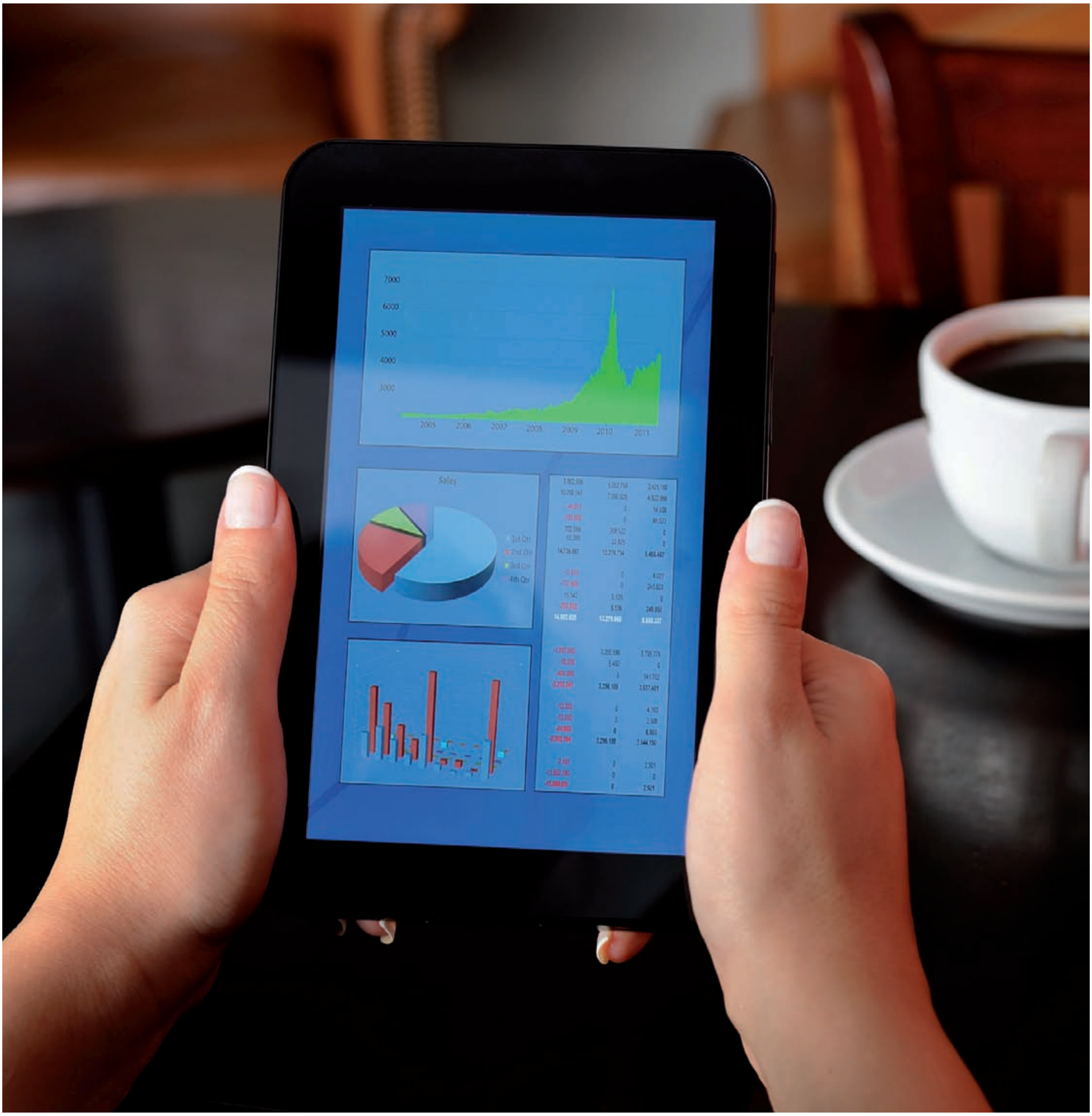

The current state and future of mobile banking in Europe

EFMA

McKinsey&Company

Foreword

McKinsey and Efma are pleased to present this new report which shows how leading European banks are preparing to take advantage of the growing "mobile" opportunity. Our joint study – comprising interviews and survey responses from more than 150 banks and their top executives – reveals a fascinating pattern of results. We hope that the report will provide readers with fact-based information that allows them to chart their way on this exciting journey.

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The current state and future of mobile banking in Europe

Interest in mobile banking is intense and getting stronger. Smartphones are taking over, new applications are proliferating and banks across Europe are mobilizing to respond to the growing 'mobile' opportunity.

Most retail bankers, however, remain unclear about how much is hype, and to what extent mobile banking represents a gradual and evolutionary shift or a revolution that will fundamentally change the industry landscape. How aggressively will competitors react? Will mobile create value for the banking sector as a whole, or could it actually reduce profits in some areas? What distinguishes those banks that stand to benefit most from mobile technology?

In a recent joint research project with EFMA[1], comprising interviews and survey responses from more than 150 European banks, we shed new light on these and other questions. This article will outline the key conclusions of that research, expand on the nature of the mobile opportunity as we see it and propose what banks should do to capture the opportunity. Our key conclusions can be summarized as follows:

- Mobile has the potential to revolutionize the customer experience in personal financial services, with non-bank organizations often leading the way
- Banks expect mobile banking to transform the retail banking landscape, but admit that they are not acting or investing accordingly
- The unique characteristics of the mobile device present three distinct areas for 'proposition' and marketing innovation: ultra convenient banking, digital commerce and the opening up of new markets and segments
- The opportunities will create significant scope for individual players to win (and lose) market share – but the overall impact on banking value creation will be at best neutral
- Banks must shape, lead, or follow the market – they will only succeed if they make a conscious choice on which strategy to pursue and take concrete action accordingly

1 European Financial Marketing Association

First signs of a mobile revolution ….

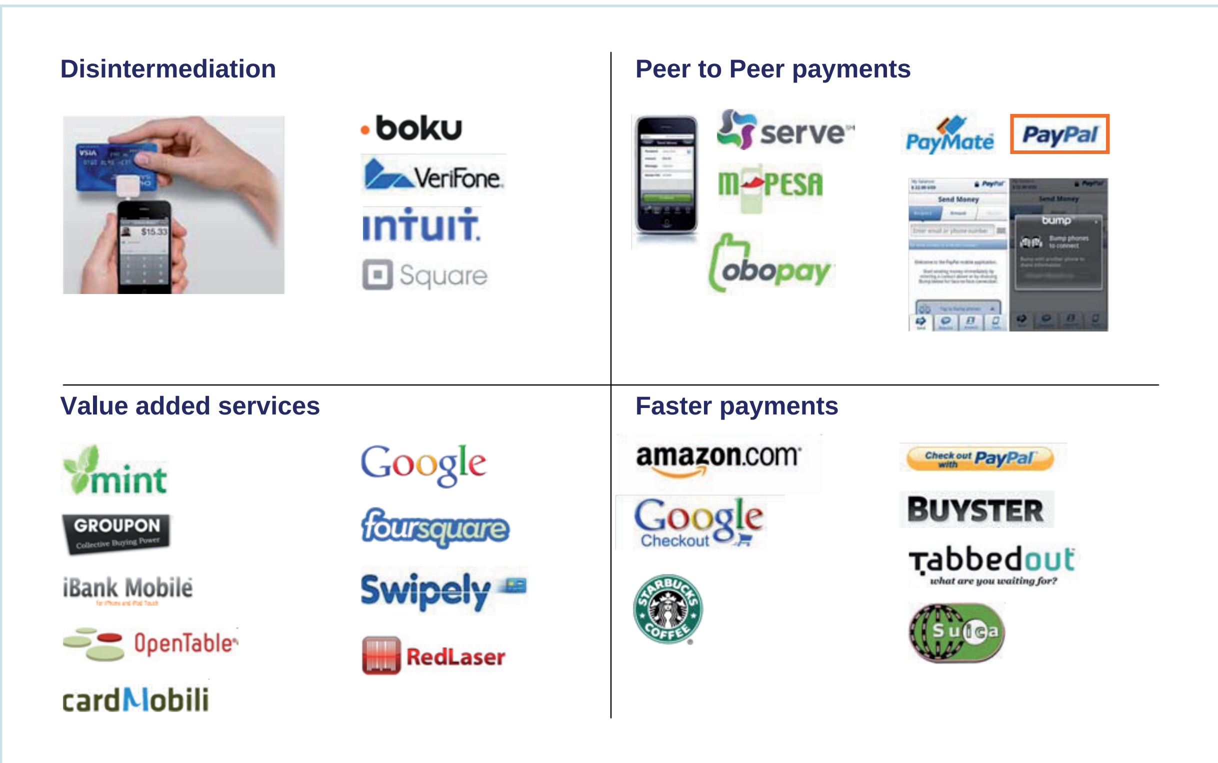
Signs of a consumer and technology revolution in retail banking, driven by mobile, are everywhere to be seen. Starbucks now has 3 million customers using mobile pre-paid to pay for their coffee, Apple and Facebook charge 30% commission vs. the 2-3% credit card players charge, and 'mobile money' is the second highest priority for Google.

Many users, meanwhile, are already actively shifting from PCs to mobile devices even in their homes: worldwide smartphone shipments overtook total PC shipments for the first time in Q4 2010.

What's new and worrying to banks is that in many respects non-banks are leading the revolutionary way with a flurry of often free applications that facilitate a range of new payment options, including cross-border remittances and peer-to-peer payments. (exhibit 1). Banks are clearly lagging behind in innovation.

Recent industry shifts underline why banks need to respond actively to the challenge, and there are many examples from other sectors that illustrate the threat. For instance, Blockbuster – a traditional bricks & mortar DVD rental company – was quickly overthrown by Netflix when it introduced postal and later online distribution of rented films. The impact of online solutions on individual banks could be just as drastic.

Exhibit 1
Non-banks leading the revolution of new services



…but banks acknowledge they are struggling to respond

Our survey of 150 banks across Europe revealed a relatively optimistic industry view on mobile banking – yet banks also admit that they are not acting to take full advantage of the opportunities or investing on the necessary scale.

Bullish about the potential

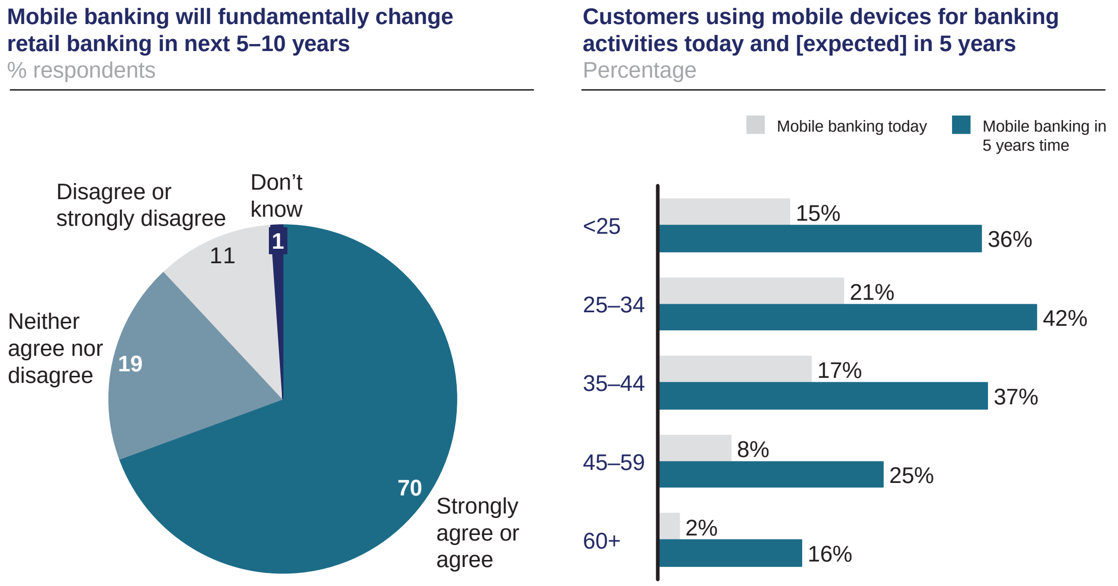
Most respondents believe that mobile banking will fundamentally change retail banking in the next three to five years. They reject the idea that it is a fad and anticipate that mobile technology penetration will not only grow but bring significant benefits to customers (exhibit 2). It will, they believe, become more relevant at all stages of the purchasing process.

Almost all banks (87%) aim to have a mobile site and 84% aim to launch some sort of 'app' within the next 12 months, up from 59% and 47% respectively today. The sort of features they offer at the moment are typically traditional banking services, such as checking account balances and recent transactions, and the ability to conduct simple transactions. But 70% of banks said they are also planning to add more advanced functionality within the next 12 months, the same number told us they are planning significant mobile platform upgrades and 10% are even contemplating a complete channel overhaul.

These ambitions are consistent with banks' expectations that the mobile channel will capture as much as a quarter of all transactions within five years as customers shift away from branches.

Exhibit 2

Banks expect mobile to fundamentally change retail banking



SOURCE: EFMA and McKinsey Mobile banking survey, 2011

Our survey responses vary widely on the outlook for more advanced and novel mobile features, with no convincing majority heading in one direction. Some plan to introduce more sophisticated financial services (such as budgeting tools), while others expect to integrate with 3rd party payment systems or non-banking add-ons like social networking or retail product vouchers.

Our survey also sought to examine the likely financial impact of mobile banking. In this respect, half the executives thought that the opportunity mobile provides to better meet customer preferences, increase loyalty, and strengthen relationships would have a positive impact on their bank's profits. Only 4% anticipate that the financial impact of mobile banking will be negative.

More than 50% of banks see investments in mobile leading to either some or a significant increase in revenues from all products except mortgages, with the rest of the respondents not expecting any change. Exactly how they would gain these extra revenues as a result of mobile devices, however, was not made clear.

On the cost side banks face an interesting balancing act. Our respondents on the whole feel that reductions in back-office and existing channels will likely be offset by increases in IT and mobile channel costs (for example, due to the proliferation of mobile platforms on which they will have to be represented to achieve full coverage of their customer base).

Marginal and slow reactions

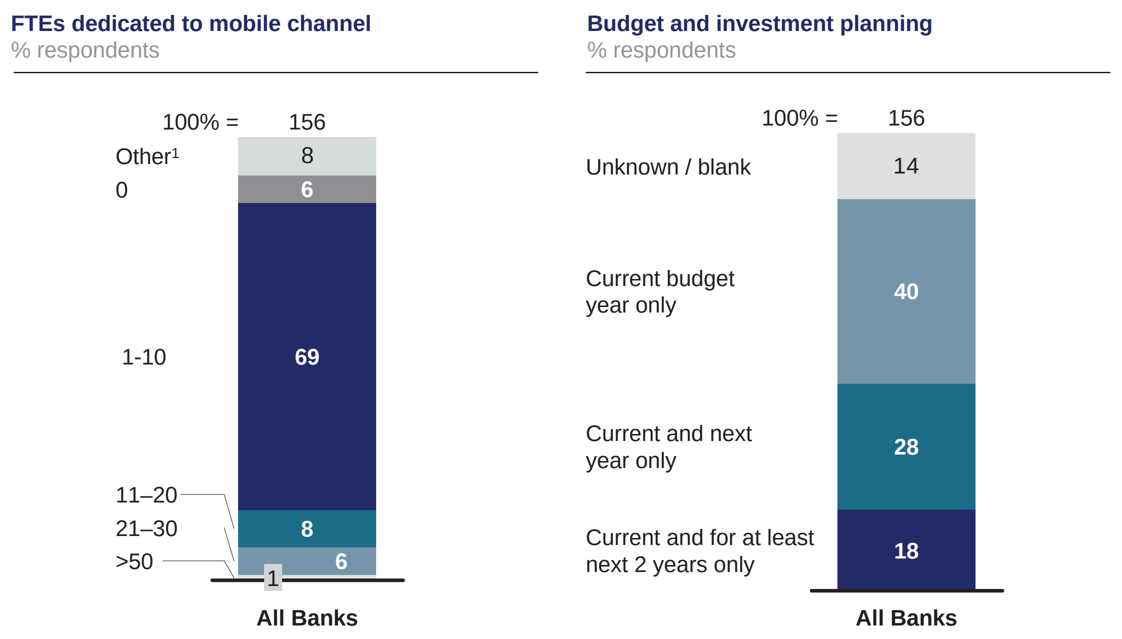
More than 60% of banks believe that new capabilities will be crucial to success in mobile: the skills involved will include multi-channel marketing capabilities and abilities to integrate IT across channels, develop smartphone 'apps' and convert digital transactions to sales.

However, the majority of banks told us they have less than 10 employees dedicated to mobile, have only committed investment to the current year and have, at best, made only minor adaptations to commercial functions. They have, in other words, so far failed to create a new underlying mobile business model or clear mobile strategy (exhibit 3).

To some extent this reticence can be explained by some of the concerns respondents expressed on the merits of the underlying business case, especially whether mobile banking will generate new revenues. We also found a clear acknowledgement by respondents that telcos, internet giants and consumer-champions are better placed to develop key components of the mobile proposition – a threat to which only a few leading banks appear to be responding by investing significantly in people and core capabilities as well as in IT.

Exhibit 3

...but banks do not act or invest accordingly



SOURCE: EFMA and McKinsey Mobile banking survey, 2011

Three breakthrough areas of opportunity

As banks think about how best to respond to the opportunities of mobile banking it is first worth understanding the nature of what they are dealing with.

The mobile device has several, distinct characteristics that collectively turn it into a unique value proposition. The mobile is portable and accessible 24/7, it has a unique ID which means its use and identification is specific to each customer, it is simple and even exciting to use with its increasingly user-friendly interfaces, it allows geographical positioning which in turn permits products and services to be tailored to different territories, and in the panoply of electronic devices it is the one that consumers most frequently use. This effectively means that bank customers can 'meet' their bank every day, albeit remotely. These features plus a flexible cloud and 'app'-based technology platform enables more rapid development and integration with third party products.

In our view these characteristics create at least three concrete opportunities for banks (exhibit 4). They are:

1. Ultra convenient and innovative banking

Banks can use mobile to create differentiating and distinctive bank propositions to customers in their existing markets.

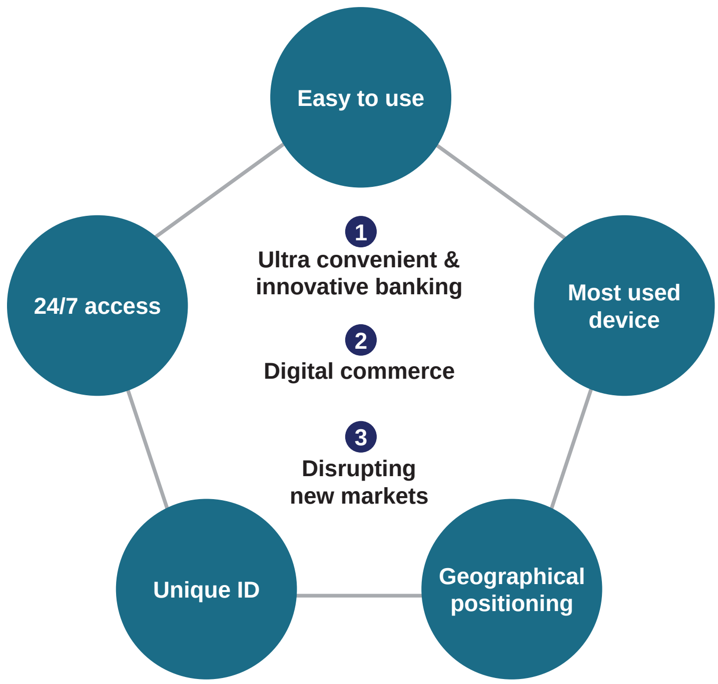
This means consumers going about the usual everyday business of checking account balances, reviewing transactions, transferring funds and purchasing new banking products – but in a dramatically more convenient way.

In the last 12-24 months, innovation in personal financial management has been a prominent activity of non-banks but banks can still catch up. In the areas of payments and overlay services, for example, new mobile apps are facilitating peer to peer transactions, providing value-added money management services and speeding up payments.

Banks are already seeing a step-change in the number and frequency of interactions they have with their customers via mobile; something that was once a monthly experience is now happening daily with a mobile device.

Exhibit 4

The characteristics of the mobile device create three major opportunites



2. Digital commerce

The internet has resulted in a revolution in consumer commerce. However, that transformation was typically represented through enabling pre-purchase online research; consumers still made the majority of their purchases offline as they wanted to see and feel what they were buying in the store.

Smartphones are the catalyst for the next revolution in digital commerce – they allow customers to take the internet with them into stores. The opportunity is massive with multiple players vying to capture the customer; Google, PayPal, Facebook, Amazon among others.

Banks must ensure they are part of this revolution. Rather than trying to own the end-to-end value chain, they should develop strong consumer digital commerce propositions for merchants and third parties.

This means banks acting as the engine that drives digital commerce from the pre-purchase phase (combining bank and non-bank data to deliver event- and location- based discount offers), to purchase financing (instant credit available at point of sale via the SMS and mobile apps), to transaction processing (bank-enabled mobile e-wallets replacing cash and cards), and finally through to consumer post-purchase activities.

3. Disrupting new markets, serving the 'un' and 'under' banked

Banks can use the low-cost mobile channel and innovative partnerships to access under-banked and under-served customers in developed and developing markets.

For instance, non-incumbent 'attacking banks' may more easily be able to build a low-cost proposition in partnership with an established telco. Mobile banking as part of a remote-only business model could prove to be a very competitive strategy in both emerging and mature markets.

M-Pesa has led the way in Kenya, making possible for the first time person-to-person transfers and facilitating international remittances. A striking 51% of Kenyan adults use this system making it the most successful mobile money deployment worldwide. Several other emerging markets players are now offering suites of mobile services or links to savings accounts for people who were previously outside the formal banking system. New players in such markets are integrating existing mobile payments platforms with online merchants, bank accounts, and microfinance platforms. The serving of 'un' and 'under' banked is still in its infancy.

Value creation is in the hands of each bank

Our analysis suggests that taking the industry as a whole the upside from mobile banking will be limited and value creation may be neutral at best. At the level of individual banks, on the other hand, the profit and revenue opportunities are considerable. As banks eye the value creation opportunities of mobile banking looming on the horizon it is worth considering three separate perspectives:

- **Individual bank profits.** Individual banks can create value either by gaining market share on the back of the three opportunities just discussed, or by capturing the savings that will come from moving out of traditional channels and into mobile banking. To gain share in home markets, banks will need to develop a truly differentiated ultra-convenient mobile banking user experience. This will deepen relationships with customers, allowing banks to cross-sell risk-based and liability products. See sidebar A for specificways that individual banks can capture value by embracing the mobile opportunity.

- **Banking industry.** It would seem reasonable to suppose that the banking industry per se will be able to generate value from the new revenue sources (new products, new customers) by charging for mobile's greater convenience and by lowering costs. However, so far new revenues have been largely captured by non-banks, most players have yet to reflect the convenience of mobile in their pricing, and the experience of many has been that the mobile channel is an extra cost rather than a cost reduction opportunity. Moreover, the risk of price erosion should not be overlooked as non-banks start to home in on core banking services, competition intensifies and transparency becomes greater. For example, telcos may offer some financial services without charge to try to slow down customer 'churn', or search engine providers may provide free financial services to encourage lucrative mobile advertising. Overall, we believe the value creation opportunity for the banking industry is neutral at best.

- **The wider 'mobile' industry.** Looked at from a broader industry perspective the emergence of mobile is already value creating for a range of non-banks such as telco providers, handset producers, and online pioneers. These players are able among other things to generate more data traffic, create new services and apps, provide marketing services, and offer social networking. Banks may want to tap into these new sources of value or at least find partners that will give them a slice of the action.

Sidebar A – The mobile opportunity – where is the value for banks?

Ultra-convenient and innovative banking

- *Increasing satisfaction and loyalty, reducing churn via a distinctive 'must-have' customer proposition that deepens banks' relationships with their customers*
- *Creating a new mobile "home" portal, driving usage and enabling targeted marketing offers, cross-selling core banking risk and deposit products*
- *Increasing uptake of savings, protection and investment products by integrating on-the-go personal financial management features*
- *Providing advice-based sales via mobile video-conference in response to users' request for help when on the move*
- *Pricing for the convenience inherent in the mobile proposition*

Digital commerce

- *Generating a disproportionate share of leads through mobile apps, for example by offering instant POS financing for small loans at users' request and through in store proactive offers*
- *Accessing new revenues by introducing completely different 'third-party' propositions, for example:*
  - *providing partners with back-end payments infrastructure and services for a fee so as to offer customers the convenience of digital wallets*
  - *leveraging data to facilitate context-sensitive merchant offers*
  - *capturing share of increased digital payments volume*

Disrupting new markets

- *Rapidly growing market share with a disruptive proposition and a much lower cost operating model versus incumbents*
- *Attracting new customers by, say, partnering with a telco and leveraging its distribution presence to activate new mobile banking accounts*
- *Increasing the size of the banking market with a proposition that allows the un- and under-banked access to transaction banking, savings and credit products*

Shaping, leading, following – the choice is yours

In our recent discussions with banks we observe that the lack of strategic direction and decisiveness is often the result of a failure to answer basic questions. What, for instance, is our overall vision for mobile? What do we really believe to be the impact of mobile banking and the speed with which it will affect our business? Should we treat mobile as stand-alone, or as an integrated part of the multichannel proposition, and how aggressively should we move?

Answering these questions can help set the strategic direction and enable banks to decide if they want to act as shapers, leaders or followers (exhibit 5):

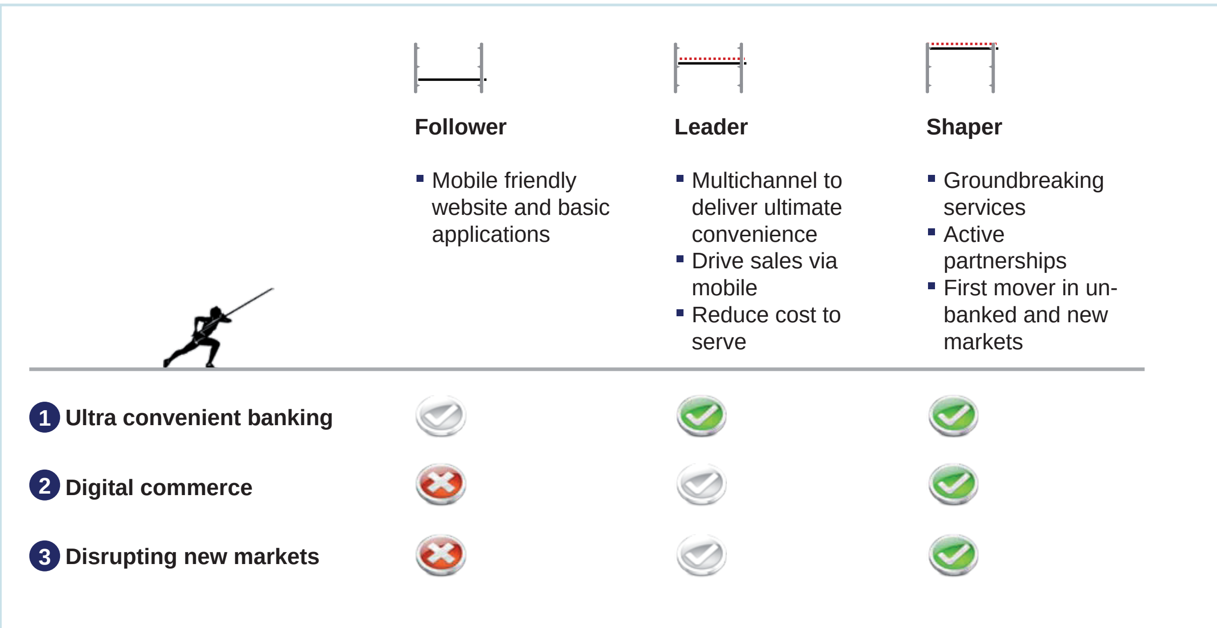
- **Shaper.** Taking the role of market shaper means aggressively pursuing the three opportunities that mobile banking creates. This includes being first mover in new territories (for say the unbanked), as well as pursuing partnerships that break new ground in banking and beyond.
- **Leader.** Acting as leader requires the use of multiple channels, including mobile, to deliver the ultimate in convenience and experience for the customer. It also requires banks to make a net reduction of total costs to improve cost competitiveness.
- **Follower.** The role of followership still requires banks to develop user-friendly mobile websites and basic applications in line with market standards. Banks need to be clear on their future market position and value proposition rather than adopting a wait-and-see strategy, which runs the risk of gradually leaking market share to leaders and shapers.

In order to decide whether they are best placed to be a shaper, leader or follower, and how decisively to act versus competitors, we have seen banks consider a range of criteria:

- Existing internal channel and data capabilities – banks that have developed an integrated

Exhibit 5

Majority of banks pursue a 'follower' strategy, thereby inviting competition



multi-channel management approach using advanced CRM techniques are better positioned to leverage mobile. A bank without such capabilities may struggle to rapidly lead or shape the mobile opportunity.

- Existing customer (retail and acquirer) footprint – banks will be better positioned to shape the digital commerce landscape if they have a broad range of relationships with retail customers and merchants. Similarly, a bank with a sub-scale branch network in either developed or developing markets has a great opportunity to shape or lead a digital banking proposition based on mobile. This is because the cost of transforming its existing channels is lower.

- Existing partnerships and relationships –banks that start off with established relationships in place – with, for example, telcos, cloud service providers and merchants – are more likely to rapidly establish a winning position in the new banking landscape.

- Management appetite – some strategic postures will be conditional on the willingness of bank management teams to accept the risks inherent in innovation and experimentation. Not all will be successful.

- Exposure to attackers – The extent to which bank managements feel their core franchise may be vulnerable to attackers such as telcos and retailers in their home market will influence the speed of their response.

Once banks have decided on their overall positioning and level of aggression, what concrete actions should they take to integrate mobile banking into their strategies and business plans? We see a number of issues that shapers, leaders, and followers must address in pursuit of maximizing their bottom-line impact. (exhibit 6):

- **Mobile vision.** Few banks currently look beyond the online version of traditional banking. Creating

Exhibit 6

Banks to capture the mobile opportunity in several ways

Example components of mobile banking strategy

		Follower	Leader	Shaper
Mobile vision	Medium term plan for groundbreaking products and services	○	●	●
Partnership model	Adaptable framework that allows rapid inclusion (and exclusion) of external parties	○	●	●
Payments gameplan	How to benefit from the shifting and increasingly complex eco system for payments and transfers	○	●	●
Low cost attacker	Anti-incumbent strategy built on remote channels only (mobile and internet)	○	●	●
Multichannel strategy	'Optimal' solution of which products & services to offer in which channel to whom	●	●	●
Mobile governance	Organization and processes that ensure end-to-end efficiency and coordination versus the customer	●	●	○
Net-cost down	Cost reduction plan to avoid mobile being an 'extra' cost instead of efficiency measure	●	●	○
Mobile basics	Near term plan for basic but competitive mobile offering for the local market	●	○	○

a mobile vision will help guide the development of groundbreaking products and services and provide the lens through which to measure market leadership. The vision should include a tangible section on products and services even if the technology or the customer demand to support it is yet to materialize

- **Partnership model.** The banking industry has confronted technological change in the past by turning to external providers, for example vendors of IT services. What's different about mobile banking is the pace of innovation. Successful players need a flexible framework that can quickly accommodate external parties as providers of services and products or joint venture partners.

- **Payments 'gameplan'.** One of the biggest mobile banking opportunities is in payments. The winners and losers in this area have yet to emerge so the benefits of taking a leading position in the transformation of the payments and transfers landscape are likely to be considerable.

- **Low cost attackers.** The advent of mobile banking allows banks to shift two gears in the low-cost game – one in emerging and one in mature markets. In emerging markets the low-cost model opens up an opportunity rapidly to capture a significant share of the unbanked population. In more mature markets, the combination of mobile and internet represents a highly competitive alternative to traditional banks lumbered with the cost burden of a branch network

- **Multichannel strategy.** Multichannel strategy has been a central part of banks' thinking for some time, even if few yet have a clear plan to match products and services to particular channels and who they should be aimed at. Either way, the advent of mobile banking requires banks to reconsider the best ways to serve their customers and to find the most appropriate channels.

- **Mobile governance.** The addition of a mobile channel will force many banks to sort out the governance and co-ordination challenge of multichannel once and for all. Any mobile effort will require a carefully devised organizational response and the setting-up of internal procedures.

- **Net-cost down.** To date, mobile banking has brought additional costs despite a lower cost for each transaction. Mobile's efficiency as far as the customer is concerned is unquestioned, but banks need must work to ensure that it brings lower overall costs at the same time as maintaining or improving customer satisfaction.

Mobile banking is revolutionizing the customer experience in banking, with non-bank organizations often leading the way. Banks recognize this development, but admit they are not acting or investing accordingly. The mobile device creates distinct areas of opportunity but the economic benefit to the industry as a whole will be limited and the banks that gain most will be those that act quickly and decisively.

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