2011: Positioning for Future Competitiveness in Retail Banking:
"Save To Invest" and "Invest To Win"

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Introduction

The global macroeconomic situation has presented the financial services (FS) industry with a myriad of challenges over the last few years. As the industry prepares to enter 2011, the financial services landscape will continue to pose many interesting challenges to FS players. As a result, most banks are reviewing the strategy they should adopt to ensure future competitiveness.

Based on work with multiple banks around the globe, the Cisco Internet Business Solutions Group (IBSG) believes that future success will require a balanced strategy: continuing to improve organizational productivity in an effort to cut costs and drive better internal collaboration, while (in parallel) identifying key growth areas for investment to create competitive differentiation.

In short, a successful retail banking strategy will require a healthy balance between both "Save To Invest" and "Invest To Win."

Megatrends Affecting Global Financial Services

Three megatrends are driving the need for retail banking transformation:

1. **Regulation:** increased regulation of the financial system
2. **Generational shifts:** banks need to address each customer segment with a targeted strategy
3. **"Consumer in control":** increasingly, consumers are taking control of actively managing their financial futures, enabled by the rapid development of technology

1. Financial Regulation

Regulation of the financial industry has increased significantly as a result of the recent financial crisis. Credit Suisse estimated that, on average, new regulations could cause a 6 percent decrease in the earnings of large global banks. Banks with a significant share of their business in capital markets and investment banking are primarily affected by the Volcker Rule and the FDIC Assessment, and will suffer the most severe earnings impact—decreases of 17 percent to 19 percent. Banks with a large share of their business in retail banking are primarily affected by the Card Act and Overdraft, which will cause decreases of between 1 percent and 9 percent to their bottom lines (see Figure 1).[1]

These new regulations will put pressure on banks not only to improve productivity, but also to find new sources of growth so that they can fill this profitability gap and ultimately satisfy their shareholders.

Figure 1. Regulation Is Changing the Game in Banking

U.S. Large-Cap Banks & Brokers: Estimated Earnings Impact from Financial Regulatory Reform Provisions

Company Name	Estimated 2012 Earnings Impact							Est. Incremental Impact (Note 1)
	CARD Act	Overdraft	Est. Debit Interchange	Volcker Rule	Derivatives Reform	FDIC Assessment	Bank Tax	
Bank of America Corp.	-4%	-5%	-1%	-2%	-1%	-1%	-2%	-6%
Bank of New York Mellon	NA	NA	NA	NA	NA	NA	-1%	-1%
Citigroup Inc.	-2%	-1%	0%	-1%	-3%	-1%	-4%	-9%
Goldman Sachs Group, Inc.	NA	NA	NA	-9%	-3%	-4%	-3%	-19%
JPMorgan Chase & Co.	-3%	-2%	-1%	-2%	-2%	-1%	-2%	-7%
Morgan Stanley	NA	NA	NA	-5%	-2%	-6%	-4%	-17%
Northern Trust Corporation	NA	NA	NA	NA	NA	NA	-2%	-2%
PNC Financial Services	-2%	-7%	-1%	0%	NA	NA	-1%	-2%
State Street Corporation	NA	NA	NA	NA	NA	NA	-2%	-2%
U.S. Bancorp	-3%	-5%	-1%	NA	NA	NA	-1%	-2%
Wells Fargo & Company	-1%	-3%	-1%	0%	0%	NA	-1%	-2%
Average	-2%	-4%	-1%	-3%	-2%	-2%	-2%	-6%

Sources: Credit Suisse, July 2010; Cisco IBSG Economics, June 2010

2. Generational Shifts

A new generation of 18- to 30-year-old consumers, often referred to as Generation Y, is becoming increasingly important in the marketplace. This generation was brought up with Internet, social media, video, and interactive games, and expects banks to use these tools in customer interactions. In 10 years, Gen Y will replace baby boomers as the largest consumer segment in the United States.

Capturing and satisfying the interests of Gen Y requires an entirely new approach to banking. Cisco IBSG recently conducted a detailed survey pertaining to the financial services needs of this segment, and the results are fascinating.[2]

Gen Y consumers are worried about their financial futures, and 37 percent say they need detailed financial-planning advice. More than any other age group, Gen Y wants a trusted bank to be the provider of this information. In addition, 25 percent say they would change banks in order to receive services tailored to their needs.

At the other end of the age spectrum, baby boomers (46- to 64-year-olds) are also deeply concerned about their financial futures; 61 percent fear they will outlive their money, and 35 percent feel "totally unprepared" for the financial situation they will face when they retire.[3] This segment wants help in defining and implementing a strategy for "aging well." Banks that differentiate themselves as providers of this financial stability will be well positioned to grow by serving the needs of this segment.

3. Consumers in Control

Consumers now have the opportunity to take control of their financial development, largely due to rapid technology advances since the Internet went "commercial" less then 15 years ago. By 2014, there will be more than 400 million mobile banking customers globally.[4] Technology development creates both threats and opportunities for banks.

Through technology, it is easier for customers to compare both the performance and prices of different banking services. For example, Bankrate.com enables customers to compare banks online and now has 6.5 million unique customers per month. MoneyAisle conducts auctions where banks compete for loans, while new entrants like Mint.com are providing alternative personal financial management tools. Traditional banks will need to counteract these emerging threats.

At the same time, technology development creates tremendous opportunities for banks to offer new services to customers. Examples include the USAA approach to self-service; an iPhone app that allows Chase customers to take pictures of endorsed checks and submit them for deposit electronically; and new cross-sell/up-sell opportunities such as MasterCard's "Overwhelming Offer," where customers receive customized deals over their mobile phones.[5]

The race to capture customers in new and increasingly creative ways—enabled by technology—has only started.

Macroeconomic Situation Creates "Burning Platform" for Action

The current, unstable macroeconomic environment is creating a burning platform for banks to take action and adapt to the key financial services megatrends.

The threat of a double-dip recession is increasing for both the United States and Europe. In addition, GDP growth in the United States and Europe is predicted to remain slow. Although estimates are continually refined, GDP growth in the Western world is expected to range from 1 percent to 3 percent over the next two years. By comparison, China's GDP is expected to grow by approximately 9 percent over this same time frame, while GDP growth in other parts of the developing world is estimated at about 5 percent.[6]

Unemployment rates continue to hover around 10 percent in the United States and Europe, a situation complicated by the likelihood that governments will not be able to afford continued stimulus funding. The "Great Recession" has increased "structural unemployment"—in other words, the unemployment "equilibrium rate"—in the United States by 1 percent to 1.75 percent. (This would imply a structural unemployment rate of 6.5 percent in the United States.)[7]

In addition, many consumers are currently stuck in a "debt trap," with household-debt-to-income ratios of 121.7 percent in the United States and more than 120 percent in countries like the United Kingdom, Canada, and Japan. Economists typically claim that consumer debt-to-income ratios must be closer to 100 percent for consumers to truly start spending again.

Banks remain under intense pressure from the financial crisis. Write-downs have reached $2.3 trillion globally (approximately two-thirds of these occurred by the end of 2009). Payments, a traditional "cash cow" for banks, are in transformation, with the traditional credit card business expected to contract by 10 percent to 15 percent. Regulations will limit interchange fees when conducting payments, with an estimated earnings impact of -2 percent for banks. Mobile payments have yet to take off, but the potential is significant and new entrants are starting to explore new mobile-payment business models. After a period of consolidation and megamergers, the main focus for banks will be on organic growth for years to come.[8]

Strategic Options for Retail Banking

The financial services industry is at a crossroads. Over the past couple of years, the focus has been almost entirely on reducing costs and minimizing risk. One strategic route would be to continue down this path.

Following discussions with various market participants, however, Cisco IBSG believes that a new strategic route—one that focuses on both *"Save To Invest"* and *"Invest To Win"*—is the preferred path for the future. Over time, shareholders will not be satisfied with a strategy that simply cuts costs and risks; there will also be a need to identify and successfully execute on strategic growth bets.

Banks will have to "Save To Invest," improving productivity through better internal collaboration and ultimately coming together as "One Bank." In parallel, banks will need to "Invest To Win" by providing priority customer segments with a differentiated value proposition to stand out versus the competition in terms of treating customers in a unique and personalized way ("One Customer").

Cisco IBSG believes there are a number of interesting strategic options from which to choose. Because no bank can do everything simultaneously, it's imperative to select the options that will create the most value.

Save To Invest

"Save to invest" encompasses two main improvement levers:

1. Boost individual employee productivity and collaboration across different functions
2. Increase operational efficiency by consolidating and virtualizing the supporting IT infrastructure

The first step is to identify which business processes have the greatest potential for improvement through increased collaboration. In most banks, these are sales, product development, and customer service. Analyze the current process, define a new approach, and then identify how technology can enable improved business performance.

Through work with multiple global banks, Cisco IBSG has seen productivity improvements for key processes of at least 10 percent to 15 percent, 30 percent decreases in travel expenses, and significant improvement in internal collaboration.

Cisco IBSG recently conducted projects with two global banks that wanted to improve productivity and decrease costs. Both had common issues they wanted to address:

- How do we quickly and efficiently get the right subject-matter experts to team up and solve a crucial problem (these experts typically reside in different organizational units and in different geographical locations)?
- How do we reduce lead times in our product development process using new collaboration tools?

- How do we improve risk and crisis management, especially in light of increased regulations?
- How do we better integrate the mergers or acquisitions we have made?
- How can we improve the speed and impact of employee training by using video?

Taking a strategic approach—starting with the necessary business transformation, but also establishing a link to the enabling technology architecture—created several benefits for both banks, including an estimated 30 percent reduction in product development lead times and travel cost reductions of 25 percent to 30 percent.

In addition to measurable results, this approach produces multiple "soft" results that oftentimes are critical to success, despite being difficult to track. For example, when one of the banks introduced a new approach to virtual training for employees, it increased speed of delivery across the organization while reducing costs. More important, however, participants said that the virtual approach created a more intimate relationship and dialogue with the presenter compared to a typical presentation in a large classroom or auditorium.

Invest To Win

Under "Invest To Win," there are at least five growth levers for banks to consider:

1. **Wealth management:** identify ways to create a tighter relationship with wealthy consumers to increase loyalty and drive cross-selling opportunities
2. **Generational strategy:** identify strategies to capture the Gen Y segment and / or strategies to differentiate your offerings to baby boomers
3. **Multichannel strategy:** identify ways to create a consistent customer experience across key channels: branches, online, mobile devices, and contact centers
4. **Role in payments ecosystem:** identify strategies for achieving success through new business models for collaborating with retailers, and define your strategy related to mobile payments
5. **Growth in Asia and Emerging Markets:** identify strategies for profitable growth in geographical regions with strong underlying GDP growth

"Multichannel" and "Wealth Management" represent two of the most promising opportunities for banks heading into 2011.

Multichannel. Today's customers want the ability to choose among several channels for interactions with their bank: sometimes they want to talk to an adviser; other times, they wish to find information online; and there are other occasions when they want to make purchases or view their account details over their mobile phones.

In addition, as it is not economically feasible for banks to have expertise on all topics in each branch, studies show that "leakage" in branches from customers not being served by an expert on a specific topic is as high as 20 percent to 30 percent.

The need to provide a consistent multichannel approach is not a new concept in banking. What's changed, however, is that customers are now familiar with a variety of tools that enable a new approach to customer interactions. As a result, customer adoption of new channels is growing rapidly:

- In the United States, 38.8 million auto insurance quotes were submitted online in 2009, up 22 percent compared to the year before, and 2.8 million policies were bought online.[9]
- In a recent survey, 15 percent of U.S. consumers said they currently use personal financial management tools, and another 40 percent said such tools would be useful in managing their finances.[10]

Many banks are currently reviewing their multichannel strategies in an effort to boost customer intimacy through services tailored to when, where, and how customers prefer to interact with their bank. Tools such as video, mobility, automated personal financial management, and social networking are enabling these new multichannel strategies.

Umpqua Bank provides an interesting example of what a small, regional bank can do to stand out in the crowd. A key element of its strategy is to test new ideas for multichannel improvements in a live environment with real customers, and to rapidly assess ideas that seem to resonate.

For example, Umpqua hosts a business-to-business social networking site for local small and medium-sized businesses. The bank has also relabeled its branches as “stores” that have been have been redesigned into “community centers” with open Wi-Fi access and ready-to-use PCs. In addition, Umpqua added “ask an expert” virtual advisers in its stores.

Among several anticipated positive results, Umpqua Bank expects its multichannel strategy to:

- Differentiate Umpqua as a bank that understands the needs of the local community
- Increase customer loyalty and cross-selling opportunities

Wealth Management. One of the most interesting “Invest To Win” strategic bets is wealth management. If we define the High Net Worth (HNW) segment as individuals with at least US$1 million in investable assets, this segment has recovered well from the financial crisis. Global wealth of the HNW segment increased 18 percent in 2009, to US$39 trillion.[11] Because wealth management is typically not served with a sufficiently tailored approach, there is significant potential in defining a differentiated strategy.

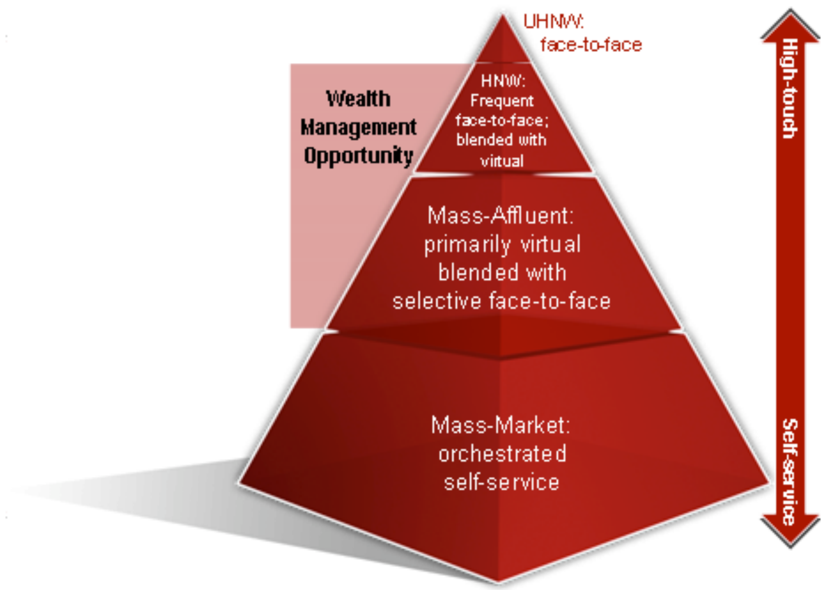
Any wealth management strategy must take a segmented approach.

Ultra High Net Worth individuals (more than $30 million in investable assets), for example, are typically well-served today, and in this segment, banks can afford to continue face-to-face interactions.

For the HNW ($1 million to $5 million in investable assets) and Mass-Affluent ($250,000 to $1 million in investable assets) segments, however, it is essential to take a carefully engineered approach that blends physical and virtual interactions. These segments represent the largest wealth management revenue opportunities for banks. They feel underserved today, creating the threat that they’ll leave for another bank. At the same time, however, there is significant upside from creating tighter linkage with more frequent interactions. This will allow banks to learn more about their personal needs, and then adapt adapt their offerings accordingly (see Figure 2).

Many banks around the world view a new approach to wealth management as one of the most important "pockets of growth" in today's macroeconomic environment. Cisco IBSG is conducting a significant study of the needs and desires of High Het Worth individuals and of their financial advisers, and will soon publish a report on how banks can address these needs. In parallel, Cisco has developed video-based technology solutions to enable FS customers to successfully implement a new approach to wealth management.

Figure 2. Wealth Management: Profitable Personalization



Source: Cisco IBSG, 2010

Conclusion

Three megatrends are reshaping the banking industry: regulation, generational shifts, and the increased ability for consumers to take control of their financial development. At the same time, banks will continue to be challenged by the difficult macroeconomic environment, which most likely will persist in the coming year.

These megatrends and the challenging macroeconomic climate are creating a need for banks to figure out how to both "Save To Invest " and "Invest To Win." This is a crucial balancing act—focusing on just one approach will not be enough.

There are a number of strategic options from which to choose, and each bank will need to define its own tailored approach depending on its starting point and where the bank sees the greatest potential to create value.

Endnotes

1. Sources: Credit Suisse, July 2010; Cisco IBSG Economics, June 2010.
2. "The Next Growth Opportunity for Banks: How the Post-Crisis Financial Needs of Younger Consumers Will Transform Retail Banking Services," Philip Farah, James Macaulay, and Jorgen Ericsson, Cisco IBSG, February 2010.
3. Allianz, June 2010.
4. Source: Juniper Research, 2010.
5. Sources: ABI Research, March/July, 2010; *Chicago Tribune,* July 2010.
6. Sources: Cisco IBSG analysis, local country sources, July 2010; IMF, July 2010; Cisco IBSG Economics, September 2010; Federal Reserve, May/August 2010; OECD, 2010.
7. This is only for the United States, not all of Western Europe. This increase is the result of a combination of the effect of foreclosures in the housing market and, to a lesser extent, skills mismatches (companies have job openings, but workers with the right skills are not available to take them). The IMF notes that it does not expect this increase to be "persistent." Once the housing market clears up, structural unemployment should return to its typical level.
8. Sources: Cisco IBSG analysis, *The New York Times,* January 2010; Cardline, July 2010; *The Economist,* July 2010; The Banker, June 2010; U.S. Federal Reserve Bank of Boston, February 2010; Gartner, June 2010; Cisco IBSG Economics, July 2010; IMF, July 2010.
9. comScore, 2010.
10. FiServ, August 2010.
11. Capgemini Merrill Lynch World Wealth Report, 2010.

More Information

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