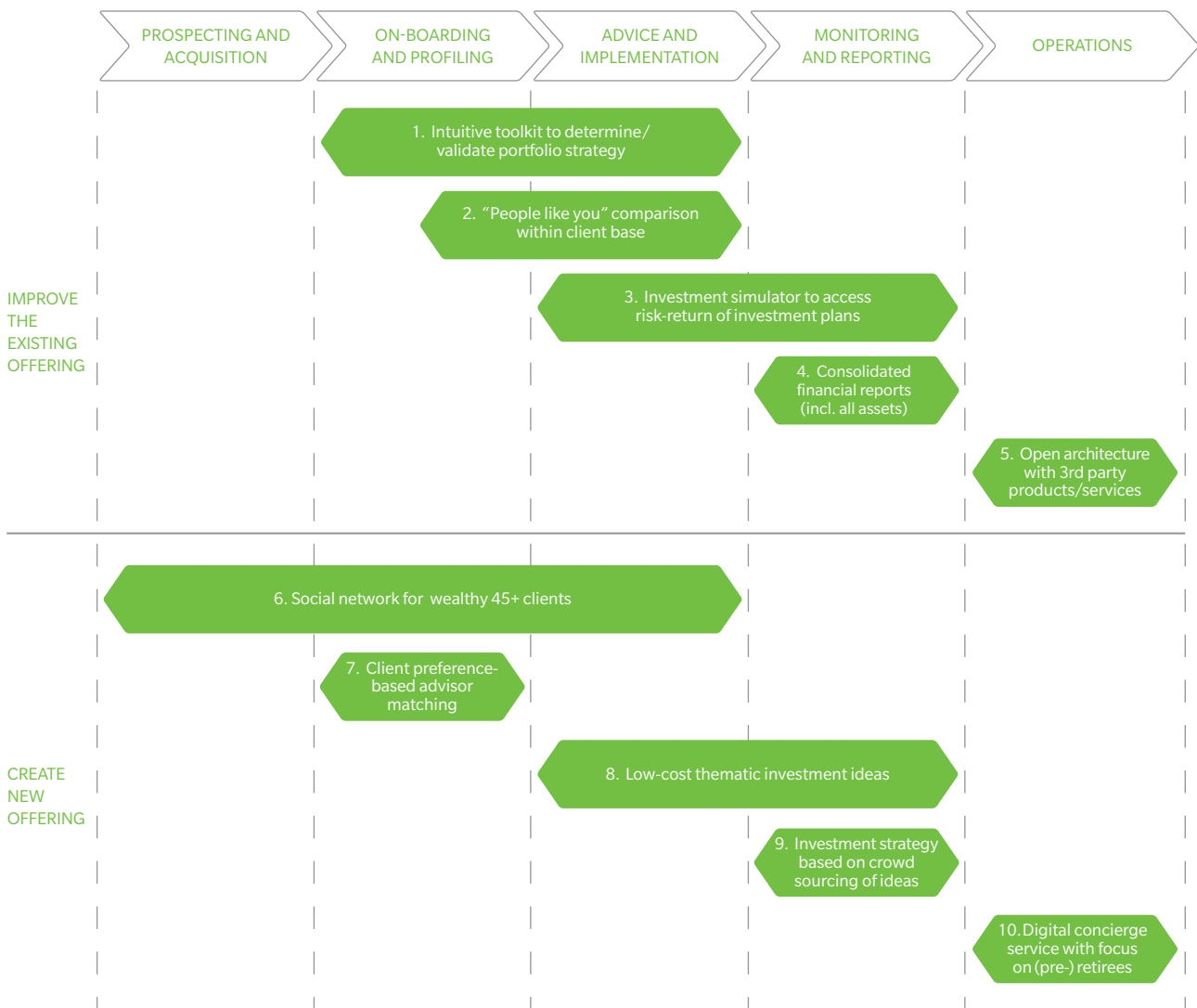
identification. New document sharing solutions, such as secure online vaults, allow better back-and-forth collaboration. New video platforms and digital workshops are used to educate customers on markets, products or usage of digital platforms.

### 3. INNOVATING IN AFFLUENT BANKING – TEN IDEAS

To illustrate how digital technology can make a difference in affluent banking we have identified ten examples of digital innovation across the whole affluent banking value chain (Exhibit 2). Some of these

innovations have already been implemented by market-leading traditional banks; others were introduced by non-traditional FS providers; all could be adopted more widely in the banking industry.

Exhibit 2: Selected digital innovations along the affluent banking value chain



Source Oliver Wyman analysis

## IDEA 1: PORTFOLIO STRATEGY

Provide overview of possible investment strategies using an intuitive toolkit, enticing new clients and delivering better service

Strategic intent:

- Retain clients by fulfilling their need for investment guidance.
- Help clients take better investment decisions driven by their risk/reward tolerance.

Choosing an investment strategy depends on many factors (risk and reward preferences, current age, income, etc.) and inexperienced individuals are likely to need help. Banks can partly fulfil this need by building an intuitive, online tool to provide initial investment guidance. Such a digital solution can be easily accessible from all relevant areas of the bank's website (including the online banking portal), and allow customers to obtain initial investment guidance more quickly and at a lower cost than what could be provided by traditional investment advisors. For example, E\*Trade offers a free "Online Portfolio Advisor" tool. First, the tool asks the user to fill out a straightforward survey. Then, based on submitted responses, it determines the user's investment profile and displays a sample portfolio allocation. Users can complete the process online or offline with the help of a professional advisor and initiate the process of opening up an investment account.

## IDEA 2: PEOPLE LIKE YOU

Use collaborative filtering to show clients how anonymised people similar to them are investing and managing their lifestyle

Strategic intent:

- Increase cross-selling and decrease advisor involvement by obtaining a better understanding of customer behavior.
- Increase client satisfaction by offering appropriate products at the right time.

Collaborative filtering allows making recommendations for "similar" items based on user's own preferences. The key idea is that if User one likes A, B and C, and a similar User two likes A, B and D, then User one is more likely to be interested in D than some alternative product. Collaborative filtering is widely used by online retailers,

including Amazon.com or iTunes. More recently the same approach has been implemented in finance. For example, OCBC Bank in Singapore and NAB in Australia both introduced simple "People like you" tools that allow users to compare their spending patterns with others in the same demographic. The same approach can be used more widely in affluent banking. It is sufficient to record initial information and on-going positions for individual customers. Then monitor them against a database of similar customers and provide anonymous recommendations e.g. "users similar to you started doing X at this point".

## IDEA 3: INVESTMENT SIMULATOR

Visualize the results of a retirement/investment plan to improve client understanding and communication

Strategic intent:

- Help clients understand the impact of their decisions now on their future investment successes and adjust the asset allocation, risk level or time horizon.
- Sell more savings products.
- Avoid self-directed clients leaving the platform to seek advice or complement an advised offering.

Choosing an investment strategy is affected by multiple factors, including time horizon, risk tolerance, desired future income, future life events, etc. To improve client understanding and communication of the available options banks can build investment simulator tools showing the results of a retirement/investment plan. Visualizing likely outcomes helps customers realize what impact their investment decisions now will have in the future and what adjustments may be necessary to achieve the desired outcome. Investment simulators can vary greatly in their level of sophistication, ranging from simple single-outcome tools focusing on life events that mainly aim to raise questions which can be addressed with an advisor to sophisticated tools aimed at investment professionals allowing detailed scenario analysis (e.g. Voyant). Banks should carefully consider optimal use of such digital tools.

## IDEA 4: FINANCIAL CONSOLIDATOR

Consolidate client's assets in one place, provide analysis tools and referrals to generate revenue



Strategic intent:

- Help clients build a complete picture of their assets and thus enable them to better manage their affairs through better product diversification, better prices, more precise view on risks taken and an easier comparison of performance.
- Generate revenue through referral fees.

As discussed in the previous section, there is a clear client need around having a consolidated view of all customer assets and liabilities in one single place. Some banks have started to offer digital solutions that provide a single customer view. One example of such a service is Mint.com, which has over 10 million registered customers across the USA and Canada. The portal supports multiple types of accounts, offers functionality to set budgets, and categorize expenditures. Based on the analysis of spending behavior it recommends potential savings. The service is provided for free, with referral fees generated through savings recommendations. In Europe, this is more developed in the Insurance space where platforms such as Comparis in Switzerland provide information on all insurances you hold. The tool contacts you proactively and before all legal deadlines to offer alternatives to switch for better products. Traditional Financial Services providers should carefully consider opportunities related to developing similar tools. A potential area for development is a service that targets pre-retirees with functionality to manage and compare multiple pension providers.

## IDEA 5: OPEN ARCHITECTURE

Increase client stickiness by offering third party services on own platform, supported by additional services

Strategic intent:

- Give clients a broader choice of products, either by filling in gaps or in direct competition with own offerings.
- Generate fees from third-party services sold.
- Position as a one-stop shop.

In recent years, we have seen significant growth of online comparison engines that allow users to choose suitable offers for a wide range of goods including financial services products, such as loans, mortgages, credit cards or insurance. Customers using comparison engines benefit from greater choice and frequently from easier administration at no extra cost. In a similar spirit, banks

should consider complementing their affluent banking offerings with third-party products (potentially limited to non-competing products). This generally requires careful consideration of benefits from increased customer stickiness versus undermining own brand and potential reputational risks. However, the business model based on open architecture can be very successful as demonstrated by the example of Fidelity, which operates a leading fund platform in the UK, US and other geographies selling its own as well as competitor products.

## IDEA 6: SOCIAL CIRCLES

Develop a social network matching client profile in order to raise customer satisfaction and gain better client understanding

Strategic intent:

- Increase understanding of clients' needs at low cost by interacting with clients online.
- Help clients to get peer advice.
- Increase brand recognition and client retention through online interactions.

Many of the most popular websites on the internet like Facebook, LinkedIn or Twitter are built around the idea of connecting and sharing with like-minded people. In addition to the largest social networking sites, many other sites provide similar services for specific niches: USAA provides community hubs for military spouses and veterans, CafeMom for mothers and aSmallWorld for the social elite and the jet set; Coutts facilitates communities within its client groups (e.g. entrepreneurs, professionals). Banks can leverage the same idea to build an opt-in social network and build a digital meeting place for wealthy baby boomers and retirees. This would allow more targeted focusing on that peer group and facilitate discussions on key topics, such as retirement planning.

## IDEA 7: ADVISOR MATCHING

Let users handpick their advisors and allow digital interaction, increasing customer satisfaction

Strategic intent:

- Maximize convenience and satisfaction by allowing clients to choose their own bank and relationship manager online.
- Earn referral fees.

Some banking customers, especially in the affluent and HNW segments, would prefer to personally choose their financial advisors and get to know them before receiving financial advice. To meet this preference and ensure closer relationships between clients and advisors, a bank may enhance its affluent banking offering to include an online advisor matching platform. Similarly to the functionality offered by unbiased.co.uk (an independent non-profit UK body), such a platform could allow users to filter through profiles of potential advisors based on a range of factors, such as expertise, geographical area or languages spoken and include a tool for quick and easy communication. In addition, all advisors added to the platform may be vetted by the bank and rated by clients to ensure quality.

## IDEA 8: THEMATIC INVESTMENTS

Use an online tool to explore, discuss investment ideas, then customize the portfolio and invest cheaply

Strategic intent:

- Drive additional volume through a stockbroking platform.
- Establish strong and sticky client relationships.

To enhance the investor proposition of an affluent banking offering, banks could provide customers access to, and perhaps guide them towards, thematic investment ideas and translate them into tangible and easily accessible trades. This could take the form of either an online platform aimed at self-directed investors or low-cost investment advice provided by relationship managers. One successful website using such an approach is Motif Investing. First, the website conducts research to identify trends and investment ideas. Then, it screens stocks and weights them to build sample portfolios around different themes, such as “Clean Technology Everywhere” or “QE Japan”. Investors can review the portfolios, discuss them in online forums and tailor as required. They pay a fixed fee for buying a motif of 30 stocks. In summary, the challenge is to translate bank research into simple trades and provide a low cost transaction service.

## IDEA 9: CROWD INVESTMENT STRATEGY

Use existing and sourced client portfolio data to inform clients what others are doing with their finances

Strategic intent:

- Use data to inform clients what other people are investing in.
- Prompt clients to invest more and thus earn revenues through increased volumes.

Another idea to drive additional volume through the stockbroking platform is to use crowd sourcing to provide or review investment suggestions. Crowd-based solutions have affected many sectors – from encyclopedias and travel industry to fund raising – and are now making their way in finance. For example, eToro, a social trading network in Cyprus, allows clients to view trading activity of others and link their portfolios to “guru traders” to copy their trades. Motif Investing mentioned in Idea 8 allows users to vote on an theme portfolio and discuss it in detail in a forum. Such capabilities can be easily added to affluent banking offerings while alerting users that crowd views may not be reliable, timely or appropriate for complex issues.

## IDEA 10: DIGITAL CONCIERGE

Provide a digitally-enabled concierge product tailored to client base, to greatly increase client satisfaction

Strategic intent:

- Provide a helpful and convenient service enabling clients to do more.
- Earn revenues through fees or advertising.

To increase customer satisfaction and differentiate from competitors, banks may introduce a complementary or paid-for concierge service for (pre) retirees. One example of such a service is MyConcierge in France, which offers: restaurant and travel reservations, cultural and sporting events, and sporting requests. Services can be accessed over the phone, via the web or by using a dedicated app. Implementation of this idea requires careful positioning next to other concierge services, e.g. offered by cards. One potential challenge is the need for the service to consistently meet bank brand and quality expectations.

## A PRESCRIPTION FOR SUCCESS

The rapid technological and social changes described above create threats and opportunities for banks in the Affluent segment. How should banks respond and manage this process? Below are what we believe to be the most important items to consider.

- A. **Understand the dynamics of your portfolio and who your customers are.** Getting a robust customer fact base is key. Different segments often have very different behaviors and profitability, therefore it is worth investing in understanding what the key customer segments are and their differences in terms of behaviors, profitability, likelihood to switch and features they value most.
- B. **Think carefully how to maximize the required investments across future market and competitor scenarios.** This requires a good awareness of existing innovation and how they will reshape the sector. What do you have in place now and coming on stream soon? How are your competitors moving in the digital space? Test your current strategy against tomorrow's environment and reconsider your digital strategy in this context.
- C. **Decide on a digital participation strategy.** This requires understanding the customer "value equation". Starting with the status quo, banks should re-assess customer value to the bank and how it is likely to change over time due to evolving customer expectations and behaviors. Based on the results, the bank should consider all options available to affect future customer value. What could be done differently? How much will it cost and how much impact can it have on customer value?
- D. **Prioritize investments.** This involves allocating planned initiatives into different groups. Typically defensive and/or high positive value impact investments are classified as "must haves" and prioritized. Lower value investments with an option to delay action are classified as "Watch points" and implemented based on market developments. Costly investments with a potentially high but uncertain impact are classified as "Big Bets". Generally, we advise banks to place competing bets, in much the same way as innovative technology companies.
- E. **Engage the organization.** Success will likely require major change in culture and infrastructure, and lessons must be learnt from other successful players. To win in the digital space, banks need to view digital as a fundamental change with potential to alter the whole value chain.

## CONCLUSION

Affluent segment providers have not yet fully embraced these ten ideas. Much of this has been for understandable reasons given the limited capacity for investment and the difficulty to find the right financial equilibrium. This is in part driven by an approach that attempts to add new digital capabilities without “risking” reducing the traditional offering. However, as more providers embrace digital offerings as substitutes rather than additions, the risk may lie with those who fail to move. Recent announcements by leading banks such as Barclays, HVB and Wells Fargo indicate movement toward reducing reliance on traditional assets such as branches in favor of investment in digital channels and offerings.

To win in the digital affluent space, banks need to view digital as a fundamental change, with potential to alter the whole value chain. The expected benefits are substantial: not only a rise in affluent customer numbers, reduced cost-to-serve and streamlined process but also a notable improvement in overall economics and enhanced customer experience. The transition won't be easy, but the future winners will work out how to do this effectively.

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# APPENDIX

## SUMMARY OF THE 10 IDEAS

Idea	Description	Potential benefits to firm	Potential downsides	Implementation challenges	Examples
<b>1. PORTFOLIO STRATEGY</b>	<ul style="list-style-type: none"> <li>Explore risk/return trade offs of an investment strategy using an intuitive toolkit then review with a real person</li> </ul>	<ul style="list-style-type: none"> <li>Attract new clients</li> <li>Strengthen advisory process by communicating risk/reward trade-offs</li> <li>Avoid mis-selling</li> </ul>	<ul style="list-style-type: none"> <li>Mechanics and time needed may not be acceptable to clients</li> <li>RMs may not be suited to playing validator role</li> </ul>	<ul style="list-style-type: none"> <li>Tool requires thought and careful design</li> <li>Integration into wider advisory process</li> </ul>	<ul style="list-style-type: none"> <li>E*Trade (US)</li> </ul>
<b>2. PEOPLE LIKE YOU</b>	<ul style="list-style-type: none"> <li>See what real people similar to you are doing with their money</li> </ul>	<ul style="list-style-type: none"> <li>Increase cross-selling</li> <li>Supports self-service</li> </ul>	<ul style="list-style-type: none"> <li>Comparisons may be misleading/not reflect complexity of client's situation</li> </ul>	<ul style="list-style-type: none"> <li>To work out the mechanics, in particular disclosure issues</li> <li>Getting clients to opt in</li> </ul>	<ul style="list-style-type: none"> <li>OCBC Bank (Singapore)</li> <li>NAB (Australia)</li> </ul>
<b>3. INVESTMENT SIMULATOR</b>	<ul style="list-style-type: none"> <li>Understand the risk/return options associated with a savings plan</li> </ul>	<ul style="list-style-type: none"> <li>Attract new clients</li> <li>Strengthen advisory process by communicating risk/reward trade-offs</li> <li>Avoid mis-selling</li> </ul>	<ul style="list-style-type: none"> <li>Mechanics and time needed may not be acceptable to clients</li> <li>RMs may not be suited to playing validator role</li> </ul>	<ul style="list-style-type: none"> <li>Tool requires thought and careful design</li> <li>Integration into wider advisory process</li> </ul>	<ul style="list-style-type: none"> <li>Julius Baer (Switzerland)</li> <li>Voyant (UK)</li> </ul>
<b>4. FINANCIAL CONSOLIDATOR</b>	<ul style="list-style-type: none"> <li>A service that will provide a consolidated view of all accounts held by an individual</li> </ul>	<ul style="list-style-type: none"> <li>Can generate revenues through referral fees</li> <li>Enables wallet sizing</li> <li>Binds clients to the service</li> </ul>	<ul style="list-style-type: none"> <li>Clients unwilling to provide all their financial information to the bank</li> <li>Clients are aware of the sensitivity of their data</li> </ul>	<ul style="list-style-type: none"> <li>Linking with sufficient providers to enable full consolidation</li> <li>Presenting data consistently</li> </ul>	<ul style="list-style-type: none"> <li>Mint.com (US, Canada)</li> <li>Personal Capital (US)</li> </ul>
<b>5. OPEN ARCHITECTURE</b>	<ul style="list-style-type: none"> <li>Complement your product offering by non-conflicting third party products (such as trust, tax, philanthropy, government support, SRI, care services)</li> </ul>	<ul style="list-style-type: none"> <li>Increase customer stickiness and fee generation</li> <li>Cross-sell opportunities</li> </ul>	<ul style="list-style-type: none"> <li>Undermining brand awareness through third party products</li> <li>Potential reputational risk due to third party products</li> </ul>	<ul style="list-style-type: none"> <li>Risks associated with product due diligence, selection and advice process</li> </ul>	<ul style="list-style-type: none"> <li>Fidelity (US)</li> </ul>

Idea	Description	Potential benefits to firm	Potential downsides	Implementation challenges	Examples
<b>6. SOCIAL CIRCLES</b>	<ul style="list-style-type: none"> <li>• An opt-in social network for wealthy people</li> </ul>	<ul style="list-style-type: none"> <li>• Increased customer understanding</li> <li>• Builds a deeper, broader client relationship</li> </ul>	<ul style="list-style-type: none"> <li>• Bank may not control all interactions and may be disintermediated</li> </ul>	<ul style="list-style-type: none"> <li>• Position the network as a “wealth circle” next to existing premium programs (e.g. credit cards)</li> </ul>	<ul style="list-style-type: none"> <li>• USAA (US)</li> <li>• CafeMom (US)</li> <li>• aSmallWorld (UK)</li> </ul>
<b>7. ADVISOR MATCHING</b>	<ul style="list-style-type: none"> <li>• Choose a personal advisor based on your preferences and begin digital communication</li> </ul>	<ul style="list-style-type: none"> <li>• Closer relationship</li> <li>• Increased customer satisfaction</li> </ul>	<ul style="list-style-type: none"> <li>• Too much choice leading to client confusion</li> <li>• Places relationship with the advisor, not the bank</li> <li>• Limits ability of bank to switch advisors</li> </ul>	<ul style="list-style-type: none"> <li>• Capturing of personality profile of advisors and what clients really want</li> <li>• Running advisor network afterwards</li> </ul>	<ul style="list-style-type: none"> <li>• Unbiased.co.uk (UK)</li> <li>• Knab (Netherlands)</li> </ul>
<b>8. THEMATIC INVESTMENTS</b>	<ul style="list-style-type: none"> <li>• Online platform offering wide range of thematic portfolios, plus structuring and risk management tools</li> </ul>	<ul style="list-style-type: none"> <li>• Interesting to savvy self-directed investor segment</li> <li>• Builds out self-service model</li> <li>• Leverages bank research</li> </ul>	<ul style="list-style-type: none"> <li>• Cannibalization of existing fund/DPM business</li> </ul>	<ul style="list-style-type: none"> <li>• Integration of research, low cost transaction services, reporting and analysis toolkit</li> </ul>	<ul style="list-style-type: none"> <li>• Motif Investing (US)</li> </ul>
<b>9. CROWD INVESTMENT STRATEGY</b>	<ul style="list-style-type: none"> <li>• Use crowd sourcing to provide or review investment suggestions</li> </ul>	<ul style="list-style-type: none"> <li>• Enables independent review of strategy</li> <li>• Supports self-service</li> </ul>	<ul style="list-style-type: none"> <li>• Crowd view may not be reliable, correct or timely</li> <li>• Not the best way to analyse complex issues</li> <li>• Not of interest to all client segments</li> </ul>	<ul style="list-style-type: none"> <li>• Building the critical crowd size to get good advice</li> <li>• Avoiding legal and compliance issues</li> </ul>	<ul style="list-style-type: none"> <li>• Etoro (Cyprus)</li> <li>• Cureensee (US)</li> </ul>
<b>10. DIGITAL CONCIERGE</b>	<ul style="list-style-type: none"> <li>• A concierge service tailored to (pre) retirees, offering proactive advice on life events and lifestyle transition</li> </ul>	<ul style="list-style-type: none"> <li>• Complimentary or paid-for service generating revenue (white-label or in-house developed)</li> <li>• Increased customer satisfaction</li> </ul>	<ul style="list-style-type: none"> <li>• Need to consistently meet bank brand and quality expectations</li> </ul>	<ul style="list-style-type: none"> <li>• Positioning next to similar concierge services, e.g. offered by cards</li> </ul>	<ul style="list-style-type: none"> <li>• MyConcierge (France)</li> </ul>

# 3. RETAIL BANKS & THE IRA ROLLOVER OPPORTUNITY

## THE ROAD TO WEALTH (MANAGEMENT)

By Inderpreet Batra, Alina Lantsberg and Tim Spence

### INTRODUCTION

Banks have long sought a bigger share of the wealth management market, and the enviable stream of capital-efficient fee income that it entails. With banks' traditional lending, deposit and transactions businesses squeezed by post-crisis regulations and low interest rates, their enthusiasm for wealth management is only growing.

The challenge for banks has always been how to break the stranglehold that more established wealth management business models hold on the market, driven both by brand loyalty and a better ability to advise clients with complex needs. This Oliver Wyman point-of-view looks at one specific "break-through" opportunity for banks: namely, making themselves the preferred destination for customers rolling over their defined contribution plans into an IRA. This is an approachable opportunity even for banks without large wealth management functions because it is scalable without having to rely on a large, highly paid staff. We argue that this is one of the best ways for a bank to build scale in, or even start, its wealth management business.

The market for rollovers today is dominated by the leading defined contribution plan administrators, such as Fidelity and Vanguard. These firms enjoy well-established retirement brands and, given their incumbent positions as the plan administrators,

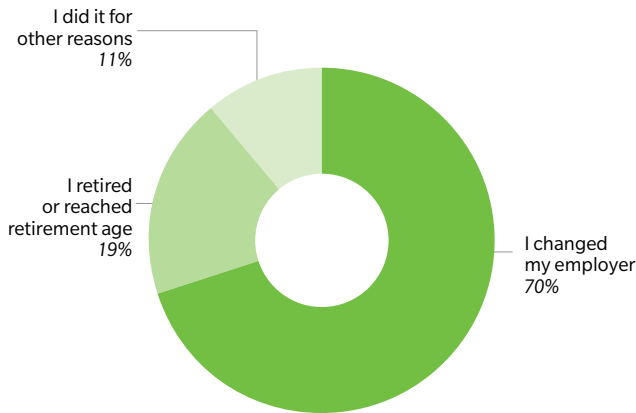
provide a logical destination for a rollover. While these are genuine competitive advantages, they are not insuperable. As we explain, banks possess significant strategic assets they could bring to bear in this fight. As the providers of core banking products, they too possess well-established brands and incumbent relationships with the target audience. And the information that banks naturally gather about their customers gives them an advantage in identifying when customers have changed jobs or retired, the events which traditionally trigger a rollover into an IRA, and a fuller view of the customer's overall financial picture.

If banks can learn to use this information to target customers, offer the investment choices they are looking for and provide the hassle-free rollover that they desire, then IRAs can provide a launching pad into the much larger wealth management business.

### MARKET CONTEXT

Individual Retirement Accounts (IRAs) were created in 1974 by the Employee Retirement Income Security Act (ERISA). Like the 401(k), or other defined contribution plans, the IRA is a long-term savings product to which the majority of contributions are tax-exempt, and where account balances enjoy tax-deferred or tax-free growth. Unlike the 401(k), however, an IRA is set up by individuals rather than by their employers.

**Exhibit 1: Why did you rollover your 401(k) account into an IRA?**



Source Oliver Wyman Retirement Insights 2013

Under the provisions of ERISA, transfers of funds from employer sponsored 401(k) retirement plans into IRAs (rollovers) are tax and penalty-free. IRAs also offer most individuals a much broader range of choices, both in terms of investment vehicles and providers, than do traditional employer-sponsored retirement plans. These factors have made IRAs a primary destination for employees rolling over their defined contribution accounts when changing jobs or retiring.

IRAs already constitute a large pool of assets – about \$5.7 TN according to ICI estimates (see Exhibit 2) – and, as of 2013, 46 million households or ~40% of all US households already hold them. They are also growing rapidly, fueled in part by rollovers from employer-sponsored plans.<sup>1</sup> Between 1996 and 2008, IRA balances grew at an annual rate of 7.5%, with rollovers peaking at \$316.6 BN in 2007. 27% of traditional IRA-owning households rolled over within the last 2 years.<sup>2</sup> The firms that provide and manage IRAs earn fees largely from trading commissions and asset management. Collectively, we estimate that IRA balances constitute a \$30 BN revenue pool.

## COMPETITIVE LANDSCAPE

IRA Rollovers are an appealing strategic focus given the frequency with which they occur and the amount of money in motion. To that end, nearly all of the large national and regional banks already offer IRAs. But recent Oliver Wyman primary research shows that 30-40% of their customers are unaware of this offering (see Exhibit 3).

**Exhibit 2: Growth in retirement market (\$TN)**

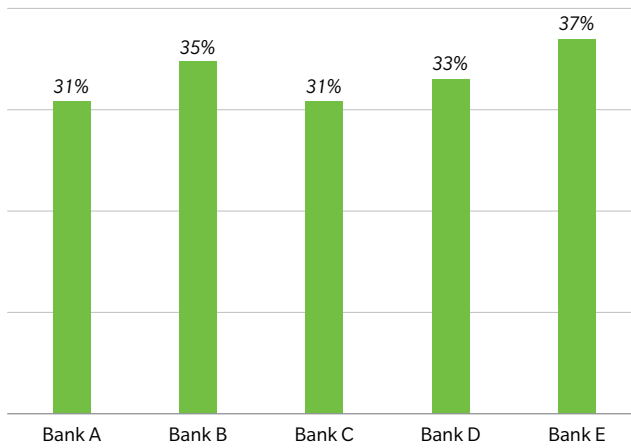


Source ICI Research Report: Defined Contribution Plan Participants' Activities, First Three Quarters of 2013, February 2014

1 ICI Research Perspective: Vol. 19, No.11, November 2013.  
 2 ICI Research Perspective: Vol. 19, No.11, November 2013.



Exhibit 3: Percent of customers who do not know that their primary bank offers an IRA (when it does offer the product)



Source Oliver Wyman Retirement Insights 2013

The major 401(k) plan administrators are currently winning the fight by a wide margin. According to our research, Fidelity and Vanguard, the two best-known plan administrators that offer IRAs as well, currently capture more than 40% of all rollovers. Brokerages such as Merrill Lynch and Morgan Stanley also do well on

this dimension. The dominance of these two business models is easily explained. Plan administrators have well-established retirement brands and, as the incumbent providers of the 401(k), appear to most customers as the most straightforward rollover destination. Brokerages have large advisor forces, the widest range of investment options and existing relationships with the wealthiest rollover candidates.

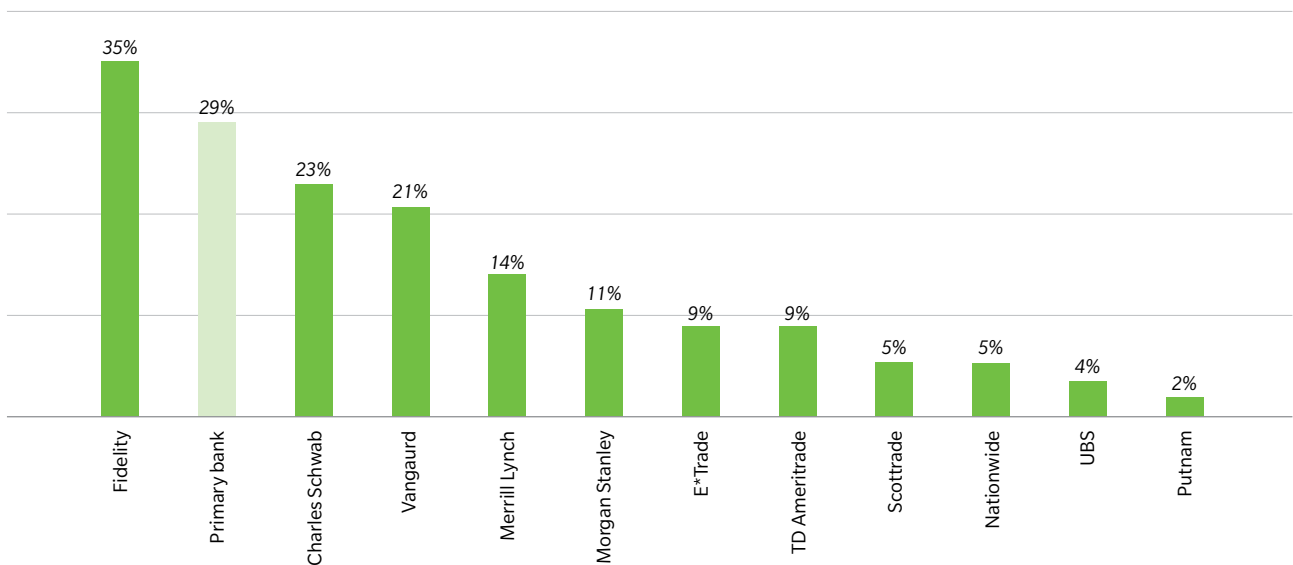
## HOW BANKS CAN COMPETE

The lead plan administrators and brokerages enjoy in the IRA rollover market may seem unassailable, but it is not. In recent research conducted by Oliver Wyman, potential IRA customers ranked their primary checking account bank second only to Fidelity as a potential rollover destination (see Exhibit 4).

We believe the recipe for converting consideration to a successful rollover strategy consists of three key elements, outlined below and then explained in detail.

1. Target customer segments: “Force concentrate” on the population where the bank possesses the strongest incumbency advantage

Exhibit 4: If you had to roll over your 401(k) today into an IRA, which financial institutions would you seriously consider rolling it over to?



Source Oliver Wyman Retirement Insights 2013

- The offer: Construct the rollover value proposition around a “no-hassle” process and a broad suite of investment choices
- The marketing strategy: Leverage data from the customer’s checking account to identify when rollover opportunities arise before brokerages or plan administrators can see them, and utilize the full breadth of touch-points to drive up awareness of the offer

## 1. TARGET CUSTOMER SEGMENTS

A typical bank can identify at least three pools of customers that it can target for IRA rollovers. These include:

- Current banking customers, including those that use the bank as their primary checking account
- Employees of commercial customers
- Non-customers in footprint, who are aware of the bank’s brand and presence

Among these pools, banks have the strongest relationships with primary checking customers, i.e. those that use them as their primary means of performing day-to-day transactions and frequently have salaries direct deposited into the account. These

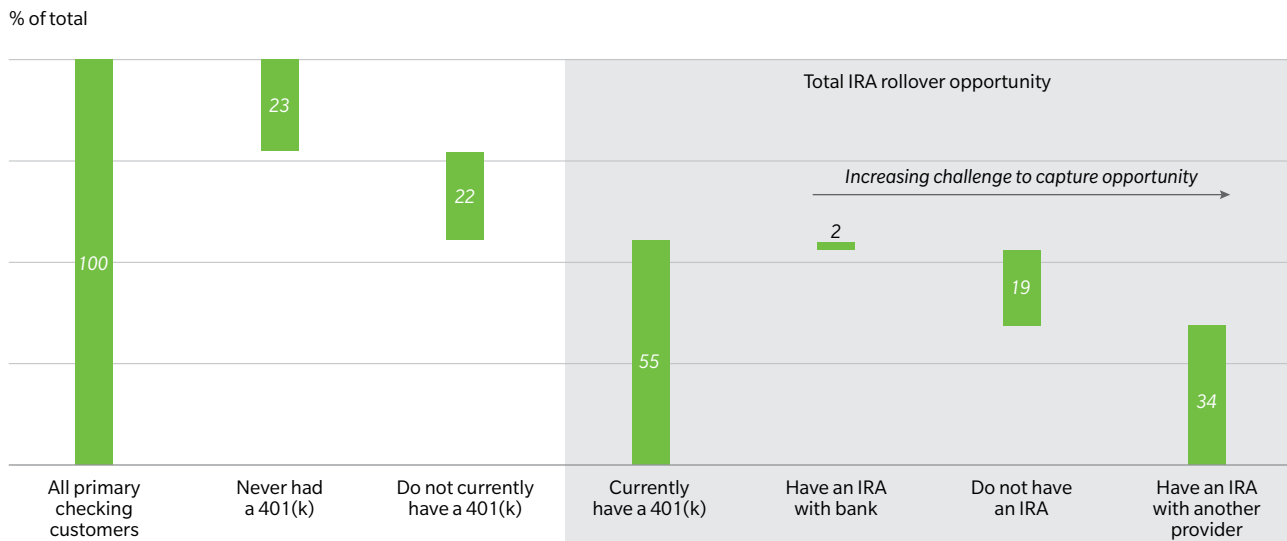
customers tend to stay loyal and have frequent ongoing interactions with the bank. We believe that this is the pool of customers that banks should focus on first.

Not all these customers will have 401(k) accounts. In recent research for a regional bank, we determined that only 55% of their primary checking customers had a 401(k) account. Among these, those that do not currently have an IRA are easier to capture than those that already do. For this particular bank, we estimated that 19% of their primary checking customers fell in this category (see Exhibit 5).

Penetration rates of 2-3% are typical for banks that have not made a concerted push in this space. Increasing this to 10% is a \$100+MM incremental revenue opportunity for a typical regional bank. And given product ownership rates and the advantages banks enjoy, this is quite achievable.

DDA data on income and balances can also be used to identify customers who have high-balance 401(k) accounts. Targeting these customers will yield more profitable outcomes in terms of higher trading commissions and asset management fees, given their strong correlation with balances.

Exhibit 5: IRA Rollover opportunity among primary checking customers



Source Oliver Wyman Retirement Insights 2013

## 2. THE OFFER

In the past few years, a “cash reward” arms race of sorts has broken out among plan administrators and online brokerages competing for IRA rollovers. Schwab, TD Ameritrade, E\*TRADE and many others offer up to \$600 in cash to prospective clients. This bounty is substantially higher than what banks have traditionally proven willing to pay for new accounts, and would spell doom but for one thing: it doesn’t seem to matter much to customers. Recent Oliver Wyman research suggests that customers place much higher emphasis on minimizing the hassles associated with the switching process and getting access to a wide range of investment options (see Exhibit 6).

Reducing the hassles associated with the rollover process can also help banks overcome any possible disadvantages of not having a robust advice offering. The rollover can be the beginning of a relationship that evolves into advice, with the early wins associated with the no-frills rollover strategy being used to fund the development of a more holistic, advice-based offering.

There are many elements that go into making the rollover process low-hassle. One, banks must make the process quick, let customers know in advance how long it will take and provide regular updates; the pain for customers is usually not the time but the uncertainty. Two, they should reduce the pain associated with reconstructing an investment portfolio. They should find out the portfolio composition in advance and try to replicate that; at the very least, they should be able to offer an alternative portfolio that is materially equivalent in its risk/return profile. Three, they should try and reduce paperwork, e.g. by enabling online submissions and letting people provide images of documents instead of only offering older, more outdated methods.

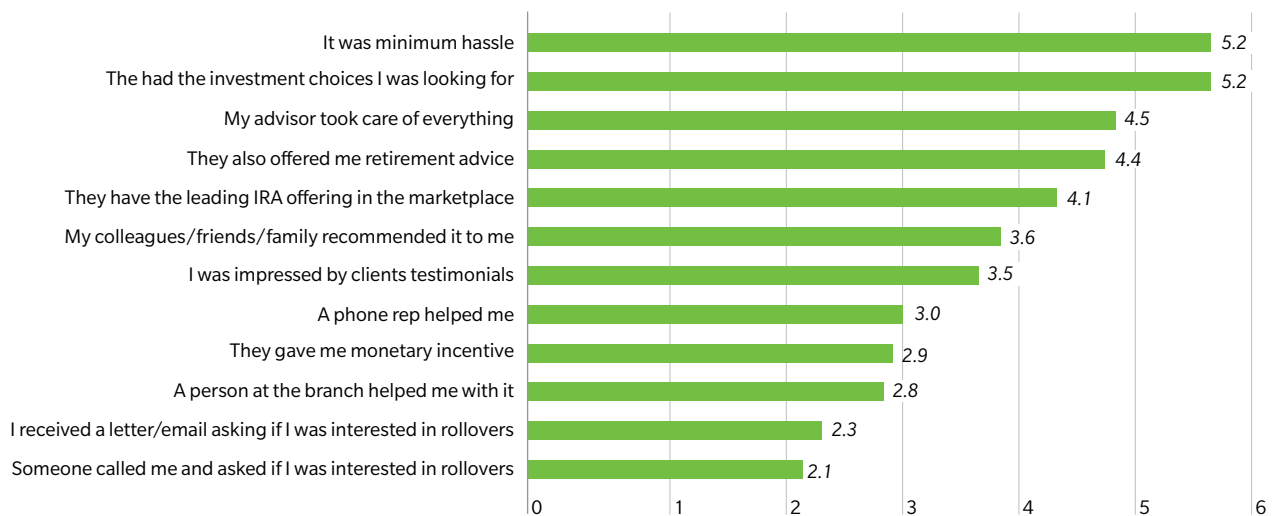
## 3. THE MARKETING STRATEGY

There are two competitive advantages that banks possess, which can drive effective marketing of the rollover offer.

First, by monitoring a person’s checking account, a bank can tell whether a person has changed jobs by observing a change in the direct deposit source. The bank can also

Exhibit 6: Why did you select your current IRA provider to roll over your 401(k) account?

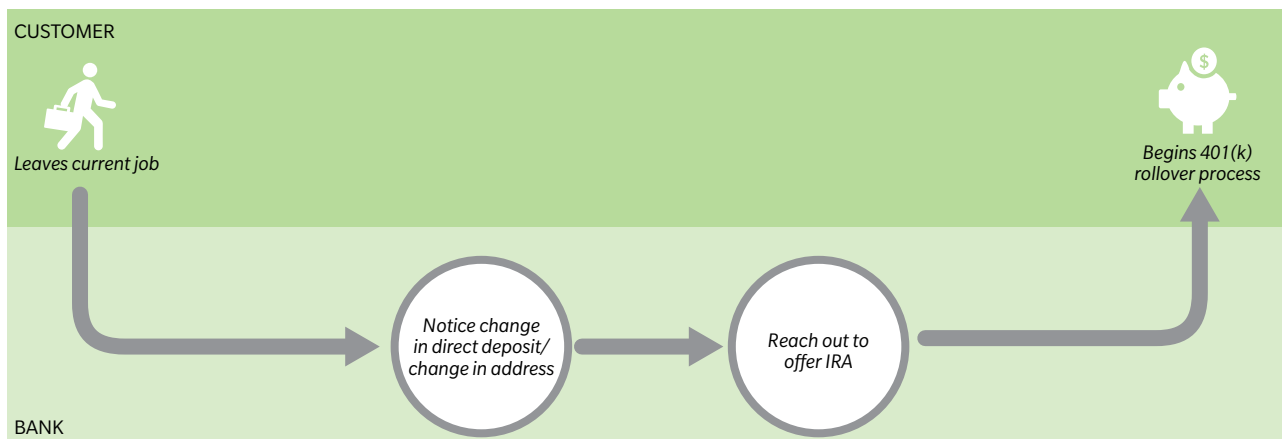
AVERAGE SCORE FOR CUSTOMERS WHO HAVE DONE AT LEAST ONE ROLLOVER\*



Source Oliver Wyman Retirement Insights 2013

\* Each respondent was asked to rank all these reasons on a 7-point scale, where 1 was “Not important at all” and 7 was “Extremely important”

Exhibit 7: Illustrative IRA rollover direct marketing process



glean if someone has retired by combining the age of the customer with a total stop in direct deposits. A change in address may also indicate a change in job or retirement. Banks can use such information to trigger direct marketing to target customers (see Exhibit 7), which is something that brokerages cannot do.

Second, banks have a significant distribution and interaction advantage with their primary checking customers. Banks can utilize the various channels their customers use to build awareness of their offering and to solicit prospects. Plan administrators typically have minimal branch networks and few occasions on which to interact with their customers. Once the bank has reached out to a prospect based on a trigger, they can use the branch to close the rollover transaction. The initial outreach can also be delivered via the channel preferred by the customer – online, mobile, or the branch itself.

## CONCLUSION

Building a wealth management business is a daunting prospect for most retail banks. Not only does it require a costly extension of most banks' infrastructure, but it also requires expensive new advisory staff who often find it difficult to fit into the culture of a retail bank. The current model whereby certain products, such as

insurance and mutual funds, are sold out of branches avoids these problems but fails to create a compelling reason for customers to use the bank as their primary wealth manager. When it comes to wealth management, many banks are stuck at the starting line – unwilling to make the investment required for the full retail brokerage-style offering and unable to see any other way to move forward.

IRA rollovers are a good way to get started because the product and platform can be outsourced so that the bank plays only the primary roles of advisor and distributor. The IRA rollover discussion can also be used as an entrée for a broader retirement-focused conversation down the line, potentially leading to an overhaul of the customer's finances and consolidation of assets into the bank. Income from the IRA assets can then be used to fund the development of a broader wealth management offering.

For many customers, rolling a 401(k) into an IRA often marks a "new beginning". If banks can capture a bigger share of this business, it may also mark a new beginning for their ambitions in wealth management.

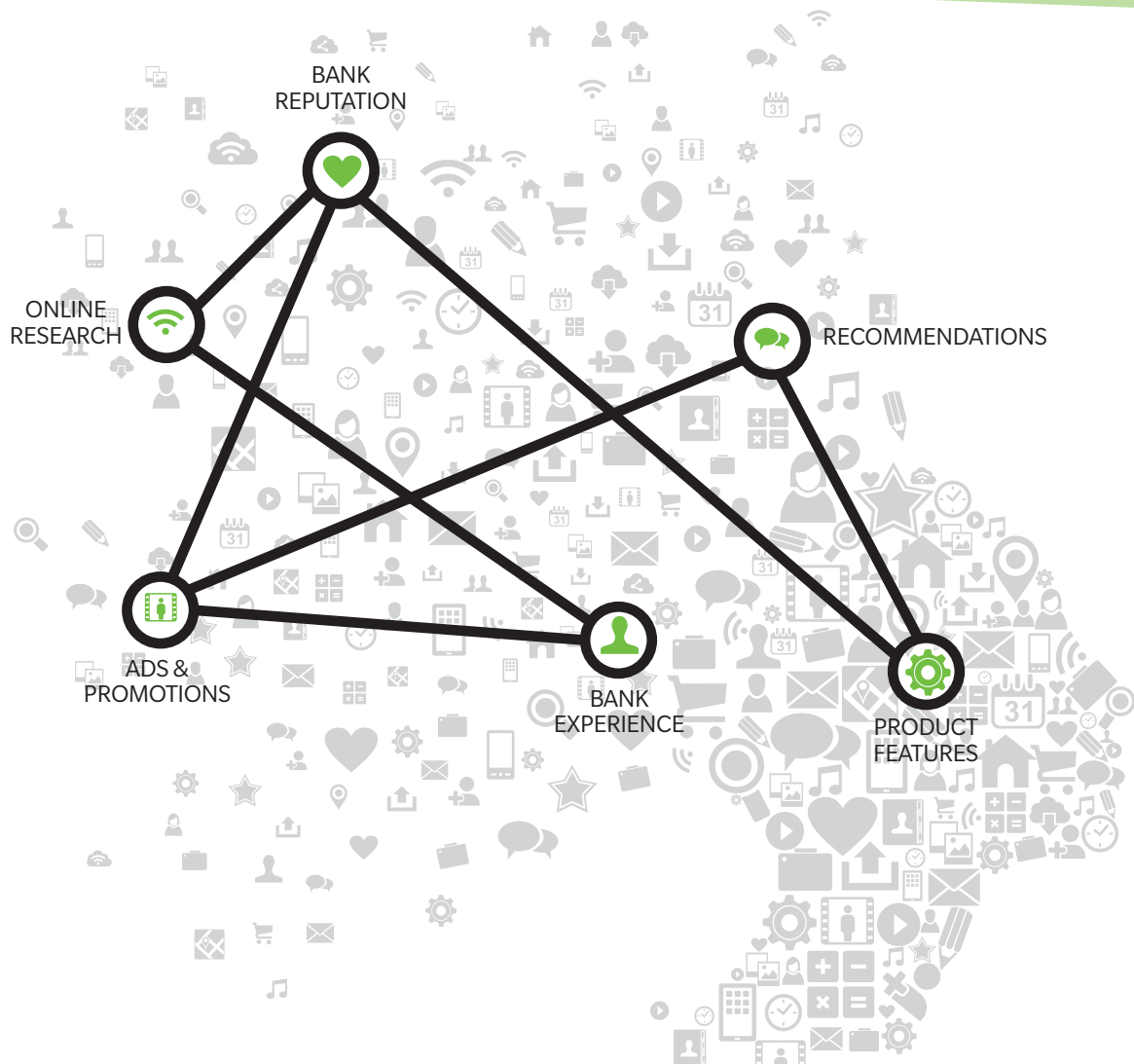
.....  
**Inderpreet Batra** is a Partner at Oliver Wyman.

**Alina Lantsberg** is a Principal at Oliver Wyman.

**Tim Spence** is a Partner at Oliver Wyman.

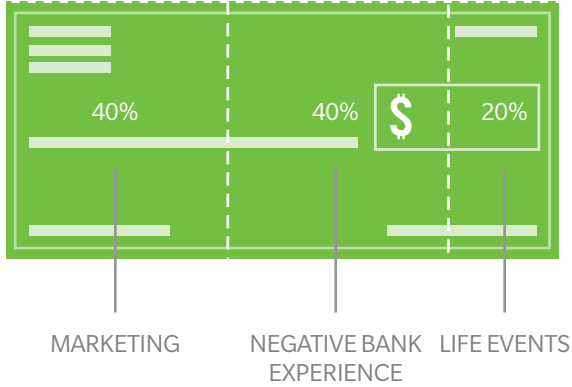
# 4. MAKING THE SWITCH

## CHECKING ACCOUNT PATH TO PURCHASE



CONSTANT CONNECTIONS WITH BRANDS INFLUENCE CONSUMERS' BANK PREFERENCES BEFORE THEY'RE IN MARKET FOR A NEW CHECKING ACCOUNT

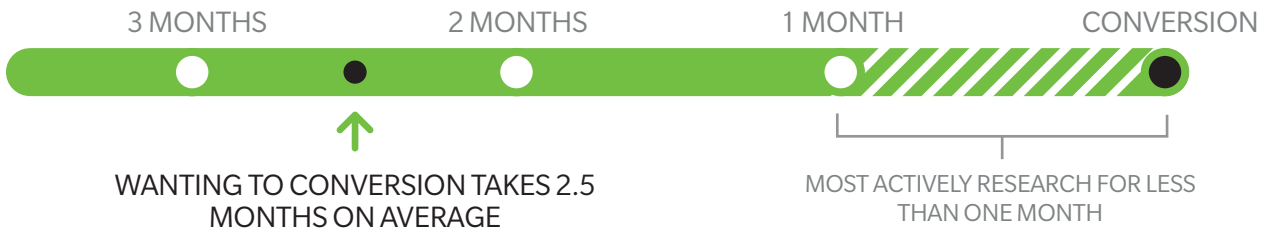
**MOTIVATIONS FOR SWITCHING CHECKING ACCOUNTS**



**THEY TAP INTO THEIR PRE-EXISTING BRAND KNOWLEDGE FOR BANK CONSIDERATIONS**



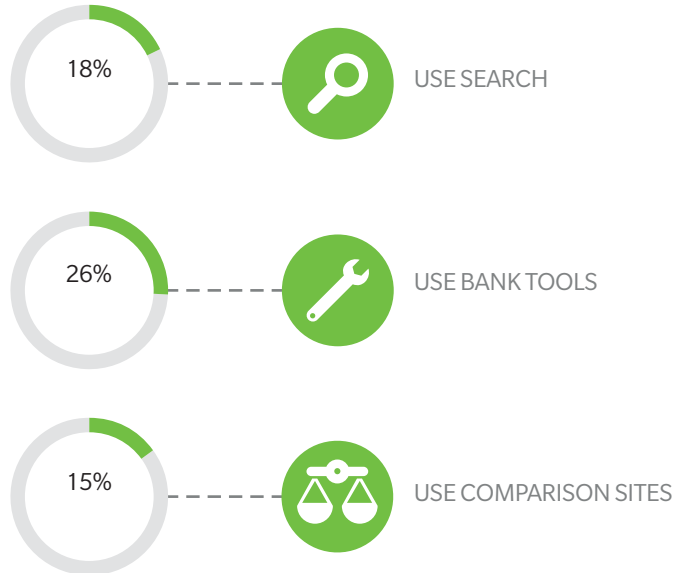
2 IN 3 ALREADY KNOW WHICH SPECIFIC BANK THEY WANT BEFORE SHOPPING



**MAJORITY OF SWITCHERS USE ONLY 1-5 TOUCHPOINTS**



IN THE 90 DAYS PRIOR TO OPENING A NEW ACCOUNT



KEY ATTRIBUTES & FEATURES



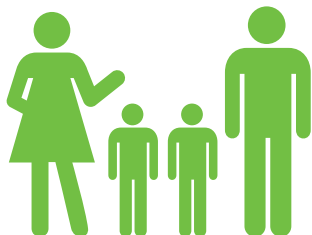
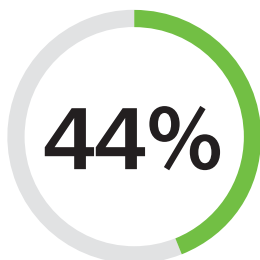
**BRAND**  
GOOD REPUTATION  
HIGH QUALITY SERVICE



**PRODUCT**  
LOW FEES  
LOW MINIMUM BALANCE



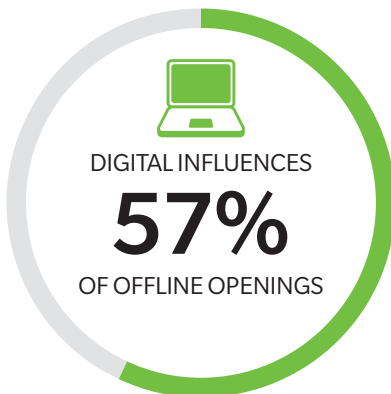
**CONVENIENCE**  
BRANCHES NEAR WHERE I LIVE  
LOTS OF ATMS



SWITCHERS LEAN MOSTLY ON  
RECOMMENDATIONS BY  
FAMILY & FRIENDS



7 IN 10  
OPEN IN BRANCH



9 IN 10  
OF THOSE WHO HAD ONE BANK IN  
MIND END UP CHOOSING  
THAT BANK

## BRAND IMPLICATIONS



MAINTAIN ALWAYS-ON BRANDING AS  
PART OF ACQUISITION STRATEGIES



YOU CAN'T RELY ON CONSUMERS TO  
RAISE THEIR HANDS



ACTIVATE BRAND ADVOCATES TO AMPLIFY  
WORD OF MOUTH INFLUENCE



ALIGN MESSAGING TO KEY BRAND,  
PRODUCT & CONVENIENCE ATTRIBUTES



RECOGNIZE DIGITAL ATTRIBUTION ON BOTH  
ONLINE AND OFFLINE ACQUISITION

Source AOL & Oliver Wyman, "Making the Switch", June 2014  
Base Switchers (n=868)



# 5. THE DECISION-CENTERED BANK

By Peter Carroll

Many banks have announced the goal of becoming more “customer centric”. It may be better to become more “decision centric”.

A decision-centric bank is one that marshals information about its customers to make highly effective decisions in its dealings with them, whether those decisions occur as part of the sales process, or as part of continuing customer service.

Being decision centric may not sound like a new concept since bankers have always made decisions. But making decisions doesn’t necessarily mean a bank is “decision centric”. In the early part of the 21st century, being decision centric has a very distinct meaning for a bank and that meaning has three key parts:

1. The collection and interpretation of information about customers
2. The conscious use of that information to decide how to act or react differently at the level of the individual customer
3. The deliberate design of operational processes that allow for, and take advantage of, the ability to make decisions and take different actions at the customer-level

In order to define more clearly what we mean by the term “decision-centric bank”, it will first be helpful to draw a distinction between two types of decision, both important, but each quite different. Let us call them

“Positioning decisions” and, for the want of a better term, “Operating decisions”<sup>1</sup>.

“Positioning decisions” are the decisions made periodically to position a firm in the marketplace. They might be thought of as “strategic” and/or “structural” in nature. They have the quality that, once they are made, they are hard to change. They are decisions whose consequences the firm must live with for a while. They are therefore decisions that should not be taken lightly as long-term success certainly hinges on making more of them right than wrong.

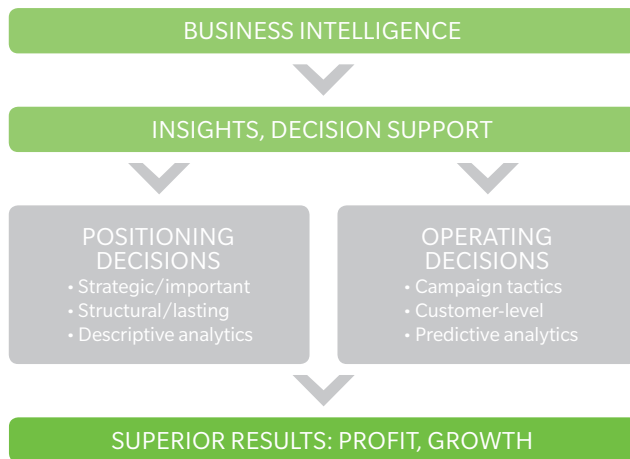
Exhibit 1 sets up the distinction between Positioning decisions and Operating decisions, in relation to the broader term “Business Intelligence”.

Examples of positioning decisions would include:

- A decision to enter (or exit) a large segment or new product area:
  - A bank choosing to enter the credit card business or auto lending
  - Starting a high net worth division
  - Selling off a merchant acquiring arm
- A decision to introduce a new value proposition for the affluent segment
- A decision to redesign the bank’s suite of DDA products

<sup>1</sup> As we shall see, “Operating decisions” are not “decisions made in Operations”, though some of them could be; they are decisions made within the established business processes of the bank and its current strategy; they are customer-level decisions that may involve material differences of action or “treatment” for one customer relative to another.

Exhibit 1: The distinction between positioning decisions and operating decisions



All these decisions require careful thought, in part because they involve the mobilization and commitment of substantial resources in the form of capital, employees and expense budgets.

They also require careful thought because it takes a while to frame, and then make, these decisions and longer still to implement some of them; it then takes even more time to generate results and for the wisdom of the decisions and the effectiveness of their execution to reveal themselves.

These decisions position the bank in the market and in relation to chosen segments; once taken, they define the ‘battlefield’ on which the bank competes, using various methods and programs to win new customers, hold on to them, increase share of wallet and so forth.

Which brings us to the idea of ‘Operating decisions’. Operating decisions are different inasmuch as they are decisions that are made after the positioning decisions have been taken. In fact, they are decisions made within the set of business processes that comprise the bank’s current market and competitive position. They are part of how the bank is run.

They tend to be decisions made frequently – on a monthly, weekly and even daily basis. And they can differentiate the action that is taken at the customer level: Mrs. Smith can be treated differently than Mr. Jones.

Using these definitions, Henry Ford made plenty of positioning decisions but really no operating decisions. Speaking of potential buyers for his ‘Model T’ he famously said, “They can have any color they want as long as it’s black!” In his pursuit of low production cost and affordability, he ruled out any attempt to satisfy different customers with different products, or with different product/feature combinations. Fast forward to today and we have reached the point where a consumer can virtually specify his car and get it custom built within a few weeks. However, auto-manufacturers still do not really make any operating decisions at the customer level. Banks, on the other hand, make plenty of customer-level decisions. And they should be making even more such decisions, with better and stronger decision support.

## OPERATING DECISIONS – AND DECISION CENTRICITY – IN BANKS

In banking, operating decisions have become just as important as positioning decisions. They have also become the strongest method by which one bank can outperform its rivals, many of whom have adopted broadly the same position in the marketplace (that is to say, they have made similar positioning decisions regarding their branch networks, product suites, value propositions, digital options, segments served and so forth). Examples of operating decisions in banking include:

- Direct mail solicitation of prospects for a product sale, where the selection of the target and the content of the offer are determined using data and models to estimate likely, differential outcomes – e.g. for a rewards card, it is important to estimate the response probability and the expected level of spend
- Online application-taking in which the screen sequence and content is adapted in real time to the available information about the applicant
- Phone center scripting for handling complaints and (in particular) account-closing calls
- Cross-sell messaging to existing customers via statement stuffer (paper or electronic)
- Small business sales/switching incentives targeted to individual “high-value prospects”
- Collections tactics that differentiate by delinquency status but also by customer classification

Banks have always made operating decisions and made them, to some degree, at the customer level. But they typically did so without the benefit of real insights that anchored a different treatment to meaningful differences between customers. Some decisions might have been differentiated only at a segment level, so that Mrs. Smith would be treated differently than Mr. Jones if she fell in a different segment than him, but not if they were both regarded as being in the same segment. In the past, individually differentiated treatment of customers was idiosyncratic and strongly judgment-driven.

For example, bank tellers (and bank managers) might have historically treated Mrs. Smith differently than Mr. Jones. But usually that would have been because the teller or the manager knew one of these customers better than the other; the differentiation would have been ad hoc and based on the employee's intuition about the best course of action. Even the goal of the differentiation was likely quite judgmental: if Mrs. Smith complained and threatened to leave the Bank, would she have been given some inducement not to leave? Perhaps. But would the bank employee have known whether Mrs. Smith's relationship with the bank was even profitable, and therefore worth keeping? If Mr. Jones came in to make a deposit in his checking account, would he have been encouraged to apply for a loan of some type? Perhaps. But would the bank employee have had any real insight into the likely profitability of the new loan (or the profitability of the existing account for that matter)?

Actions that differentiated how a customer would be treated were based only on ad hoc interpretations of a customer's uniqueness and vague assumptions about how the bank's action might pay off.

Some people feel that this type of relationship-based customer centricity should be brought back – that bank-client interactions should be mediated by branch staff “who really know the customer”. Every Christmas, in “It's a Wonderful Life”, we enjoy watching George Bailey (Jimmy Stewart) win back his panicky customers, each of whom he knows personally, with heartfelt appeals to their individual circumstances, while old Mr. Potter tries to steal the Bailey Building & Loan Association out from under him. But the truth is that human judgment is a notoriously unreliable guide to wise banking decisions. George Bailey's approach to customer-level decisioning, based on his own judgment, would very likely have led to a poor loan

portfolio. Mr. Potter would probably have run the bank more successfully than George Bailey, although the movie wouldn't have been as good.

In fact, studies of the way bank employees make ad hoc customer-level decisions have shown that those decisions are often made in ways that run counter to the bank's best interests. In some cases, bank employees take advantage of any latitude available to them to benefit either themselves or the customer – at the expense of the bank. But in general, employees empowered to make decisions at the customer level do so inconsistently.

Many studies have explored the consistency and accuracy of human judgment in repetitive situations like loan application underwriting. The sad truth is that human beings are not as good decision-makers as automated methods that employ mathematical models to interpret available data. More specifically, human beings are about as good as mathematical models when dealing with easy cases (e.g. making a credit decision about applicants who are either very well qualified or very poorly qualified). But in the so-called “grey area”, human decision-makers tend to be far more inconsistent than mathematical models based on applicant data. This is not only true in banking; the phenomenon has been widely studied and it turns out to be true across a spectrum of situations calling for judgments based on available data.

Mathematical models tend to outperform human judges in three main ways:

1. Better selection of relevant variables from among a large number of possibly useful ones
2. Better estimation of the “meaning” (i.e. predictive power) of the selected variables
3. Greater consistency in the application of *de facto* decision criteria that use these variables

## THE NEW POWER OF OPERATING DECISIONS

No, the thing about “operating decisions” in banking isn't that they are entirely new; it is that they are newly powerful. These decisions can now be made in a way that is far more accurate and consistent than when the only available basis for making them was the intuition of bank employees.

A decision-centric bank makes “operating decisions” using customer-level data and supporting tools such as predictive models to achieve effective differentiation of the action to be taken for each customer. And in making these decisions, the bank can establish a clear economic goal: *the expected value added by the action about to be taken.*

In this sentence, the term “expected value” means more than just the general expectations of the program designer; it means the calculation or direct estimation of the outcomes of the action involved in the decision. For example, if the decision involves sending out a piece of direct mail to solicit a credit card application, then “expected value” is derived from the estimated cashflows that will result from the action, shaped by predictions of relevant customer behaviors like response/application rate, approval rate, usage rate (or balance level), account life/term, default rate, and so forth.

## THE PREDICTIONS FOR MRS. SMITH

To take another example, if the decision involves offering a customer an incentive to stay with the bank, after she calls to close an account, then “expected value” will consider the current profitability of the account, focus on the new likelihood of the relationship remaining loyal, combined with the current and future profitability of the relationship (where “profitability” could, of course, be negative), while taking into account the cost of the incentive.

The new power of operating decisions, and by extension, of being a decision-centric bank – lies in these concrete factors:

- Having a clearly defined objective for the supporting decision analytics: the value added, or the change of account value, resulting from the decision or action to be taken. Banks have made important strides in understanding the baseline economics of their products, and the sources of profit variance at the product-account and customer level; this understanding must now be migrated into the banks’ decision-support processes
- Deriving the estimate of “decision value” directly from predictive analytics focused on the customer and account behaviors that will define post-decision cashflows; banks have significantly improved their data environments and now they need to exploit these data to generate decision-specific predictive analytics

- Focusing decision-support processes for operating decisions on those decision-points – *on the comparatively small number of decision-points* – that most directly affect downstream profits; and having this focus reflect two important considerations:

- i) Where profit really comes from. The bulk of consumer and small business banking profits come from about 25% of all customers, in a handful of key products, when they exhibit attractive characteristics (like high account balance or spend volume)
- ii) How easy or hard it is to develop and deploy decision support. There is a methodology that allows a bank to build out support for key operating decisions that takes three key factors into consideration:
  - i The frequency with which this decision is taken (or could be taken) per year – higher is better
  - ii The magnitude of the range in possible ‘decision values’; that is, the range of profit or value outcomes associated with a good versus a bad decision in one area – higher is better
  - iii The implementation challenge of deploying and maintaining the particular type of decision support; generally, things involving direct mail and online actions are easier to implement while things that involve training all branch tellers or writing new code, for example, are much harder

By focusing on the most important levers of profit, support for operating decisions can be developed and deployed more rapidly and more effectively than in typical Business Intelligence programs.

## DECISION MAPPING

In making the distinction between positioning decisions and operating decisions, a few examples of each type of decision were given earlier. It is worth returning to the question of operating decisions for a moment because most banks today do not actually make as many such decisions at the customer level as they could. Once a bank realizes that it has a viable methodology for making decisions at the customer level it should carefully re-examine its business processes to see if there are places where the methodology can now be applied.

Our approach to this exercise is called “decision mapping”. Typically, we draw two decision maps, the first being the business-as-usual decision map. Think of the decision map as a kind of process flow-chart for the business or for some part of the business. The chart will often flow from left to right in a way that reflects a “customer life-cycle” showing prospects on the left, applicants in the middle, customers to the right of center and departing customers (e.g. perhaps, those in collections) on the very right. And on the chart, we highlight the points in the process flow where an action is taken, along with the basis for the action, and any differentiation that is embedded in the action (e.g. a segment-level or customer-level differentiation).

The second decision map is more creative, and could include entirely new tactics, with new decision support, at different points along the flow-chart. Equally, the new chart could still show decisions from the first map but now with improved differentiation methods deployed as decision support to achieve superior outcomes. The improved differentiation could reflect a move from segment-level differentiation to customer-level differentiation. It could also reflect the employment of new data, in new predictive models,

to anticipate differences in customer behaviors more accurately.

Take the mortgage business for example. In most mortgage operations, the pursuit of applicants is relatively “aggregate” using mass advertising to reach potential borrowers, and mortgage brokers as conduits for applicants. There is relatively little attempt to appeal differentially to individual borrowers/applicants. This could be done differently, however, using far more differentiation. How? One example would be to use information from online Multiple Listing Services (MLS) to identify sellers (i.e. those who have just listed their home for sale). This is a leading indicator of two new borrowers: the seller, who is highly likely to borrow soon in order to purchase a new home somewhere else, and the yet-to-be-identified buyer of the house that was just listed. An ambitious lender can approach the seller and deliver a message that includes being the lender of choice to the seller himself, as well as to prospective buyers. More importantly, faced with 1,000 new home listings, the lender can decide which sellers to approach, using data-driven models to assess the differential likelihood of success and value.

During times of extremely high capacity utilization, a mortgage lender can use such tactics to adjust the total

## DECISION-CENTRICITY AND “BIG DATA”

In the late 1990s, many banks were charmed by the promises of large technology vendors and other sirens into building major data warehouses linked to data mining tools. The promise was that the investments would pay off in better insights and decisions. Today, “Big Data” is being presented as the basis for yet another round of large programmatic investments with very similar promises. And some of our clients who are interested in building better analytics and better decision support seem to be tuning in to the sirens’ new song.

Books have been written about the reasons for the failure of data mining, but two reasons are worth singling out: the first is lack of focus. Most data mining implementations then, and most Big Data efforts today, pretend to offer banks a “panoptic system” – an all-seeing, all-powerful decision-engine that will enable the bank to make the right decision at the right time and at the right place.

These decision-engine approaches all failed before, and likely will again. A contributing factor may be that their designers, perhaps because they do not understand bank economics and a handful of basic truths about consumers, fail to focus on the comparatively small number of decision-points where better decisions will have the largest impact on downstream profits.

The second reason for failure then, and likely again now, is closely related to the first. In data mining, the thinking ran in the wrong direction: collect the data, store it and clean it, then attack it with “analytics” and finally figure out how to make money from what you just did. The right way to approach things is to understand where you make money, and why, then look at the decision-points that already do, or could, make the biggest difference – and then build the data and analytics infrastructure to support just those decisions.

number of applicants entering the workflow pipeline, and do so with a bias towards the applicants and loans most likely to be valuable.

Or take Small Business banking: most banks have some form of segment-driven approach to Small Business, but they do not differentiate at the individual customer level. This is a huge lost opportunity, because analysis of the profitability of small business relationships shows that the entire profit made by banks in serving the SB sector comes from just 25% of small businesses. Instead of using marketing tactics like newspaper and radio ads that implicitly target all small businesses about equally, and relying on locational convenience as the prime underlying draw, banks could deploy targeting models to pre-select the highest-value SB relationships and then target them directly. To select the high-value SB targets, a predictive model must be built using available third-party data from vendors like Experian, Lexis Nexis or Dun & Bradstreet. To predict the likely value of a new SB relationship, the critical things to predict are basically: average checking account balance, average monthly charge volume (if the SB is a merchant) and whether the SB has a business credit or charge card.

Once the targets have been identified, face-to-face meetings are used to acquire the account. Face-to-face selling is expensive, so the targeting models need to be reasonably accurate; even so, the high-value small business owner will typically not be predisposed to switch and so a “switching incentive” may also need to be offered, if the decision-support models suggest a sufficiently strong NPV – with the level of that switching incentive calibrated to the predicted NPV.

In this new account-acquisition approach, the operational processes use data about individual prospects to determine, first, whether to act or not (i.e. to target or not target), and then the type of action (i.e. the amount of any switching incentive). This is a huge break with traditionally undifferentiated decisioning.

Decision mapping, then, is a simple visualization technique for the much harder and more fundamental task of thinking through – and creatively re-thinking – the way the bank organizes, operates, decides and acts. This technique places strong emphasis on the identification of points in the process flow where the bank can differentiate its action at the customer level, using expected value as the primary decision criterion.

## CONCLUSION

A decision-centric bank is a bank that recognizes that its core business processes contain numerous critical decision points where it can marshal information about its customers and deploy decision-support tools to translate that information into different actions for individual customers. It is also a bank that recognizes that the aggregated effect of making these thousands of decisions better is a very substantial improvement in financial performance.

This paper started with a casual reference to the fact that many banks have announced a goal of becoming more customer-centric. Having instead laid out the argument for becoming more decision centric, we can perhaps revisit the idea of *customer* centricity. In some important ways, a decision-centric bank is a customer-centric bank because it understands bank customers, understands how they differ, and understands how to use its insight into each customer to take actions at the individual level that will control the profitability of its overall portfolio of customers. This may not be the same idea of customer centricity that motivates many bank programs; it is not predicated on a general assumption that if you treat customers with a more human touch they will repay you with share of wallet, longevity and “net promotion”. But it is a form of customer centricity that ties the bank’s knowledge of its individual customers directly to profit improvement.

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Peter Carroll is a Partner at Oliver Wyman.

# 6. MORTGAGE CROSS-SELL

## THE ELUSIVE OPPORTUNITY

By Ahmet Hacikura and Sayako Seto

Many banks are re-evaluating their commitment to residential mortgage lending in the face of the significant investments required to meet regulatory and customer expectations. These investments would have a higher return if mortgage could have a role in establishing and deepening customer relationships. Unfortunately, recent Oliver Wyman research indicates that mortgage is not effective as a relationship-deepening platform outside of a few niche areas.

If mortgage is to be a strategic relationship product, it should be easy to cross-sell into, or out-of, a mortgage. Therefore, we set out to test two deepening hypotheses:

- **Hypothesis 1:** A primary banking customer can be sold a mortgage more easily than a non-customer
- **Hypothesis 2:** A stand-alone mortgage customer can be sold other bank products, such as a checking account, to become the customer's primary bank<sup>1</sup>

However, Oliver Wyman's recent Survey of Consumer Finances supported neither hypothesis, except in niche cases.

## THE OPPORTUNITY

There are a number of intuitive reasons to pursue mortgage as a relationship product:

Obtaining a purchase mortgage is a significant life event for customers

Buying a home is a highly emotional and aspirational transaction that represents a key life event for customers. Serving this need with as few pain points as possible can make a lasting impression on the customer's relationship with the bank.

### TOP 10 REASONS CITED FOR HOME OWNERSHIP ASPIRATION<sup>2</sup>

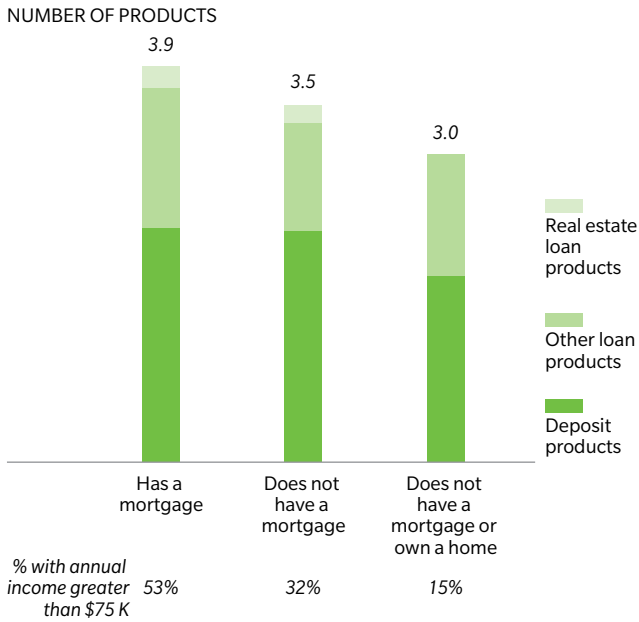
- 1 Having a good place to raise children
- 2 Better physical safety for your family
- 3 More space for your family
- 4 Control over living space, e.g. renovations
- 5 Paying rent is not a good investment
- 6 Allows you to live in a nicer home
- 7 A good financial opportunity
- 8 Allows you to select a community that shares your values
- 9 A means to build wealth that can be passed on
- 10 More convenient location closer to work, family, and friends

<sup>1</sup> A bank with a customer's traditional checking account.

<sup>2</sup> Based on share of mortgage holders considering the reason to be major in buying a home. Other reasons include tax benefits associated with owning a home, good retirement investment, something to borrow against if needed, a symbol of success or achievement, and motivation to become a better citizen and engage in important civic activities. Source: Fannie Mae National Housing Survey (Q4/2011).

**Exhibit 1: Mortgage customers\***

**COUNT OF PRODUCTS HELD BY MORTGAGE STATUS (EXCL. MORTGAGE) AND AVERAGE INCOME BY DEMOGRAPHIC**



Source Oliver Wyman Survey of Consumer Finances (Q1/2012)

\* "Other loan products" include auto, credit card, other installment, payday, and other loans. "Deposit products" include traditional checking, savings, online checking, online savings, money market deposit, and CDs. "Real estate loan products" consists of home equity loans/lines of credit

Level of customer insight is unparalleled

The mortgage application process reveals deep financial and demographic information on customers, which may be used to identify optimal cross-sell opportunities for other banking products.

Mortgage customers are desirable banking customers more broadly

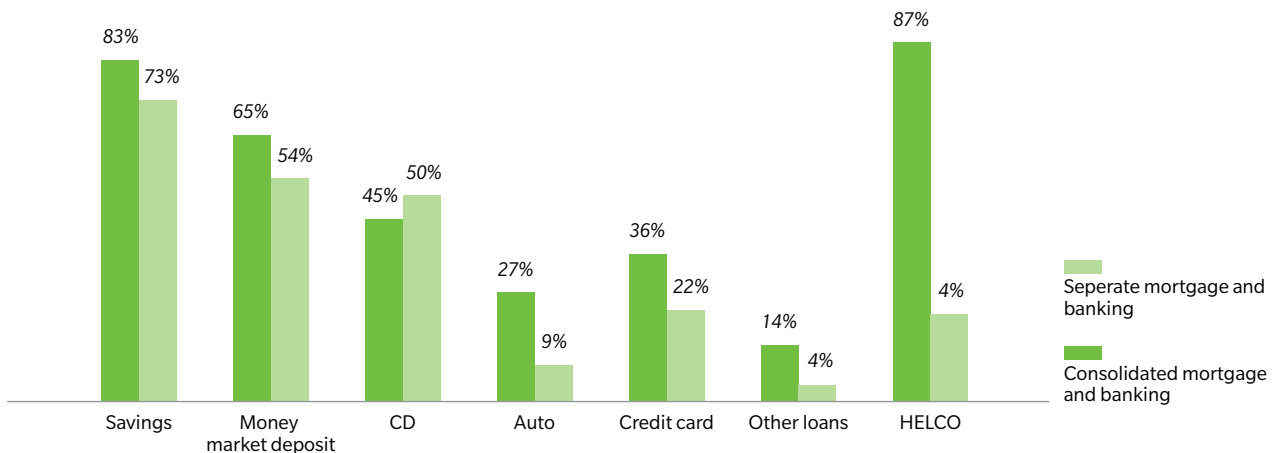
Consumers who qualify for a mortgage tend to have higher incomes and are greater users of banking products overall, making relationships with them attractive.

Customers who consolidate their mortgage and primary banking relationships with one bank tend to have deeper relationships with that bank

Our research shows that customers who consolidated mortgage and primary checking also have a higher share of their other product holdings at their primary bank. It is important to recognize that while the mortgage product may have played a role in deepening the relationship, the stronger driver is likely these customers' general preference to consolidate products at a single institution, i.e. this cross-sell may have happened naturally even without much effort from the bank.

**Exhibit 2: How primary bank share of non-mortgage products varies by mortgage consolidation behavior\***

**PRIMARY BANK'S SHARE OF OTHER PRODUCT HOLDING FOR CUSTOMERS**



Source Oliver Wyman Survey of Consumer Finances (Q1/2012)

\* Share of products based on count of products held



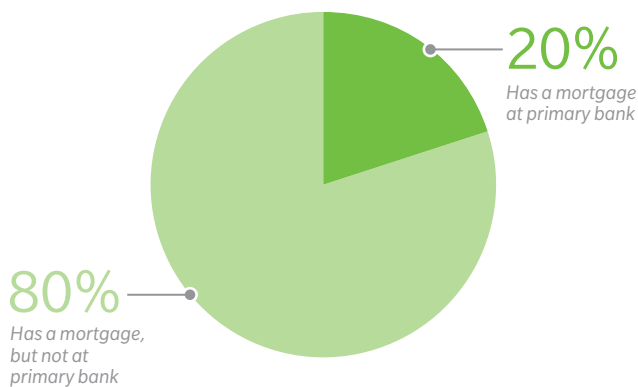
## THE CHALLENGE

Consolidation is the exception, not the norm

Customers who consolidate their mortgage and primary banking relationships with one bank are a minority. Most customers, even those who express a preference for consolidation, do not consolidate in practice.

Exhibit 3: Only 20% of customers obtain their mortgage from primary checking bank

MORTGAGE CUSTOMER RESPONDENTS ONLY\*



Source Oliver Wyman Survey of Consumer Finances (Q1/2012)

\* Even for the 17% of customers who "strongly agreed" with the statement, "Ideally, I would keep all products at one financial institution", the percentage who actually consolidated mortgage and banking was only 27%

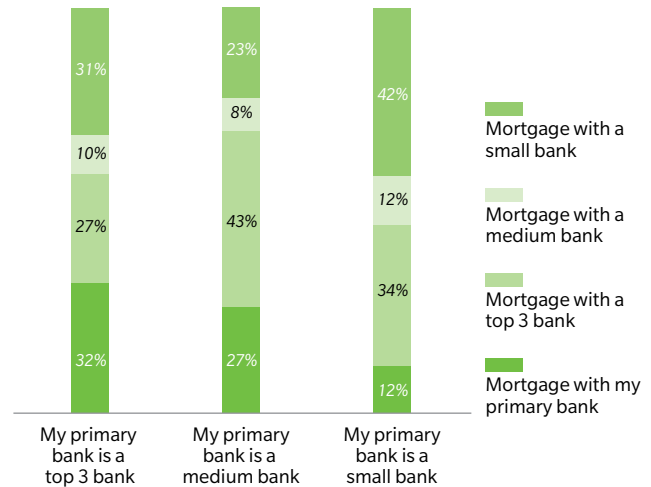
Even large banks struggle to promote consolidation of mortgage and banking relationships

The mortgage market is highly concentrated, with the top three players accounting for nearly 40% of all originations. Given their high market share in both mortgage and banking, these banks tend to have more customers who consolidate their primary checking and mortgage. However, even for them, consolidated relationships are a small share of all mortgage customers. Plenty of their banking customers get mortgages elsewhere, and plenty of their mortgage customers have their checking relationship elsewhere.

Exhibit 4: Mortgage market share among primary checking households\*

HOUSEHOLDS WITH A MORTGAGE AND A CHECKING ACCOUNT ONLY

SHARE OF CUSTOMERS



Source Oliver Wyman Survey of Consumer Finances (Q1/2012)

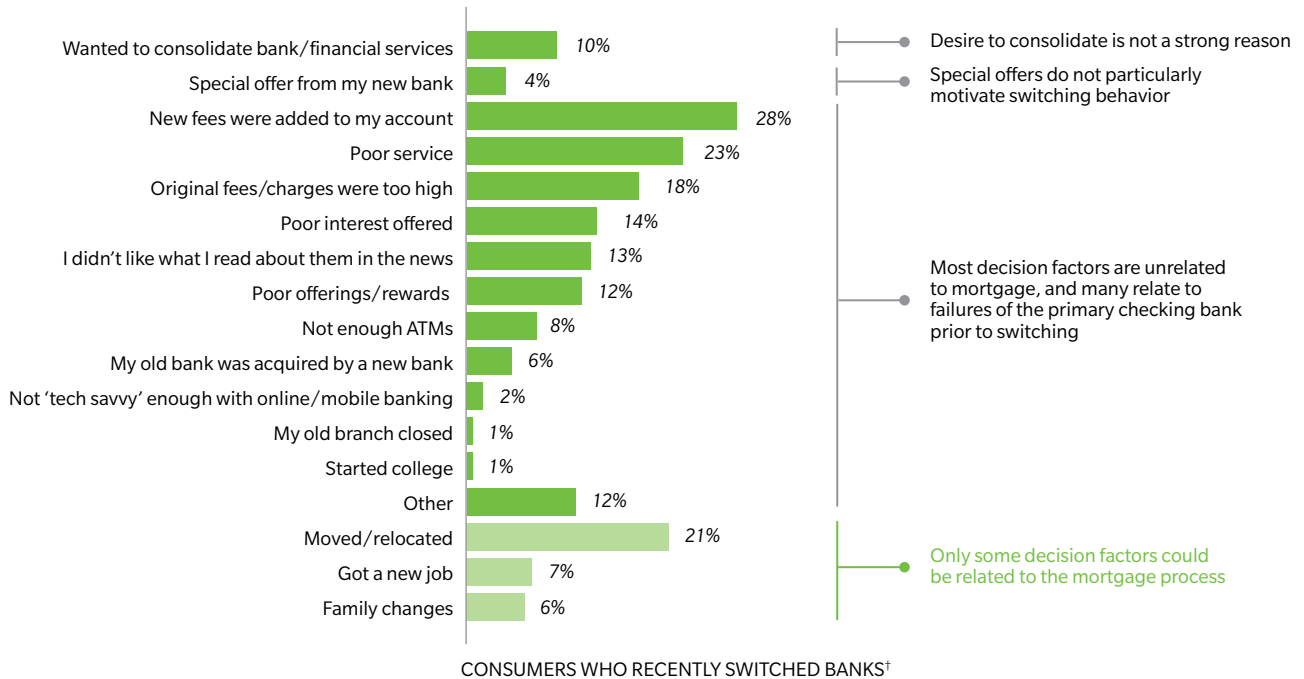
\* Top 3 mortgage banks are Wells Fargo, Chase and Bank of America. Medium banks (next 5) include US Bank, Citibank, SunTrust, BB&T and Fifth Third. Bucketing derived from rankings based on Inside Mortgage Finance: Top 100 Mortgage Lenders 6M2013

Primary banks do not appear to be advantaged in offering mortgages

When selecting mortgage lenders to apply with, customers consider competitive pricing to be the most important factor. Among remaining factors, many are just as important as an existing relationship, including referral by a realtor or developer (for purchase mortgage customers), reputation for good customer service, or referral by a colleague, friend or family member. Convenience of branch locations, a potential advantage for primary banks, is among the lowest ranked factors, which also include strength of brand and quality of marketing materials. Once they receive quotes or pre-approvals, customers overwhelmingly consider pricing to be the key decision factor. None of this suggests a competitive advantage for most primary banks.

Exhibit 5: Reasons for switching primary banks \*

WHAT WERE THE MAIN REASONS YOU DECIDED TO CHANGE YOUR PRIMARY BANK?  
 BASED ON RESPONDENTS WHO SWITCHED PRIMARY BANK IN LAST 18 MONTHS (12% OF ALL RESPONDENTS)



Source Oliver Wyman Survey of Consumer Finances (Q1/2012)

\* Respondents were asked to check all that apply

† Defined as consumers who switched their primary checking bank with within the last 18 months; Consumers are not counted as a “switcher” if their new bank was acquired by their old bank and they did not actively switch banks

Using mortgages to attract primary banking relationships may be too lofty a goal

While lenders often sell mortgages to customers with a primary banking relationship elsewhere, cross-sell of primary banking to these customers is limited. Our research shows that deposit products are “sticky” financial products – customers rarely switch primary banks (in a given 18 month period, only 10-15% of customers switch). When they do switch, their stated reason is most frequently the incumbent bank’s failure to deliver rather than a desire to consolidate products elsewhere, or special offers from other banks.

Our research also suggests that a fair share of customers find it difficult to justify consolidation of financial products with one provider, citing concerns around proximity of a new bank’s branches, breadth of their services, pricing, and the effort required to switch.

Even if banks are able to address these concerns, it is not clear that many customers will care to consolidate their mortgage and primary banking relationships – some customers exhibited a level of indifference specific to mortgages, indicating that they held all financial products with one institution, save for their mortgage, and did not intend to change that.

## Exhibit 6: Reasons why customers do not consolidate financial services relationships

EXPLANATION	ILLUSTRATIVE QUOTES
Value placed on brand and specialization	"I am loyal to my small hometown bank, but I wanted to go with a national bank for my mortgage."
Locational convenience	"I would like to consolidate everything to [mortgage provider], but they do not have a local branch where I live."
Price	"Service and fees associated with each product make me shop for best deal."
Breadth and quality of offerings	"No one financial institution suits all of my needs and preferences." "Each institution offers different advantages for their different products."
Hassle factor and lack of urgency	"It is a lot of work to move everything to a new bank." "I have not gotten around to it." "It is not important enough to go through the trouble of getting all at one institution."
Mortgage is a unique and separate product	"I presently have everything except my mortgage in one institution. I will not change that."

## IMPLICATIONS

Cross-sell into and out-of-a mortgage relationship are both attractive in theory, but uncommon and challenging in practice. Consequently, the strategic role for mortgages is most often:

- As a stand-alone business with attractive product-specific economics
- As an accommodative product sold to the minority of primary bank customers that prefer to consolidate their relationships

Due to the scale requirements and compliance burdens, pursuit of mortgage as a stand-alone business is likely to be feasible and attractive primarily to large banks and specialist lenders.

However, all banks should consider providing mortgages as an accommodative product to capitalize on the available, albeit limited, customer demand among consolidators. Outsourcing options can be considered to execute this strategy in a cost-effective manner.

While there are some clear limits to mortgage cross-sell potential, we see several opportunities to improve performance:

Update basic marketing and sales approaches

Ensure that all primary banking customers are aware of the bank's mortgage product offerings and that sales representatives can easily identify customer demand for a mortgage, i.e. leave no natural opportunity on the table. In addition, ensure that customers applying for mortgages are aware of the bank's primary banking and other products and encouraged to purchase them. In a recent mystery shopping exercise we observed that few banks consistently attempted these forms of low-effort cross-sell.

Consider a segmented approach for higher-effort cross-sell

The customer's reasons for applying for a mortgage and their relationship status with the bank can be useful in determining cross-sell potential.

**Existing bank customers getting new mortgages** from the bank should be a high priority for multi-product cross-sell efforts as they have demonstrated a willingness to consolidate, and the mortgage application will provide a detailed profile to help target cross-sell offers. Given their natural inclination to consolidate, these customers likely do not require high cost tactics or incentives, and banks should not overspend to get such sales. Additionally, banks may consider simplifying the mortgage application process for existing bank customers by pre-populating forms using information already available in bank systems. This is only a partial reduction of customer hassles, as the typical mortgage application requires significantly more information than what a bank may have on file, but banks may find this worthwhile if the required investment is low.

**New customers getting new mortgages** should be the next priority and banks should first attempt to cross-sell a primary checking account to gauge the customer's level of interest in consolidation. There are two types of new customers that may warrant use of tailored tactics to establish a checking relationship:

- Customers who are getting a mortgage due to a recent or pending life event may be more likely to switch their primary bank. For example, in the coming purchase mortgage market banks may see a higher percentage of applicants getting purchase mortgages due to a long distance move away from their current bank, generating the need to find a more convenient bank. For these customers, some higher cost attempts may be worthwhile (e.g.

outreach by a branch manager, customized letter displaying conveniently located bank branches and ATMs near the purchase property, prepopulated checking account opening forms using information from mortgage application, etc.).

- Affluent customers, as identified by their needs for larger loans and information available in the mortgage application, may be worth pursuing through higher cost acquisition tactics (e.g. an in-person visit, concierge services for checking account setup) since the high potential return may justify the costs even taking into account the expected success rate. Banks may also tailor mortgage terms and product features at the margin for large nonconventional loans, particularly if the loans are to be kept on balance sheet.

**Refinance customers** are likely to be the least attractive target for cross-sell (excluding other real estate credit) as they neither demonstrate a willingness to consolidate, nor signal a heightened need to switch banks. That said, checking customers may be good targets for mortgage refinance offers as their transaction data may be used to identify their current mortgage and how long they have had it, thereby assessing whether they would benefit from a rate reduction.

#### Be careful with relationship rate discounts

Unless they are used specifically to generate profitable multi-product relationships with affluent customers, the net result is likely to be a loss of profits. Instead, consider the use of lower-cost relationship enhancing benefits on primary accounts, such as ATM fee refunds, free checkbooks, or elevated service levels (e.g. dedicated service lines) for affluent customer segments.

## CONCLUSION

Mortgage generally is not effective as a relationship deepening product, but there are still attractive pockets of opportunity for improved cross-sell. Banks should consider higher-effort cross-sell tactics focused on those niches where expected returns justify the costs, while avoiding generalized efforts that may be value-destroying.

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**Sayako Seto** is an Associate at Oliver Wyman.

# 7. LAYING THE FOUNDATIONS FOR RECOVERY

Excerpts from Oliver Wyman's 2014 European Retail and Business Banking report

By Simon Low, Jason Quarry, Vanessa Lopes Rodrigues and Mark Barrie

## 1. TRANSFORMING SMALL BUSINESS BANKING

Small business banking is an area of heavy focus in European banking today. It is a major source of credit issues in the weakest economies, but – at the same time – lending to small businesses is the focus of efforts by many policy makers to stimulate economic growth. A combination of cost and regulatory pressures are forcing many banks to revisit their sales and service models. Furthermore, the needs of the small business customer are rapidly evolving, as the expectations of business owners (in terms of channel access, connectivity of applications, speed of turnaround, etc.) are set by their experiences as a consumer.

The current model has resulted not only in unsustainable credit losses, but also a cost base that is too high for the revenue generated. Furthermore, it is only tolerated by an unhappy customer base, that often feels that it is not receiving the service it has been promised, because of the lack of alternatives.

In short, the small business banking model needs to be transformed. We would prioritize four areas for small business banking management teams:

1. Establishing “best in class” NPL management
2. End-to-end lending process review
3. Smarter organizational and operational segmentation schemes
4. Digitalization of the small business offer

### ESTABLISHING “BEST IN CLASS” NPL MANAGEMENT

Small and medium businesses have been a major source of NPLs for many banks across Europe, and a significant backlog of lower value (particularly small business) cases remain unresolved. These cases must be tackled quickly and consistently. Both banks and the economy will benefit from the reallocation of resources post-restructuring or resolution, but it is imperative that individual customers are treated fairly throughout the process.

However, small business NPLs demand a different approach than those employed in consumer or corporate lending. Neither the policy settlements used in the former (characterized by the clearly defined central rules and highly standardized elements that allow banks to handle high volume, small ticket problem loans) nor the bespoke restructuring of the latter (with its complex underwriting and solution set of restructured debt, new equity or “Payment In Kind”) are appropriate when tackling small business NPLs.

“Best in class” small business NPL management is anchored on a set of structured processes and decision trees, that allow a standard set of solutions (such as debt consolidation, basic debt restructuring) to be deployed according to well defined objective criteria. Banks must develop the analytics to support an NPL strategy that is focused on small business borrowers, including

segmentation of the portfolio, development of resolution options, and the implementation of triage and impact assessment models. Furthermore, they must establish an operating model anchored on a “mass customized” approach to NPL management: standard forms that distil key information for decision makers, workflows that ensure processes are structured and efficient, triaging criteria that focus scarce resource on the highest priority assets, etc.

Adopting such an approach will allow banks to work quickly and consistently through the small business NPL backlog by enabling case managers to take responsibility for the delivery of appropriate solutions, while at the same time removing inconsistencies at the front line and driving faster decision speed.

## END-TO-END LENDING PROCESS REVIEW

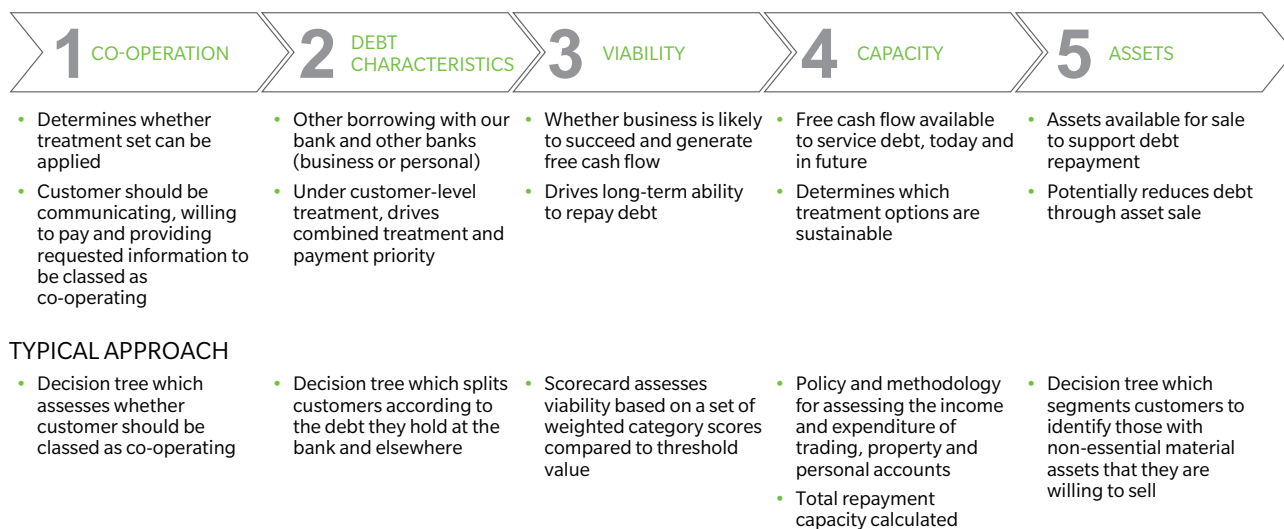
Small business lending remains a focus of policy makers, at both a European and national level, given its ability to stimulate and support economic growth. This is particularly true for markets like Greece and Italy, where small businesses constitute a large proportion of national GDP and drive the majority of employment. Central bank initiatives, such as the Bank of England’s Funding for Lending scheme and the ECB’s Long Term Refinancing Operation (LTRO) scheme, have become more targeted at small business lending. Bank recapitalization programs have sought to ensure that banks have the

capital to lend into the economy, while development institutions, such as the pan-European JEREMIE fund or Greece’s IfG, have boosted the availability of equity funding for small businesses themselves.

However, while these initiatives have removed many of the balance sheet constraints that may hinder European banks from lending to small businesses, we believe that – in some cases – they will not be sufficient to ensure the free flow of funds to the sector. The experience of the Royal Bank of Scotland, the UK’s largest small business lender is instructive: an independent report written towards the end of 2013 highlighted how softer factors can also reduce the ability of banks to lend.

Even if banks have the capital and funding to support the sector, it will be important to ensure that there is also sufficient management bandwidth to champion small business lending again, and that front line staff are not overly focused on other priorities (such as risk management or deposit gathering). Institutional risk appetite must also be matched by individual risk appetite: changes made after the crisis (to risk policy, incentives, delegated authorities and so on) may have dented the latter to the extent that risk aversion level at a deal-by-deal level is preventing portfolio level targets being reached. Changes in focus (away from lending against property to lending against cashflow) may also expose latent capability gaps that were not as evident pre-crisis.

Exhibit 1: Key decision tree modules



Source Oliver Wyman analysis

We expect the political pressure to lend to small businesses to continue to mount. As a result, all small business lenders should challenge themselves sooner rather than later to ensure that they are doing all they can. This should include a review of the end-to-end lending process, including the effectiveness of marketing activity designed to stimulate demand, conversion rates at the pre-application stage (where many marginal deals are filtered out by front line staff) and the behavioral implications of policy changes introduced post-crisis.

## SMARTER ORGANIZATIONAL AND OPERATIONAL SEGMENTATION SCHEMES

Over the past year, we have seen many banks re-segment their customers across organizational boundaries. In some instances, small business banking has moved from the Retail to the Corporate division, although in most cases it has gone in the other direction. This shift in organizational responsibility is a cyclical (and often political) event which occurs every few years. However, we also observe a number of powerful forces at work that suggest a more definitive solution is required. For example:

- Which core banking platform (Retail or Corporate) is best able to meet small business needs? With so much investment now going into the development of both (see the section on digitalization below), it is all the more important to have small business customers on the right platform from the start.
- How do the regulators define small businesses (for example, as “unsophisticated”, “vulnerable” or qualifying for “retail treatment”)? Wherever these definitions apply, small businesses must be served by a (retail) operating model that has the necessary processes and controls in place, to avoid exposing the bank to unnecessary conduct risk.

- At what point do automated processes break down? There is no point in offering a “direct” model to small business customers if every major interaction (from account opening to incremental product sales to credit underwriting) requires information that a relationship manager would be best placed to gather and qualify.
- What value do individual small business customers place on having a named relationship manager (and what incremental value does the bank get from assigning one)? It is clear that turnover-based segmentation schemes assume a generic inflexion point, and apply it to the whole portfolio. Other indicators (such as whether the small business has a CFO or professional finance function) may provide a more reliable guide.

The most thoughtful players are seeking an organizational segmentation scheme that solves for all of these questions; so that the overall proposition offered to small business customers (whether they be above or below the Retail/Corporate boundary) is internally consistent, and therefore more effective and efficient.

Within each organizational unit, we also expect to see a continued focus on operational segmentation. Quantitative research techniques need to be deployed to refine and enhance the differentiated propositions being offered to the smallest businesses served by a direct or branch-led model, as a way of both growing share (by focusing on the attributes that each sub-segment values) and profitability (by ensuring that value is recovered through differential pricing). Equally, banks must find a way of delivering “mass customized” propositions to the larger small businesses served by a relationship manager: the latter cannot be given the discretion to create bespoke solutions for each individual client, but a “one size fits all” solution will not be sufficient for such a heterogeneous client base.

Exhibit 2: Conversion rates along the lending process for small and medium enterprises (SMEs)

STAGE	PASS THROUGH RATE PER APPROACH FOR BORROWING	
Initial engagement	SMEs contacting bank to discuss financing	100%
Application, approval and appeal	SMEs submitting a formal application to the bank	51%
	Bank approves the application	39%
Competition, contracting and draw down	SMEs accepting the approved facility	37%
	SMEs drawing down on the approved facility	27%

Source RBS Independent Lending Review

Exhibit 3: Illustrative - organizational segmentation schemes for SMEs and corporates

<b>Multinational</b>	>€3–5 BN			
<b>Large Corporate</b>	€5 BN to €1 BN			
<b>Large Mid-cap</b>	€1 BN to €500 MM			
<b>Mid-cap</b>	€500 MM to €250 MM	<b>Micro Business Banking:</b> no dedicated RM, remote sales and servicing via internet, telephone	<b>Small Business Banking:</b> branch-based RM/SB specialist, with large portfolio size (300+ customers), offering face-to-face point of contact	<b>Commercial Banking:</b> dedicated RM, often based in commercial centers (rather than branches) offering standardized product solutions
<b>Small Mid-cap</b>	€250 MM to €10 MM			
<b>SME</b>	€10 MM to €1 MM			<b>Corporate Banking:</b> dedicated RM, supported by multiple product specialists, tailoring banking solutions to customer need
<b>Micro</b>	€1 MM to startup			

## DIGITALIZATION OF THE SMALL BUSINESS OFFER

Digital is setting a new standard for small business banking. In part, this is being driven by ever more demanding small business owners, whose expectations of their business bank account have been raised by their experience as a consumer (in banking and beyond). Equally, of course, small business banking is often able to piggy-back off the investments that have already been made into retail banking digital platforms.

Banks that visibly succeed in setting these standards can benefit enormously: in North America, both Bank

of Montreal and PNC claim significant increases in customer numbers as a result of well thought through online and mobile banking offers targeting small business owners. In most European markets, all major players are already adding new features and functionality to existing platforms. In many of the banks that Oliver Wyman has worked with, the driving force is therefore the desire to maintain market parity: falling too far behind in any particular area that is valued by small business owners (such as mobile or user access management) risks an uptick in customer attrition and the erosion of the customer base.

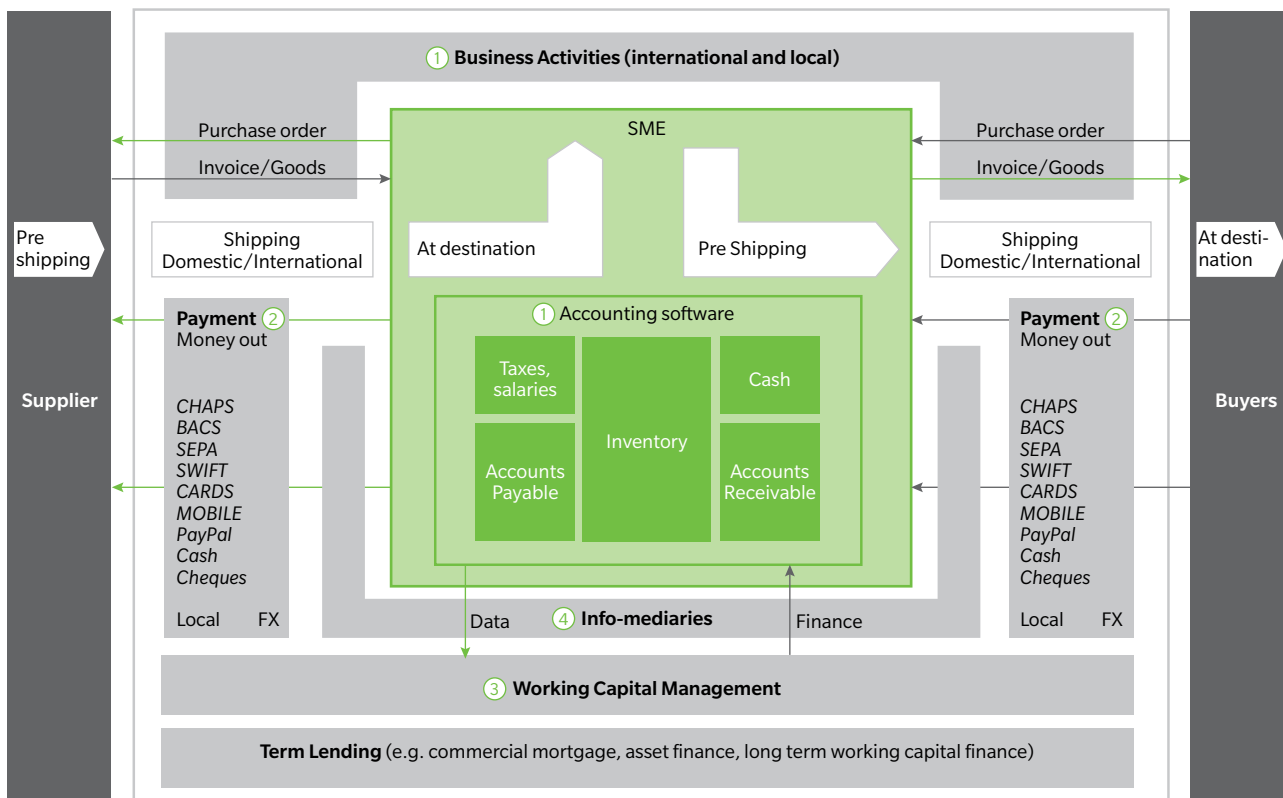
Exhibit 4: New digital standards in small business banking

VALUE CHAIN	DESCRIPTION OF KEY THEMES	EXAMPLES
<b>Customer interaction</b>	<ul style="list-style-type: none"> <li><b>Integrated banking solution</b> for personal and business needs of the small business owner</li> <li><b>Consumer Web 2.0 experience</b> is influencing SME user interface design, leading to a more intuitive layout and visualization of information</li> <li><b>User access management</b> tools support multiple different modes of interaction (e.g. transaction initiation vs. authorization vs. reporting)</li> <li>Increasing <b>differentiation of client service levels</b>, pricing and product offering, based on modular approach</li> </ul>	<ul style="list-style-type: none"> <li>Standard Chartered</li> <li>Wells Fargo</li> </ul>
<b>Channel</b>	<ul style="list-style-type: none"> <li><b>Mobile Banking</b> applications offer streamlined access to core functionality, with a focus on owner/manager oversight and authorisation</li> <li><b>Social Media</b> used for marketing/promotions and customer servicing, and moving towards collaboration and transactional banking</li> <li><b>Video/webchat</b> used to enhance basic servicing, and increasingly to access product or industry expertise</li> </ul>	<ul style="list-style-type: none"> <li>La Caixa</li> <li>ASB</li> </ul>
<b>Product/Service</b>	<ul style="list-style-type: none"> <li><b>Aggregator and portal models</b> combine bank and third party services (e.g. community, learning hub, service hub, group purchasing schemes, etc.)</li> <li>Banks begin to leverage core attributes (e.g. trust, security) to offer new <b>products and services</b> to existing customers (e.g. data storage, secure email, digital signature, etc.)</li> <li><b>Mobile payment solutions</b> to allow businesses to take payments remotely</li> </ul>	<ul style="list-style-type: none"> <li>Bank of America</li> <li>Barclays</li> </ul>
<b>IT/Back office</b>	<ul style="list-style-type: none"> <li>Increasing <b>automation of processes (STP)</b> and/or decision making, to meet SME client service level expectations (e.g. KYC/KYB)</li> <li>Process <b>enhancing features</b> such as real-/near-time delivery, alert system, full product view, review tools, research</li> </ul>	<ul style="list-style-type: none"> <li>Citibank</li> </ul>

Source Oliver Wyman analysis



Exhibit 5: Small business value chain



- ① Professional production and management of paperwork and record keeping that supports business activities, via dedicated software
- ② Using open architecture to encourage the creation of business-specific applications by independent developers that can then be deployed through point of sale devices (e.g. loyalty/voucher schemes, table booking, bill splitting, etc.)
- ③ Leverage financial and payment information to develop comprehensive liquidity forecast and cashflow management tool, and to facilitate 'one touch' financing of working capital
- ④ Analysis of small business data to improve small business outcomes

Source Oliver Wyman analysis

However, being good at delivering core banking products and services online and through mobile and tablet applications will not be enough to stand out from the crowd in the medium term: to do this, banks need to find ways of supporting small businesses in their own business activities, solving their day-to-day problems and helping them acquire and retain more customers. In the graphic above (Exhibit 5), we highlight four areas along the small business value chain where we see significant innovation. These areas are adjacent to core banking services, but the innovation is not typically being led by banks.

What is clear is that the pace of change in small business banking has accelerated rapidly with the advent of digital technologies. Small business bankers rely on retail (and occasionally corporate) platforms for developments in core functionality, and must now be able to articulate crisply and clearly what the small business specific requirements are, if they hope to compete for their share of digital investments. They will also have to develop capabilities (such as data management, customer analytics and proposition design) that are not traditionally associated with the sector, and to establish partnership frameworks to allow them to access technologies, software and skills that simply don't exist in most banks. Above all, they will have to get used to a much, much faster pace of change.

## 2. DELIVERING IMPACT VIA IMPROVED CUSTOMER EXPERIENCE

The world’s perception of retail banking has fundamentally changed following the financial crisis – trust in banks needs to be rebuilt, increasing conduct regulation makes differentiation through greater sales effectiveness and product pricing harder to achieve and customers are slowly becoming less loyal (more banking relationships) and less sticky (shorter product lifetimes), albeit from high levels relative to other service industries. As a result, alongside marketing, competency in delivering a high quality customer experience has increased in importance to the success of retail banks as they have discovered that the negative impact of their existing poor service is high and increasing.

Oliver Wyman’s analysis suggests that there are some clear priorities for generating impact via customer

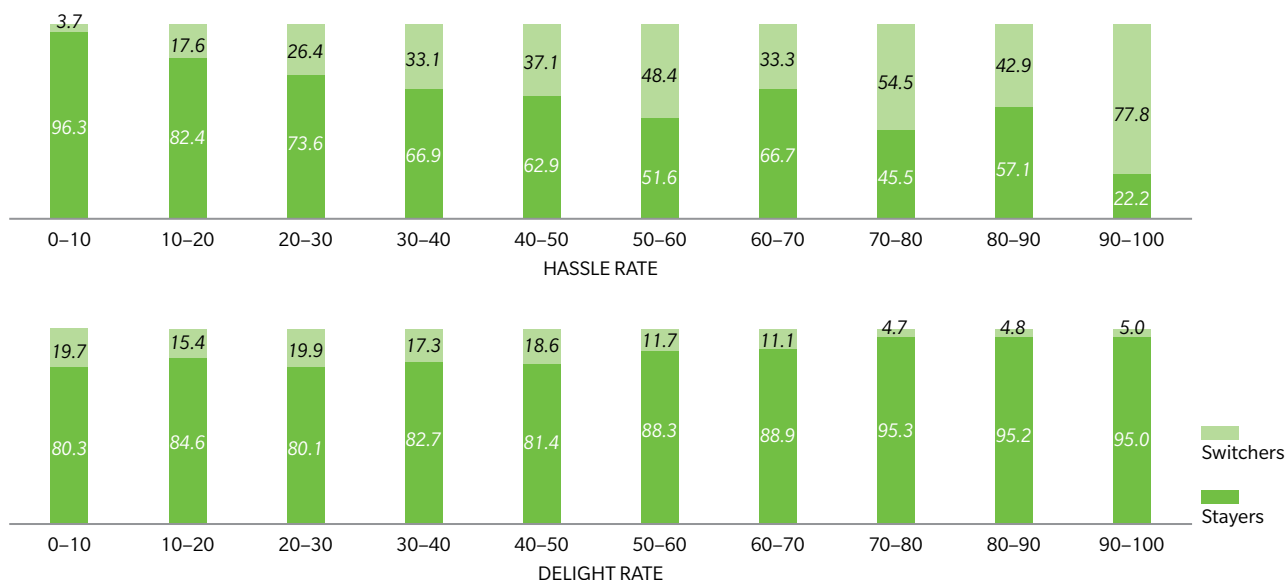
experience and that differentiation in this area is both achievable and sustainable.

Firstly, in terms of the impact on customer value, fixing areas of poor customer experience (“hassles”) is more important than delighting customers in retail banking today. Customers that experience poor service are prone to leave the bank, resulting in the loss of all value, whereas while delighted customers will stay, the value impact is less strong. This effect is shown in Exhibit 6 below using UK customer research data.

These skews in value impact mean that banks need to think carefully about where to make their investments in improving customer service – this should be based on the experience itself, how it impacts customer value and the value of the customers that are affected (Exhibit 7).

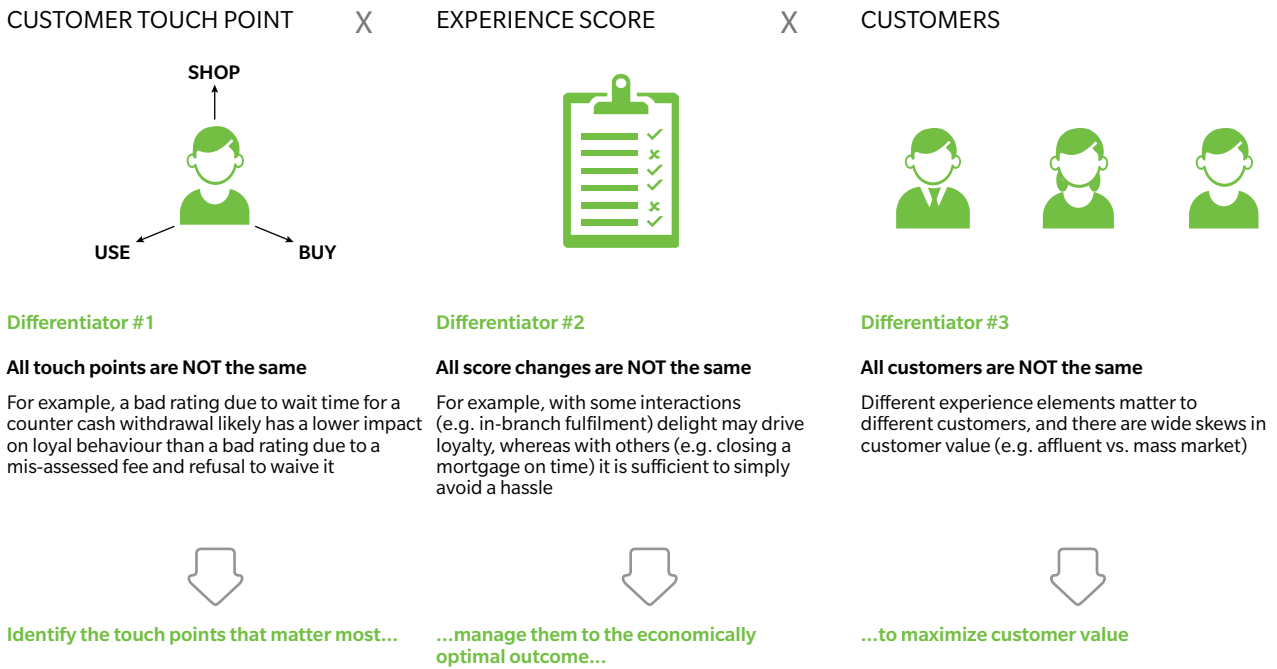
Exhibit 6: Switcher and stayer status by hassle and delight rates

AS % OF TOTAL RESPONDENTS FOR EACH RANGE OF HASSLE/DELIGHT RATES



Source Oliver Wyman analysis

Exhibit 7: Key differentiators in customer experience



Source Oliver Wyman analysis

As the retail banking experience becomes increasingly digital, the digital (particularly mobile) experience will become the battleground for retail banks on this dimension. Banking transaction capability through mobile channels is increasingly becoming a hygiene factor and expected by customers and we expect that this will evolve to become a real source of competitive advantage

for those banks able to deliver a smooth, error free experience via mobile digital channels.

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