

The new digital tipping point



Traditional banking is facing its steepest challenge in over a generation. We believe that a new tipping point has been reached, with digital at its fulcrum.



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Introduction: Driving customer value through digital

We are in an unprecedented period of increasing regulation and continuing cost pressures for banks. This is being compounded by the persistent trend in margin compression and alarming market uncertainty.

The emergence of new technologies into banking has had a permanent impact, as once traditional banking revenue pools are now being sucked up by new competitors, especially in the payments' space. All of this is happening at a time when customer expectations for banking services (both offline and online) are being reset by the experiences being provided by retailers and online providers, elsewhere.

Finally, to this long list add the general lack of trust customers have in financial services – owing to the credit crunch – and the general perception that the major banks all contributed to the global market collapse. We can quickly conclude that traditional banking is facing its steepest challenge in over a generation. We believe that a new tipping point has been reached, with digital at its fulcrum.



Towards a customer-centric value model in banking

Before the financial crisis, banks relied heavily on financial leverage to create shareholder value. Today, the economic climate, increased regulatory intervention and competitive challenges are forcing banks to deleverage and look for other sources of value. In the 'new reality' since the crisis hit, a new value model is required, based upon securing customer relationship primacy (the position of being the preferred and main bank for a customer), through efforts to regain trust and build customer engagement.

Preference for digital is now globally pervasive among banking customers

Digital will play an instrumental role in achieving this strategy. The preference for digital is now pervasive across all customer segments, globally, and especially so for Generation Y (the definition varies widely, but broadly, it refers to those people born in the 1980s and 1990s). In fact, for this group, now at the threshold of deciding primary banking relationships, the quality of the digital offering is an important factor in their decision process. Banks have a real imperative to act now to attract these customers and thereby lock in future value. Banks' digital strategies will need to move beyond cost reduction objectives to do this.

'Digital' has evolved from basic online banking to a broad, rich set of capabilities...

The full extent of what digital can offer customers goes beyond the basic mobile and internet banking services that are now widely provided, although there is still value to be obtained for many banks from simply delivering these basic services well. Digital banking will evolve into a richer set of offerings, providing new value for banks and their customers through a new 'digital feature set', based on innovations in: user experience; mobile devices and networks; social media and collaboration; customer analytics; and channel integration. By embracing digital, banks can deepen their existing customer relationships as well as access new sources of revenue.

...now disrupting and catalysing change in the banking ecosystem

Digital has also opened up banking to a number of innovators – big and small – seeking to capture value across the banking value chain. In markets where banking is widely accessible, we believe that while these new entrants will secure a place as part of the banking ecosystem, there is little evidence to suggest that they will be successful in taking over the entire customer relationship from banks. Despite challenges to this position, banks remain the most trusted providers of banking services by customers. In growing markets where the under-banked population is sizeable, the threat of being out-competed by new entrants could potentially be greater.

Provides a platform for innovation

Mobile is coming of age and is moving beyond simple banking functionality to embrace mobile payments and other innovative offerings such as marketing services, sophisticated authentication mechanisms, location-based personalisation, etc. These innovative services serve to create a superior customer experience, one that the customer is willing to pay for.

Strategic partnerships will pave the way to success for banks

We believe that banks should acquire or partner with innovators that are acting as catalysts for change. The alternative for those banks that accept the need to change is to develop these capabilities alone – an expensive and risky effort.

Traditionally, banks have preferred a 'build' approach for most changes. However, we believe that in this scenario, a 'buy' or 'partner' strategy would be more optimal as this change requires a new way of thinking and building that is difficult for competitors to copy.

We believe that the real battle will take place between banks, as they seek to secure primacy of the customer relationship as the basis of future shareholder value. Many banks, however, may react late or continue to persist with old ways and methods and as a result, lose market share in the changing banking landscape.

Customer relationship primacy is the new source of value in banking

Banks need to focus their strategies on a customer relationship primacy model, by regaining trust and building engagement with the customer. In the ‘new reality’ of banking, financial engineering is no longer sufficient to create value and banks need to look at demonstrating customer value to remain relevant in the market.

A number of things have driven this change in banking including increased regulation, the erosion of public trust with a series of high-profile banking failures, the collapse of liquidity in the market, increased capital requirements and a reduced risk appetite among customers. All these have contributed to a difficult environment for banks to operate in.

In developed markets, growth in banking is flat or shrinking. The shift from assets to liabilities, though preferred for funding, is resulting in lower average margins for banks. In these markets, the only way for banks to maintain and grow value is to pursue a displacement strategy against other banks and increase their share of wallet with the customer. Our research revealed that a vast majority of customers preferred to purchase additional financial service products from

their primary banking provider rather than any other source (see Figure 1). This underscores the importance of achieving primacy in a relationship, as it leads to a greater share of wallet for banks.

Although retail banking has benefited from high levels of consumer inertia in the past, there is now a concerted effort from regulators around the world to make the process of switching banks easier.¹ Evidence from other industries such as utilities and insurance suggests that this will lead to an increase in the level of switching within banking. These industries are typically more regulated and banks can learn from these as they grapple with similar challenges.

Banks can proactively address this more by using digital to deepen their existing relationship with customers and gaining primacy.

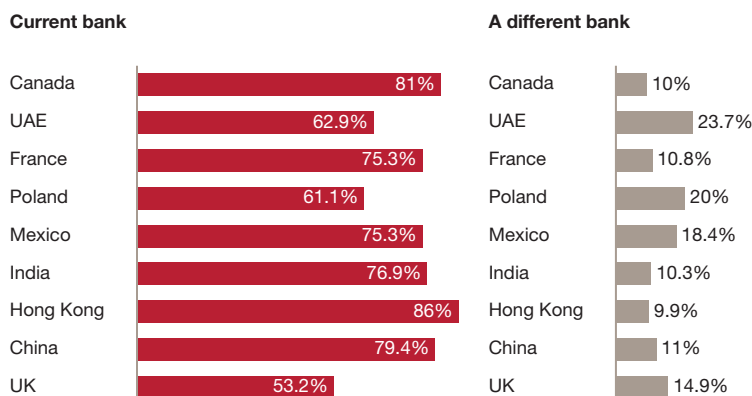
Furthermore, the wide availability of information about financial products propagated over the internet has helped expose the gap between price and value for banking products to consumers and regulators. This has undermined traditional pricing strategies, forcing banks to demonstrate intrinsic value to their customers.

PwC² conducted research with almost 3,000 banking customers from a range of segments across markets to discover their expectations of banking in the digital age. We selected both emerging and developing markets including China, India, Mexico and the UAE, as well as developed markets like the UK, Canada, France and Poland.

Our research revealed that there is a very high correlation between digital engagement and share of wallet for a customer and that digitally active customers tended to have the largest product holdings. We also found that primacy in a banking relationship drives increased share of wallet leading to higher revenue generation from the customer pool.

Figure 1: Primacy drives share of wallet

“If you were going to purchase a new banking product, how likely are you to buy from the following?”



Source: PwC Digital Tipping Point Survey 2011

% of respondents that chose current banking provider or another banking provider in response to the question. Other options included a provider that is not a bank but has a physical presence (e.g. a supermarket chain) and an online provider.

1 Independent Commission on Banking, Final Report Recommendations, September 2011, UK

2 In this document, “PwC” refers to PricewaterhouseCoopers LLP (a limited liability partnership in the United Kingdom), which is a member firm of PricewaterhouseCoopers International Limited, each member firm of which is a separate legal entity






Digital is crucial in addressing changing customer behaviour

Today, a successful digital offering in banking implies the provision of high quality online and mobile banking access. We find that the new digital feature set can be used to meet the increasing demands of the customer.

There are four main considerations for a bank to invest in a robust digital offering:

- 1) A number of factors are changing customers' attitudes and behaviours.
- 2) Preference for digital is globally pervasive.
- 3) Generation Y, who are now at the point of choosing their primary financial services provider, cite digital as an important factor in this decision.
- 4) Digital itself, is evolving: the new set of disruptive features of the latest round of digital innovation is proof enough.

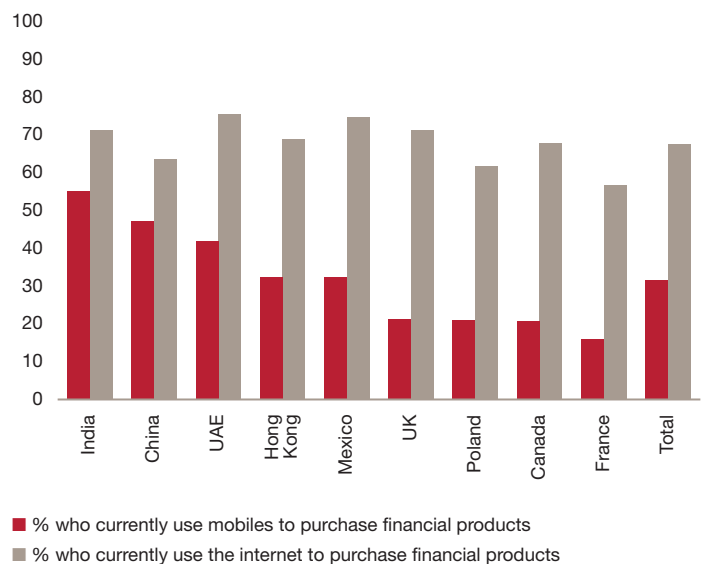
We believe that there are five key aspects of changing customer behaviour

Customers...				
...expect more	...trust their peers	...are informed	...have choices	...have a voice
				
Expectations are being shaped by experiences outside of the banking industry where content, interactions and features are richer, delivering a more engaging and rewarding experience for the consumer.	The role of banks as the financial expert has been replaced by 'word of mouth' peer conversations, or independent influencers. The rapid emergence of social media in parallel with the rise of mobility has seen customers increasingly turn to their peers for information and advice, rather than to financial experts in banks.	Financial consumers are more savvy today, due to the easy access to research, data and 'expert' views. This has also exposed the lack of differentiation between different providers' banking products. As more financial services customers become 'self-directed', they are coming to rely less upon traditional sources of financial advice.	Comparison and purchase of alternative financial products and services online is now straightforward and widespread. It has opened up a wide range of choices for consumers, some outside the boundaries of traditional banking services, such as peer-to-peer lending.	The rise of social media platforms has allowed a single consumer voice to be amplified to a tremendous degree, and consumers have not been shy about raising it. Stories of bad customer experiences rapidly spread through these media and often cause irreparable damage to associated brands.

The growth of mobile has significant implications for banks. As mobile phones get equipped with more and better functionality, it will transform the traditional interaction model with the consumer. Well-appointed branches and slick websites will no longer be enough, as customers expect services on the move. Location-based offers, timely and relevant content, and interactive applications will form the basis of the mobile customer's engagement with their banks.

In banking, the internet is now widely used by all segments around the world to purchase financial services products. Mobile banking is still in its infancy, but is following a similar usage curve with China, India and the UAE leading the trend in terms of adoption. For the emerging markets, mobile is more than just a new channel, as it provides basic banking facilities to a previously under-banked market.

Figure 2: The global usage of internet and mobile usage in banking



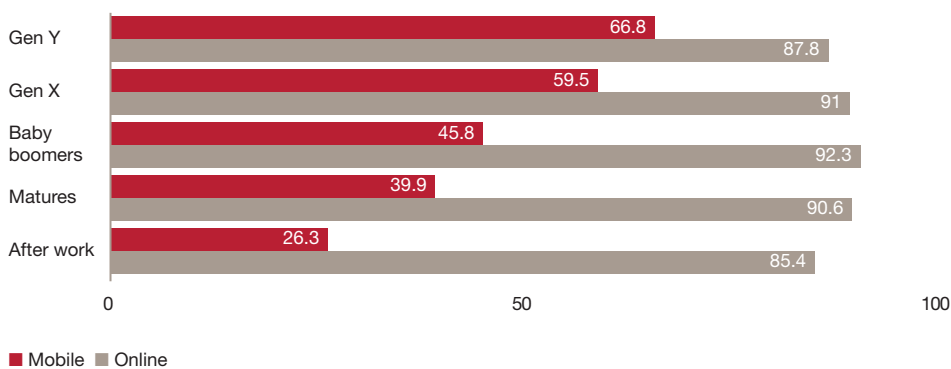
While the preference for digital can be seen across all segments and markets (see Figure 2), it is especially important for those customers who form part of Generation Y, now at the point of choosing their main banking provider.

Consequently, banks need to target and acquire these customers now to lock in the future value that will be generated by this segment. Our research suggests that the extent to which a bank exploits the new digital feature set will play a very important part in this customer group's decision-making process, much more so than traditionally important criteria such as branch location, or even brand.



Generation Y, or ‘digital natives’ as they are sometimes referred to, naturally expect a rich digital experience that is both mobile and social, and seamlessly integrates their banking needs with their digital lives. This group represents a highly important customer segment for banks, as they are starting to reach the peak age of financial consumption and will be an important source of value for banks.

Figure 3: Online and mobile are preferred channels, particularly for Generation Y customers



Combined proportion of respondents who are 'currently using' or 'considering using' online or mobile banking services

Source: PwC Digital Tipping Point Survey 2011

As Generation Y ‘grows up’ with digital, it will be more important for banks to match their digital expectations.

The propensity of Generation Y to use mobile channels was higher than any other consumer segment. Sixty-seven percent of respondents in this segment said that they were either currently using or considering using, the mobile channel. This number progressively decreases for older customers.

The new digital feature set has led to:

- Improvements in **user-experience design through interactive, game-like interfaces** that are starting to merge the boundaries between the real and the virtual, and bringing data to life through rich visualisations.
- Advances in **mobile devices and networks**, providing new services such as enhanced digital security and the ability to access the internet from anywhere (partially limited by high international roaming charges).
- The rise of **social media and collaboration tools**, empowering customers and employees, and moving control of the 'brand message' from businesses to consumers.
- Innovation in **digital analytics and predictive models**, driving deeper insight into customers' behaviour and enabling highly targeted and relevant treatment strategies to be executed through digital media.
- New **channel integration** technologies, enabling a more seamless end-to-end experience for customers with their bank.



The new digital 'feature set' will increasingly be exploited to provide a much richer set of banking offerings for the customer. The impact of these digital innovations on banks goes beyond their technology, security and infrastructure capabilities: it is opening up new business models and propositions, redefining the customer experience, and enabling new potential from employees and business networks.



easyJet, a British low-cost airline, became the first in the UK to launch an e-commerce website in 1998, marketing itself as 'the web's favourite airline'.

As easyJet redefined the market, the rest of the industry including traditional leaders like BA had to follow suit or risk being left behind. By 2005, BA had stopped paying commission to travel agents, previously its main channel to market, as ba.com took over that mantle. Today, almost two-thirds of BA's sales are made through ba.com.

As consumers gravitated towards ba.com, it provided the airline with both the means and the opportunity to develop new propositions for customers in a virtuous circle of innovation. The launch of new digital services, e-ticketing, online check-in and mobile boarding cards were all built on the success of the channel shift to ba.com. This channel shift has not only sparked the redesign of the end-to-end traveller experience, but has inspired BA to design new digital services for which some customers will pay, such as priority seat booking more than 24 hours in advance of departure (BA charge from £25 for economy passengers to choose seats if it's more than 24 hours before the flight; for exit row seats, this charge is £50).³

The implication for banks is that as business models are transformed by the shift to digital channels, it opens up new opportunities for engaging and interacting with customers to build relationships and grow revenues. For banks that manage to engender a similar shift in their own distribution models, similar opportunities await.

Customers value new digital offerings

Not only does digital deepen levels of customer engagement, it also opens up avenues for the monetisation of new services. In our research, PwC tested the level of interest in a number of theoretical digital capabilities.

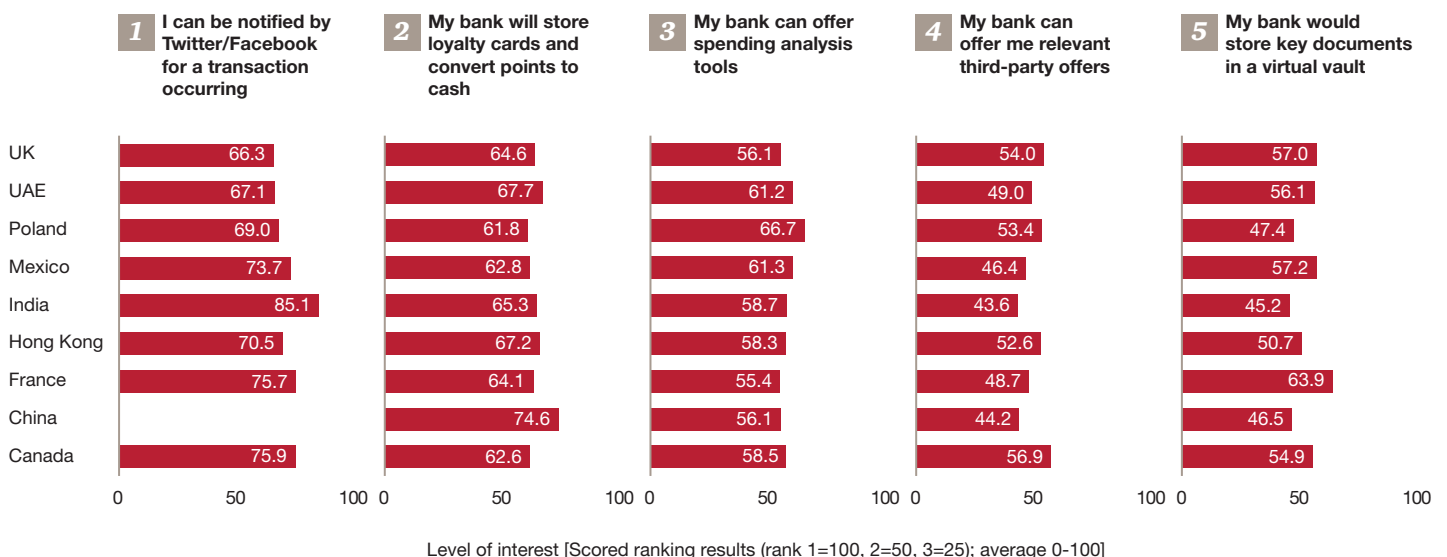
As part of our survey, we tested the willingness of customers to pay for some innovative digital capabilities such as a digital wallet for loyalty cards, notifications through social media, spending analysis tools, third-party offers and storing documents in a virtual vault (see Figure 4).

In all markets, social media notifications (except China), an electronic wallet for loyalty cards and financial tools were rated among the top three from this list.

Our research indicated that across different regions a base price can be charged for these digital capabilities, in the range of GBP2–10/month for each capability. At a time when banks are finding it difficult to sustain revenue and margin growth, the fact that customers appear prepared to pay for the perceived value of using digital services that offer new value to customers, is significant.

Figure 4: Appetite for innovative digital services

'Which of the following would you be willing to pay for, please rank your top 3?'

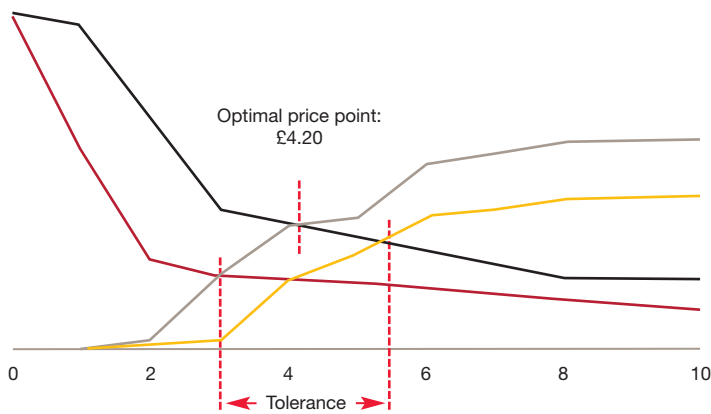


Source: PwC Digital Tipping Point Survey 2011

Figure 5: Customer willing to pay

UK willingness to pay

Sample proposition – My bank will store loyalty cards and convert points to cash



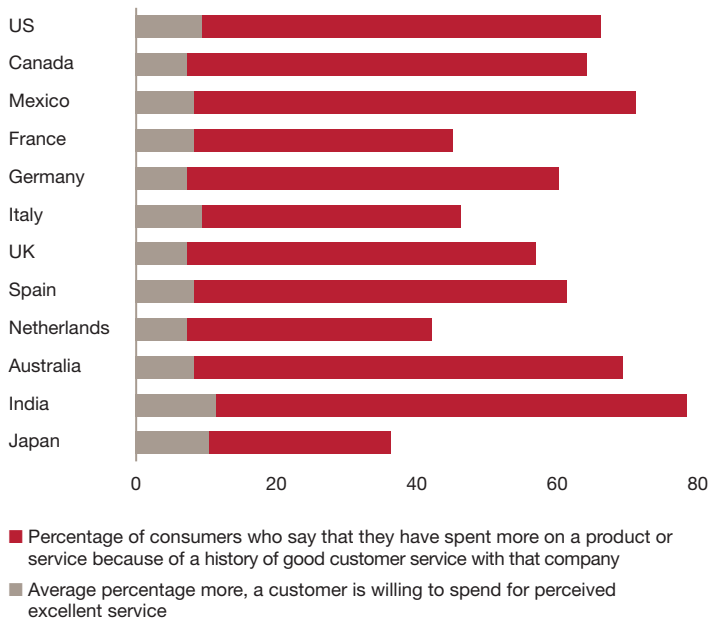
Point of marginal cheapness: £3 Point of marginal expensiveness: £5.40

— Too Inexpensive — Inexpensive — Expensive — Too expensive

Source: PwC Digital Tipping Point Survey 2011
PwC Van Westerland pricing analysis

The percentage of respondents who suggested that they would be willing to pay for loyalty services provided by a bank in the UK was 65%. They suggested they would be willing to pay an optimal price of £4.20 per month for this service. This would translate into an annual fee income of approximately £50 per customer.

Figure 6: Consumers will pay more for good service



Source: American Express Global Customer Service Barometer 2010

Research (see Figure 6) has shown that across markets in the world, customers demonstrate a willingness to pay a premium for products or services from companies who have offered them good customer service in the past.

This translates to a higher willingness to pay for perceived excellence of between 5% and 10% more for products and services, highlighting the value for customers and companies when they get this right.

Considering the likely uptake of digital, especially among younger, affluent customers, there is a real opportunity to enhance ROI by investing in digital capabilities that drive additional value and better service for customers.

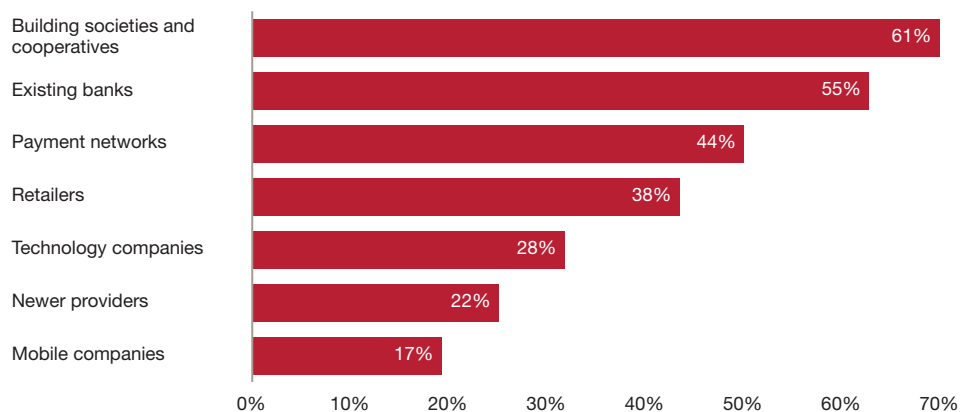
New digital entrants are disrupting the banking ecosystem

There are several new entrants competing for inclusion in the banking value chain and we believe that a number of these will be successful in securing their position as part of the banking ecosystem. Our research suggests, however, that these are unlikely to displace banks as the primary provider of financial services, especially in markets where banking is widely accessible.

Customers across all groups continue to put their trust in banks (see Figure 7) to manage their financial affairs, despite their continuing relative unpopularity. When asked about who they would trust with their current accounts, customers still prefer banks to any other financial services provider. We do believe, however, that despite this, innovative challengers will continue to act as catalysts of change in banking. Banks should look for strategic acquisitions, or partnerships with these firms to secure their long-term positions in the battle against other banks for customer relationship primacy.

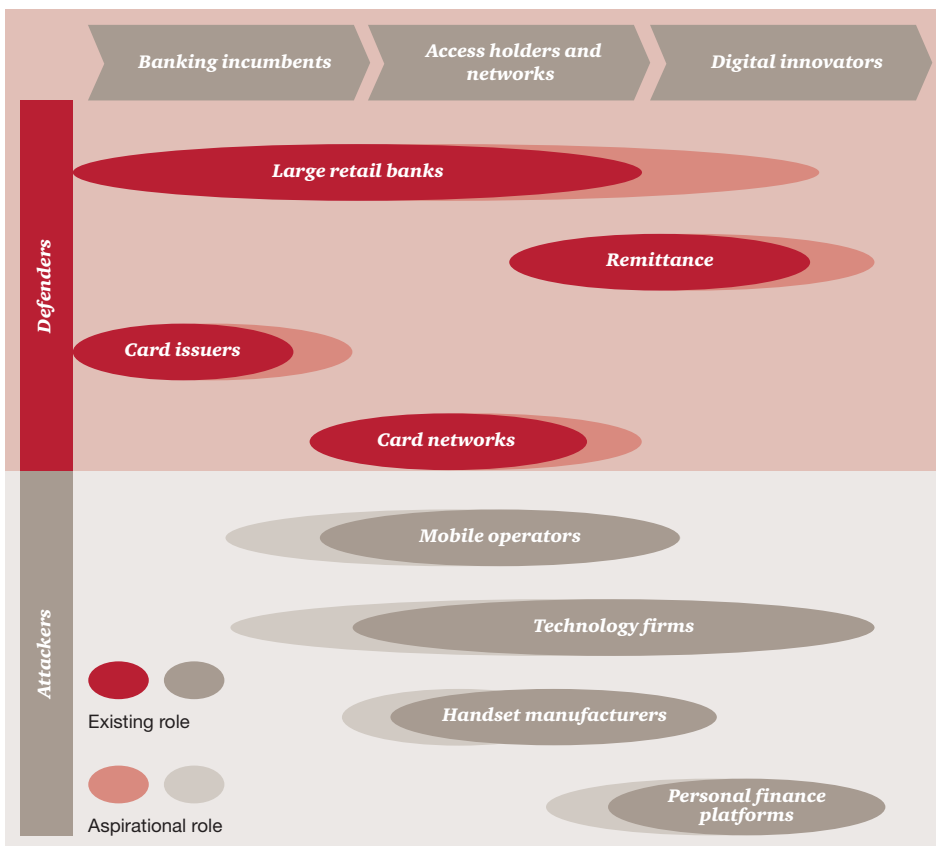
Figure 7: UK 'trust' in current account providers

Percentage of respondents who chose trust absolutely, or trust somewhat when asked about the extent to which they trusted these providers with their current account



Source: PwC survey

Figure 8: The emerging challenge to the banking ecosystem



Source: Company websites, press releases and annual reports, PwC analysis

We have analysed the banking ecosystem and identified that there are both ‘defenders’ and ‘attackers’ in the market.

‘Defenders’ are market incumbents that have traditionally controlled their own segments in the banking value chain. While almost all of them aspire to move into the digital innovator space, few are equipped to do so without external help (through acquisition or partnerships).

‘Attackers’ are new entrants who are trying to wrest share away from the incumbents by intermediating themselves into the value chain. These include established players in technology and mobile as well as smaller and more nimble start-ups. We believe that while these players may be able to secure positions on the value chain, they will be unlikely to displace banks as the primary provider of financial services



Incumbents in emerging markets that have a large share of unbanked, or under-banked consumers are likely to experience a greater threat from new players. Here too, a strategic partnership between a bank and an innovator has the best chance of creating the winning combination to acquire and retain new customers, assuming banks act. However, it must be acknowledged that a game-changing innovation by a pure play provider (e.g. in growing or emerging areas such as mobile payments or digital wallets) may also prove successful, especially if banks fail to act.

The battle for customer relationship primacy among banks has begun

With the battle lines being redrawn amongst banks, the winning bank should focus on taking steps to develop deeper relationships with their customers. Focusing on gaining trust, building engagement and creating value for the consumer should be the guiding principles for doing this.

We believe the most important elements in getting started are:

Develop a vision and strategy:

Acknowledge that the new digital feature set is changing the way consumers interact with their banks. Understanding the different needs of different customer groups is essential, as a one-size approach will prove insufficient to meet the range of needs of customers. Developing a vision and a digital strategy – with the customer at its heart – is the first step towards succeeding on this journey.

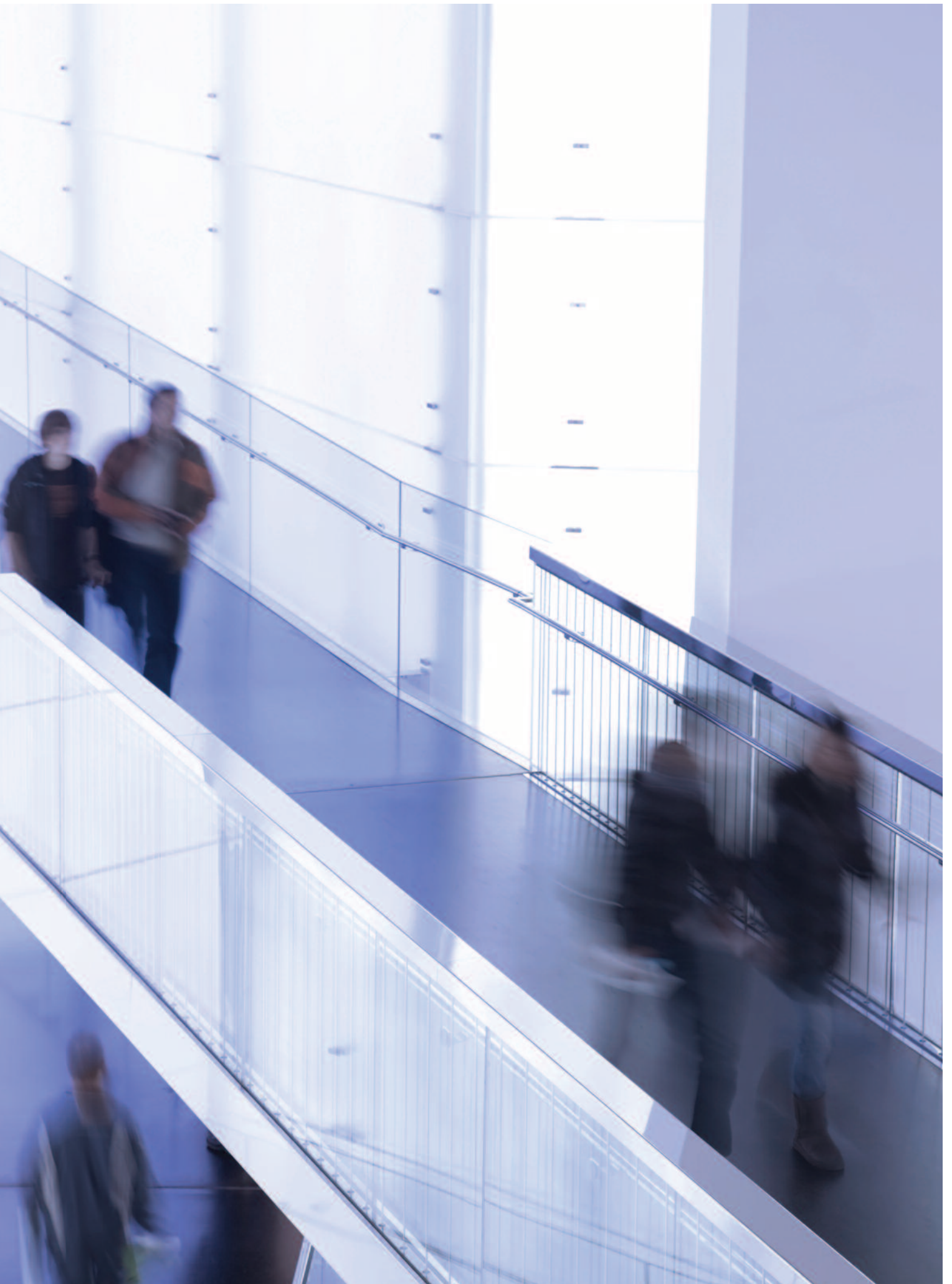
Be prepared to partner: Banking will necessarily become increasingly intertwined with customers' digital lives. New business models and means of interaction will be required in order to be successful in this changing business context. In most cases, it will prove more effective to work successfully with innovators from technology, telecommunications and other non-traditional banking providers, than to go at it alone. Identifying partners to acquire or help deliver the vision becomes of critical importance.

Achieve first-mover advantage, or become a high-quality fast follower:

Given the benefits that digital can bring – both for existing customers as well as Generation Y – banks need to act now to avoid being displaced. While many banks have traditionally copied their competitors, this strategy may not be suitable for this scenario as first movers will have tied up the most innovative partners and banks will find it expensive to replicate these capabilities in house.

Banks face the dilemma of having to choose one of two available paths open to them: whether to stay with traditional banking models that have served banks well until now, or embrace change and serve the customer in a way that the customer wants.

We believe that the perfect storm banks are facing today will produce some clear winners. The victors will be those that recognise the changing ecosystem and set out a clear digital vision for securing customer relationship primacy. Others will see the challenging environment of today as a distraction at best and continue persistently with old ways and methods, eroding value in the process by disengaging the customers.



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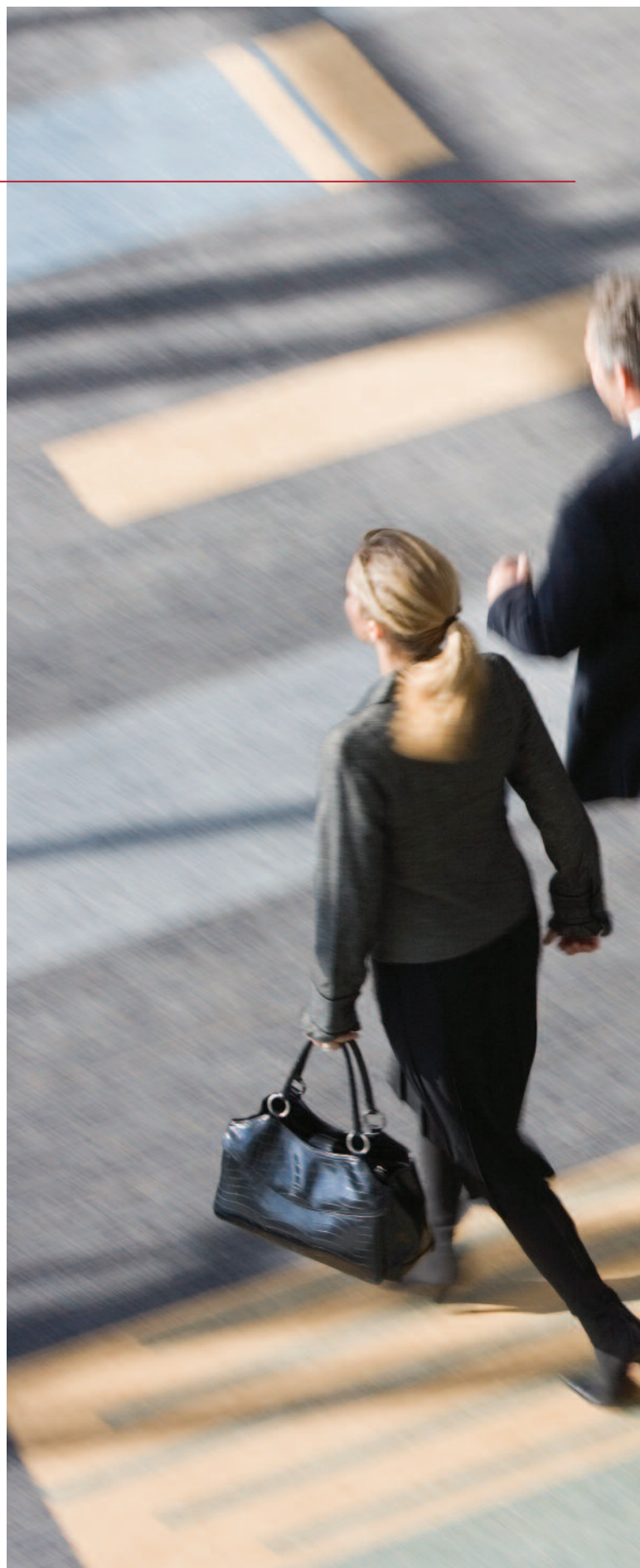


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