How the banking industry can find itself once again after a ‘lost decade’

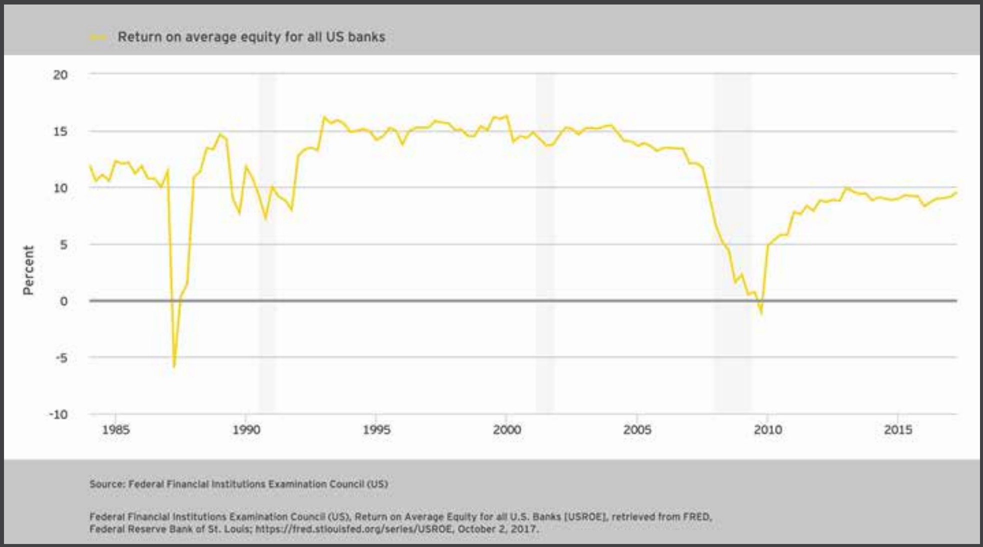
It’s been more than a decade since the beginning of the global financial crisis, yet for the banking industry it seems like just yesterday.

Until the crisis, banks enjoyed a return on average equity (ROAE) of around 14% to15% . Since the crisis, the ROAE at major banks has been about halved, now lying in the single-digit range. In the first quarter of 2017, the average ROAE for all US banks was 9.15%[1] (see Figure 1).

Banks have failed to find themselves in the aftermath of the crisis, and the past 10 years may go down in history as a “lost decade” for the industry.

Banks today face a host of challenges: eroding profitability due to inefficiencies, low productivity and high structural costs; too many and too similar products, unjustified in their high costs and meager revenues; rising legacy technology maintenance costs and new market entrants disruptive to banks' business models; and lastly, a changing consumer.

Figure 1: The banking industry's 'lost decade'[2]



These issues are not unique to the banking industry; other industries have faced fundamental shifts and are acting on them. To bring about a brighter future, change is necessary. The industry can improve its performance and profitability by streamlining and unifying the banking experience for customers and creating efficiencies throughout operations. But to do so, banks must embrace three pillars of optimization: simplification, differentiation and flexibility.

Simplification

Banks need to establish streamlined operating and business models; simplify their technology and processes; offer more rational products to customers; and pave the way for pragmatic IT strategies that take advantage of emergent technologies. Simplification means making the customer banking experience faster, easier and more meaningful — whether it takes place online, on mobile or at the local branch.

Differentiation

Banks must find ways to differentiate their products and services if they hope to grow. That means transforming existing services, such as payments, and developing new products and services to bring about a differentiated customer experience. Innovative differentiation can drive value and yield advantages over competitors. To differentiate themselves from the competition and remain distinct, banks will need to partner with best-of-breed FinTech companies that are creating new products and customer experiences.

Flexibility

Those days are past when banks could rely on stable business models and assume customer loyalty. The global financial crisis undermined the stature of traditional banks in customers' minds, and the rise of digital competition added to that insecurity. Flexibility is key: banks must be ready to break from the rigid processes of the past to meet the needs of customers today.

This path will not always be smooth. Along the way, banks must be ready to:

- Rethink products, processes and businesses from the customer's perspective
- Encourage innovation within their organizations
- Delegate decision-making

[1] "Economic Research at the Federal Reserve Bank of St. Louis," Return on average equity for all U.S. Banks (USROE), https://fred.stlouisfed.org/series/USROE, accessed 29 October 2017.

[2] Ibid.

Case study

The client: Our client, a midsize bank, is a regional financial services institution with a community bank segment offering deposit and investment products; personal finance services and loans, including residential mortgages, home equity, credit cards and various installment loans; deposits, investment and credit products, and business advisory services; financial, estate and retirement planning; and asset management services to high-net-worth clients.

The challenge: The client faced three key challenges: its high operating costs, inefficiencies developing new capabilities and products, and resulting stagnant revenues. Its ROE was stuck in the single-digit range. The bank provides various retail and commercial banking services to individuals, corporations and institutional clients in the US. To grow, it needed to increase its ROE.

The solution: Working with the client, we identified key areas in need of simplification and flexibility. We found the bank had engaged too many third-party vendors over time to create features and capabilities across channels that ultimately didn't work well together. The overabundance of third-party-sourced elements created unnecessary complexity and limited the bank's flexibility. Any change to consumer online banking or mobile banking required coordinating multiple vendors, each with their own time constraints. Another issue arising from over-reliance on third-party vendors was a lack of differentiation between the bank and its competitors. We helped the client prune the number of such vendors it had turned to over the years. This process of pruning gave the bank greater flexibility and openness to FinTech solutions, hastening its development process.

Significant improvements came also in streamlining customer experiences for online and mobile banking. These experiences, too separate and distinct, were the result of a siloed development process. Because of the sometimes ad hoc manner in which the bank had developed its online and mobile banking channels, a channel-centric approach was emphasized; thus, the online banking's "feel" was at odds with the mobile channel's. Both channels had been developed with the product, not the customer, in mind. To address this problem, we worked with the bank to imagine different digital personas — customers the bank wanted to attract — and designed functions to fit their preferences.

The outcome: The bank reduced costs 20% by uniting what had been two channels (online and mobile) into one. The bank saw a 50% increase in the speed of bringing new capabilities to market as it began making use of FinTech solutions. Moreover, the bank experienced an improvement of 10% to 15% in online customer acquisition.

Going forward, the bank will need to transform its more complex business units, such as business banking and wealth management, as well as its branch network, applying our principles of simplification, differentiation and flexibility.

Conclusion

On their side, banks have brand, scale, customer base and infrastructure. Even the most digitally savvy customers believe banks have an important role to play in the financial ecosystem. But winning with consumers requires a committed transformational road map focusing on simplification, differentiation and flexibility.

To meet the changing behavior and preferences of their customers, banks must develop new, optimized, digital frameworks. Today's consumers have come to expect efficiency, transparency, ease of use and the intuitive feel they get from their interactions with digital-age companies. To this end, banks must build simpler customer products and operational capabilities.

Banks can modernize their core businesses with:

- Simplified digital operations and automated business models
- Increasingly personalized customer experiences; thoughtfully designed, cross-channel customer journeys
- Radically simplified product portfolios, product features and pricing
- A better understanding of customer behavior and tailored propositions to different customer types

To overcome the challenges of the last decade, banks will need to re-orient their thinking and lay out a road map for the journey ahead. This journey will differ bank to bank. For some, the actual execution of client-facing sides may be the biggest hurdle; for others, it will be overcoming the burden of their legacy environments.

This journey is not unique to the banking industry. Every industry within every sector has had to set out on a similar journey. The time to hesitate has past. Now is the time for banks to put their lost decade behind them and set out on a journey of transformation.

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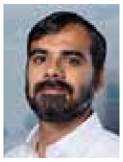

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US SCORE no. 06515-171US

1710-2441528 ED None.

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