THE RELEVANCE CHALLENGE: WHAT RETAIL BANKS MUST DO TO REMAIN IN THE GAME

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How relevant are banks for today's consumers?

Banks have historically played an important part in people's lives. While consumer demand for financial services will continue, it is unclear to what extent traditional banks will provide these services in the future. In order to shed some light on this dilemma a survey was conducted by Ernst and Young (EY) using 55,000 inputs of consumers worldwide, to gather deeper understanding of customer preferences and behaviours, as well as attitudes towards new emerging competitors. It was revealed that 75% of consumers still consider a traditional bank with branches to be their primary financial services provider (PFSP); however, 40% of customers express both decreased dependence on their bank and increased excitement about what alternative companies can provide. The implication is clear: the relevance of banks is waning. The threat to retail banks' relevance is driven by three factors.

- Firstly, digital native companies are changing consumer behaviours and expectations by showing them what a great customer experience looks like. Customers are expecting instant gratification, outstanding service quality, simple, intuitive processes, 24/7 availability, self-service, transparency of products and pricing, personalization and tailoring, and a consistent experience across channels.
- Secondly, banks are ill-equipped to respond to this demand and deliver against these expectations. Most incumbent banks are burdened by legacy technology and operations that make it difficult to deliver change quickly. This is exacerbated by a traditionally siloed organization structure and cultures characterized by heavy governance and avoidance of risks rather than empowerment of teams to innovate.
- Finally, credible players are entering the market that do not have such legacy issues and are able to deliver what customers are hoping for. While the market share they are taking away from banks remains limited in most cases, it is becoming material in payments, lending and foreign exchange.

In this environment, banks are finding it difficult to differentiate themselves from competitors. Only one-third of customers perceive product differentiation among providers, and only 14% feel extremely confident in the banking industry today.

The banking landscape is changing, creating opportunities for those banks that understand the underlying drivers and act swiftly to capitalize on their own competitive advantages. Non-traditional competitors are emerging. In addition to the more established alternatives to banks, such as credit card and insurance companies, new entrants are contributing to altering patterns in bank loyalty and switching service providers. In this new environment, ensuring sustainable profitability requires a more nuanced service strategy.

For many banks, the strategic response will draw heavily on technology solutions that were not available just a fewyears ago. New digital banking channels are being adopted and embraced by a significant proportion of mid-market companies. The new tools and capabilities provide banks with a degree of efficiency and flexibility that will change the economics of service in the commercial banking business. Beyond efficiencies, enhanced technology capabilities will 'improve banks' abilities to provide "always-on" access and enable relationship managers to dedicate more time to positioning product and service solutions. The speed of change in the digital IT space requires a different approach to monitoring and managing IT innovation and investments.

Bank relevance

To measure the state of bank relevance, the survey conducted by EY produced the Bank Relevance Index (BRI), to measures a range of current and future behaviours and attitudes to build a composite score based on:

1. How customers bank now: the proportion of customers considering their primary financial services provider to be a traditional bank and the mix of products they currently hold with a bank.

2. How customers want to bank in the future: customers' level of trust in banks and the mix of products they would consider a traditional bank for in the future.

Building customer trust

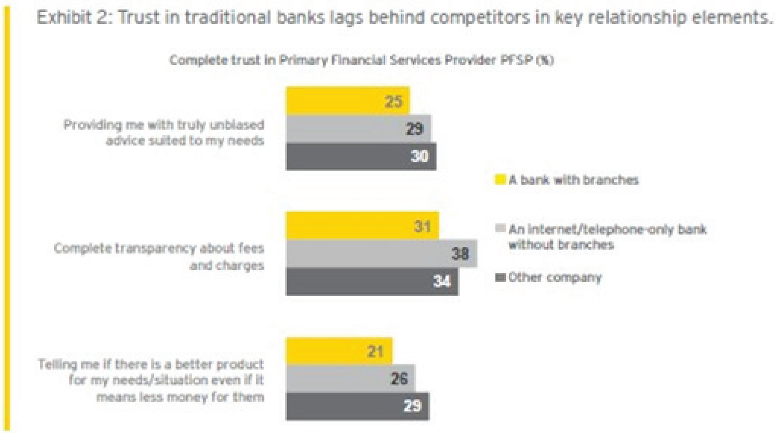
Customers have diminishing trust in their banks.They broadly do trust banks to look after their money securely across markets, but few have complete trust in their banks to give them unbiased advice that puts their interests first.

In terms of trust, banks lag behind non traditional competitors, such as digital-only banks, FinTechs or supermarkets offering banking services. This applies across dimensions such as: transparency in fees, providing unbiased advice and recommending products that are in the best interest of the customer.

This is an opportunity for the banks to re-focus on rebuilding trust to overtake new challenges and make this a differentiating competitive advantage.

In order to build customer trust, banks may consider to:

- Radically transform the front line's ability to provide unbiased, high-quality advice
- Enforce operational excellence to eliminate errors and shorten service timelines
- Foster a customer-centric culture by empowering both front-line and back-office employees to directly engage with customers
- Ensure complete transparency on product pricing and features
- Proactively protect the customer from data privacy and cybersecurity threats
- Reassess the range of services they offer, perhaps straying into territory they have not previously engaged in, to create an ecosystem of services, including nonfinancial services



Enhance customer understanding: you may not know them as well as you think you do

Banks have traditionally relied on readily available customer data, such as age and wealth, to predict customer preferences, develop customer propositions and tailor service models. Such approaches are generally recognized as overly simplistic and poor predictors of actual behaviours. As a result, banks have developed a perception of their customer base that tends to result in misaligned customer experience elements.

Banks need to take a fresh look at their customers in order to gain more sophisticated insights into preferences and how their products fit into customers' lives. One simple and effective way of doing this, may be to combine financial savviness (their level of understanding of and comfort with financial products) and digital savviness (their level of experience and comfort with online and mobile digital interfaces).

One of the key insights is that digitally savvy customers are not necessarily financially savvy customers – and vice versa, which brings to light the challenge facing banks in catering to different types of customers.

Financial maturity	Digital maturity: Not savvy	Digital maturity: Savvy	Total
Savvy	11%	16%	27%
Not savvy	36%	37%	73%
Total	47%	53%	100%

Even more interesting are the next two facts:

1. across all age groups and countries, respondents are typically more digitally confident than they are financially savvy, and
2. against common belief, digital savviness is only slightly correlated to age.

This means that banks need to carefully consider how to serve customers who are digitally competent but do not feel confident in their own understanding of financial products — just as much as the reverse, in other words, customers who feel financially savvy but not digitally savvy.

As per survey results, it becomes apparent that while some customer groups are well served by major banks, (Ex: the financially and digitally savvy who are comfortable fulfilling a lot of their banking needs through digital channels with limited support) others are not, for example:

- Over a third of customers are digitally savvy but do not have a firm grasp of financial products and the financial choices they are making, suggesting that they need better advice and more hand holding through digital channels than is currently available in the market.
- Almost half of customers are not yet comfortable with digital channels, suggesting a need for better customer education and careful consideration of various strategies used by banks, such as, branch closures.

To better serve and engage with customers in a way that is relevant to them, banks should:

- Think about customers in new ways, using data and analytics, to develop better ways to approach and market to their customer base
- Use data and customer research rigorously to support service proposition design and avoid relying on assumptions
- Develop a proposition with each of the quadrants in mind, with a particular focus on

digital advice and the role of branches.

Rethink distribution and customer engagement

While digital is undoubtedly on the rise and will be the core of consumer banking in the future, customers want human interaction too. Eighty-two percent of consumers globally go online first if they are looking to buy a new product or service; but, at the same time, nearly 60% indicate that they want to visit a branch or call a real person to purchase a new product or get advice, and 55% of consumers say it is important that they can speak to a person at their bank 24/7.

Importantly, 44% of customers tell us that they would not trust a bank without branches, with a much higher number in some markets (e.g., Mexico with 63% and Malaysia with 54%).

In other words, digital is not replacing the human experience; they are complementary to each other.

The findings suggest that closing branches rapidly (which is common in mature markets due to cost pressures and decreasing traffic) may need a rethink. While branch networks do need to be progressively decommissioned in order to address cost challenges and compensate for the rising cost of digital, we foresee a future where branches function differently and assume new formats, such as digital channels with a physical presence or micro-branches in high-traffic locations.

Innovate like a FinTech

Banks struggle to give customers the exceptionally simple customer experience and flexibility they are seeking and have become accustomed to technology companies, such as Amazon. Banks barely differentiate themselves from competitors in the eyes of customers. Product features and pricing are typically complex and difficult for many to understand. Competitive rates and fees matter, but the allure of a better customer experience is what pulls customers away to nonbank competitors. Importantly, for consumers in some countries (e.g., Russia, Mexico, Turkey, India or Malaysia), attractive rates/fees are not even in the top three of the reasons why they consider switching to a nontraditional bank.

Globally, 42% of consumers have used nonbank providers in the last 12 months, and 21% of the remaining customers who have not yet used them are considering doing so. Emerging markets are ahead of developed economies in terms of adoption of nonbank providers, particularly driven by the rise of FinTech. Even in countries where current uptake is smaller (e.g., Germany 22%, France 26%), the potential for future use includes at least 40% of consumers.

Customers want simple experiences, easy to understand products, transparency and 24/7 access to products and information – and that's what FinTech companies are delivering. Across the 32 countries of our study,41% of customers indicate they would not hesitate to change financial services providers if they found one that offered a better online/digital offer/experience.

In order to fend off the threat and give customers what they want, banks need to start innovating not only like FinTechs, but with FinTechs. The FinTech world is increasingly being perceived as the innovation engine for the industry, with banks scanning the market for companies to emulate, partner with or acquire.

Elements of the customer experience rank just behind more attractive rates/fees for customers considering a digital only, non banking provider

To elevate customer experience, banks may:

- Set up a formal FinTech engagement program and continuous FinTech scan to identify potential opportunities to emulate, partner or acquire
- Radically simplify product portfolios, product features and pricing
- Set up cross-functional teams to redefine end-to-end customer journeys with the customer at heart

What should banks do to grow market share and deliver higher returns?

First and foremost, Banks must increase relevance with their customers and reclaim their central place in people's lives. In order to remain relevant, the Banks may focus on:

- Build and earn trust, not trust in a bank's ability to securely look after customers' money, but its ability to always do the right thing for the customer and provide unbiased, high-quality advice
- Better understand customer behaviours and tailor propositions to different types of customers
- Rethink distribution and customer engagement, in particular the role of branches
- Innovate like FinTechs to radically simplify products and deliver exceptionally simple customer experiences.

In the midst of such magnitude of change, Sri Lankan banks also need to address issues such as system infrastructures and updating legacy systems pieced together over the years. In order to take advantage of emerging uses of technology, major core-system upgrades may be required. Technology is changing the way banks collect, access, and analyse data, manage risk and compliance, improve the speed of core processes and build resilience. Banks need to transform businesses for future success, which may require long term investment.