Demanding more

Since the pandemic forced customers online in 2020, consumer banking behaviours have been in flux, boosting competition among banks and non-traditional competitors.

- Four in five bankers (81%) believe that banks will seek to differentiate on customer experience rather than products, according to a global survey of senior banking executives conducted by The Economist Intelligence Unit. Mastering both customer experience and digital marketing are ranked as top strategic priorities for the next four years.
- As consumers increasingly expect banks to take a stand on environmental and social issues, survey respondents view microfinance for entrepreneurs (34%), accounts for the unbanked (33%) and responsible lending to underbanked populations (32%) as top actions to promote financial inclusion and empowerment.

More than a year after much of the world went into some form of lockdown, many customers previously resistant to digital banking have grown accustomed to it, and most do not plan to return to their old banking habits. A survey of people in the US aged 18 to 65, conducted by Chase Bank, found that four in five now prefer to manage their finances digitally rather than in person, and three-quarters are likely to continue using digital payment options even after the covid-19 threat subsides.[1] These findings are mirrored in many other countries around the world.

"Overnight people became digital, when it was supposed to take ten years," says Michal Kissos Hertzog, chief executive of Pepper, an Israeli digital bank, of the impact of the covid-19 pandemic. "It doesn't matter if you are Gen X or Gen Z—everyone became digital."

Banks have been forced to adapt as a result. "All banks have had to up their game, so competition has become stronger," says Ms Kissos Hertzog. The shift to online brought by the pandemic has proven a boon for

[1] https://media.chase.com/news/swipe-tap-track

digital-only banks. As of January 2021, 14m Brits (27% of UK adults) had a digital-only bank account—16% growth from January 2020 and a threefold increase compared to January 2019.

The shift has brought forward expectations of the demise of the branch, traditionally the centre of the retail banking experience. According to our annual global banking survey, supported by Temenos, 65% of bankers now believe that the traditional branch-based banking model will be "dead" within five years, while 71% expect cash to represent less than 5% of all retail transactions globally by 2025.

Senior executives report that technology is driving customer experience. Survey respondents cited changing customer behaviours and demands around digital banking, the new technologies needed to understand and serve customers better, and regulation on digital technology (including data protection, which dictates how banks can interact with customers and their data) as the top three trends that will have the biggest impact on banks in their countries by 2025.

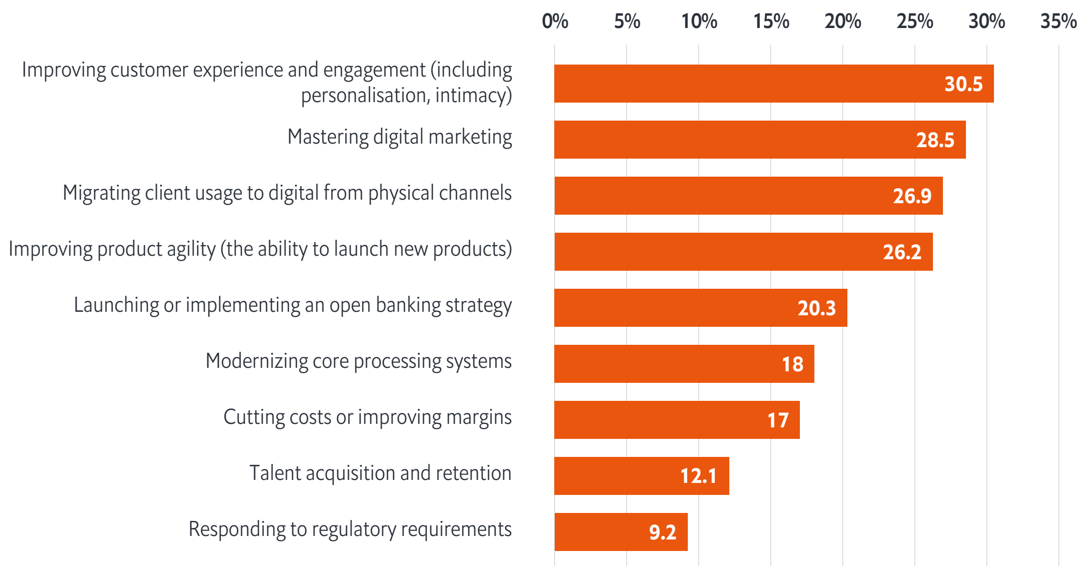
Consequently, survey respondents' top strategic priorities by 2025 are all customer-focused: improving customer experience and engagement, including personalisation and intimacy; mastering digital marketing; and migrating client usage from physical to digital channels.

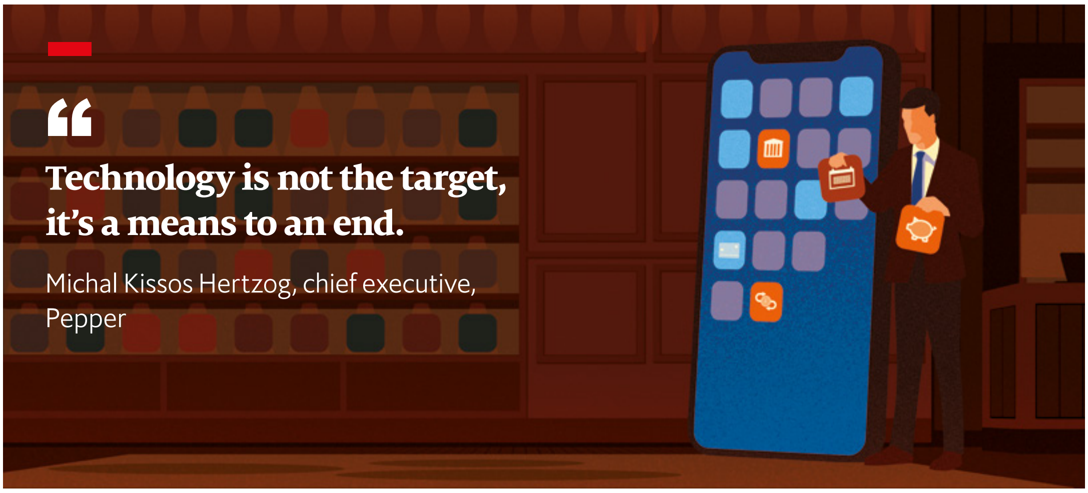
At Pepper, the focus has been personalisation. When individual customers open the bank's app, they see a homepage personalised to their specific actions, says Ms Kissos Hertzog. "Different customers will see different products, will receive different marketing." The goal is a "segment of one", tailoring the experience precisely to the individual consumer based on their activity and preferences. "The more personalised the service is, the more engaged customers are."

Technology investment

According to survey respondents, banks' top investments in customer-related technology

Figure 1. What are the top strategic priorities for your company by 2025?
Select up to two.





include developing artificial intelligence (AI) platforms, such as digital advisors and voice-assisted engagement channels, and advanced and predictive data analytics for customer experience.

Adoption of this technology starts with data, says Ms Hertzog. "Banks are sitting on a humongous amount of data, but they are not doing a good job [of using it]," she says. "I want to use data to give customers a better understanding of their money, to help them decide how to save, to budget, whether they should invest in the stock market."

But she cautions against focusing investment on specific technologies just because they are the latest trend. "I've never heard my users saying, 'I chose you because you have the best artificial intelligence of all banks'. What they care about is that they will have good service, that they'll see the benefits from their bank, and that we meet their needs," she says.

"When we speak about technology, it's important to understand that the technology is not the target, it's a means to an end. Of course, we have to have great AI, and we are implementing machine learning and blockchain—we're doing all of that. But we are doing all of that in order to give the best customer experience."

Competition and collaboration

At Fifth Third Bank in the US, the focus has been on supporting open banking. "We've been investing in this space substantially for the last five years and expect to double our investment over the next two," says Melissa Stevens, executive vice president and chief digital officer. "The foundational elements of open banking—modularity in the value chain, flexible technical and business architecture, and portable data—represent a shared vision across the enterprise and are core to what we build across the bank."

"We have a few models to best meet the needs of our customers—from leveraging enablers from fintechs and vendors to building or joining platforms to distribute offers beyond banking services and package products and services provided by third parties," says Ms Stevens. "Increasingly, we view the way to deliver on our vision is by creating and participating in open ecosystems—acting both as a distributor of others' products and by distributing our own products through others' channels."

Fifth Third is not alone in its efforts to take advantage of the opportunities presented by open banking to improve customer experience. According to respondents to our survey, one top innovation strategy is giving customers the option to connect

Figure 2. What is the primary way in which you see your current digital business evolving over the next 12-24 months?
Select one .

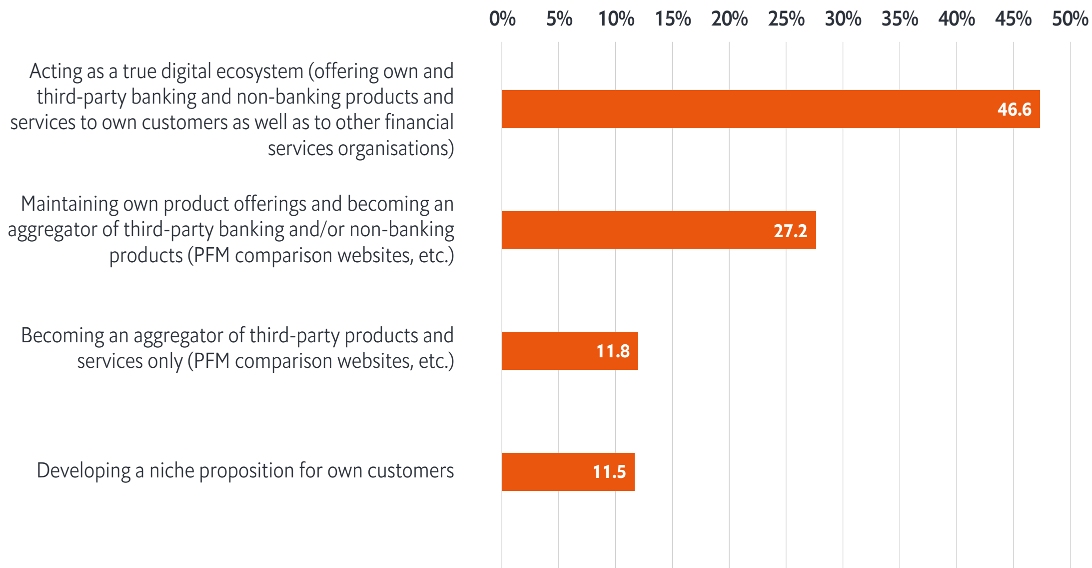
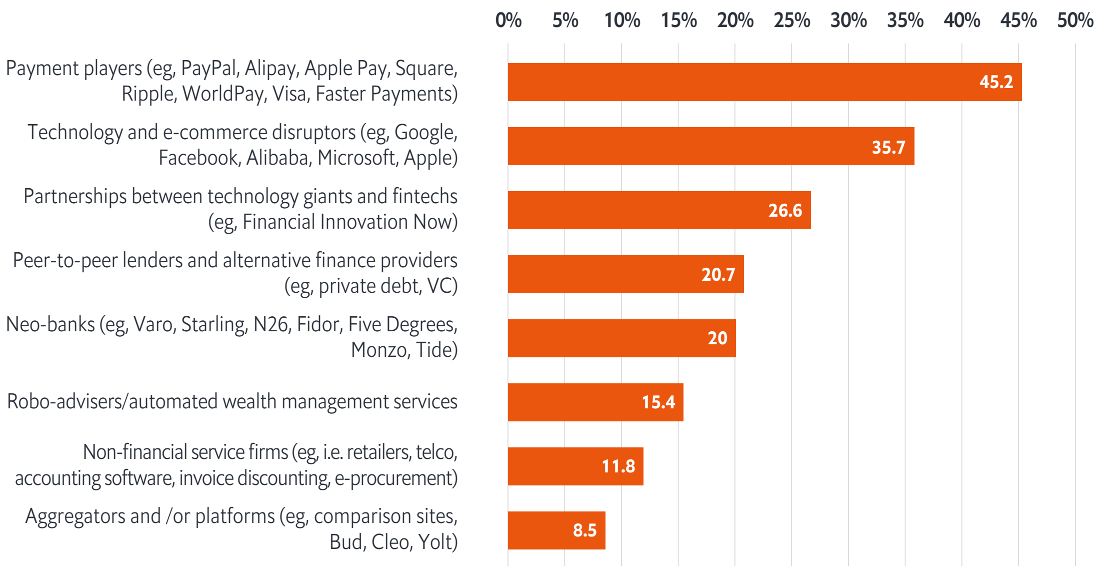


Figure 3. Which non-traditional entrants to the banking industry will be your company's biggest competitors by 2025?
Select up to two.



their bank data with third-party providers though open bank hub initiatives. To achieve that, almost half (47%) plan on evolving their digital business over the next 12-24 months to act as a true digital ecosystem, offering their own and third-party banking, and non-banking products and services, to their own customers, as well as to other financial services organisations. A further 27% report that they will maintain their own product offerings and become an aggregator of third-party banking and/or non-banking products.

For example, TSB, a UK bank, offers its personal customers a "marketplace", including products from Wealthify, ApTap, and Legal & General, while business clients can access services from Square and Enterprise Nation. Digital-only Starling Bank offers an even wider range of third-party products and services across insurance, pensions, savings and investments, mortgages, credit scores, and loyalty programmes—including the addition of the UK's largest digital wealth manager, Nutmeg, in December 2020.

As a digital-only bank, Pepper has always been open to collaboration. "I don't think I need to develop everything by myself," says Ms Hertzog. "The core is mine, but for additional services I will collaborate to bring in the best technology. For example, we use an Israeli fintech called Eco-Bill, which our customers can use to pay their bills. They gave us a great tool and through working with us they have been able to improve it. We both win. I'm really looking forward to collaborating with more Israeli fintechs."

Ms Kissos Hertzog believes that collaboration with fintechs can help to bring a true customer focus to banks. "The young start-ups, they see things differently—they are much faster than traditional banks and they have one single focus: the customer. It's not something you have to teach them, it's within their being. I think that's really an opportunity, not just for the fintechs, but for the banks as well."

Fintechs are seen not just as collaborators but as competition, particularly in payments. Digital wallet services such as Apple Pay, Google Pay and Samsung Pay are increasingly used for online and in-store payments. Digital wallets now account for 32% of all online payments in the UK—more than debit or credit cards (29% and 21% respectively)—and this number is expected to rise to 40% by 2024.[2]

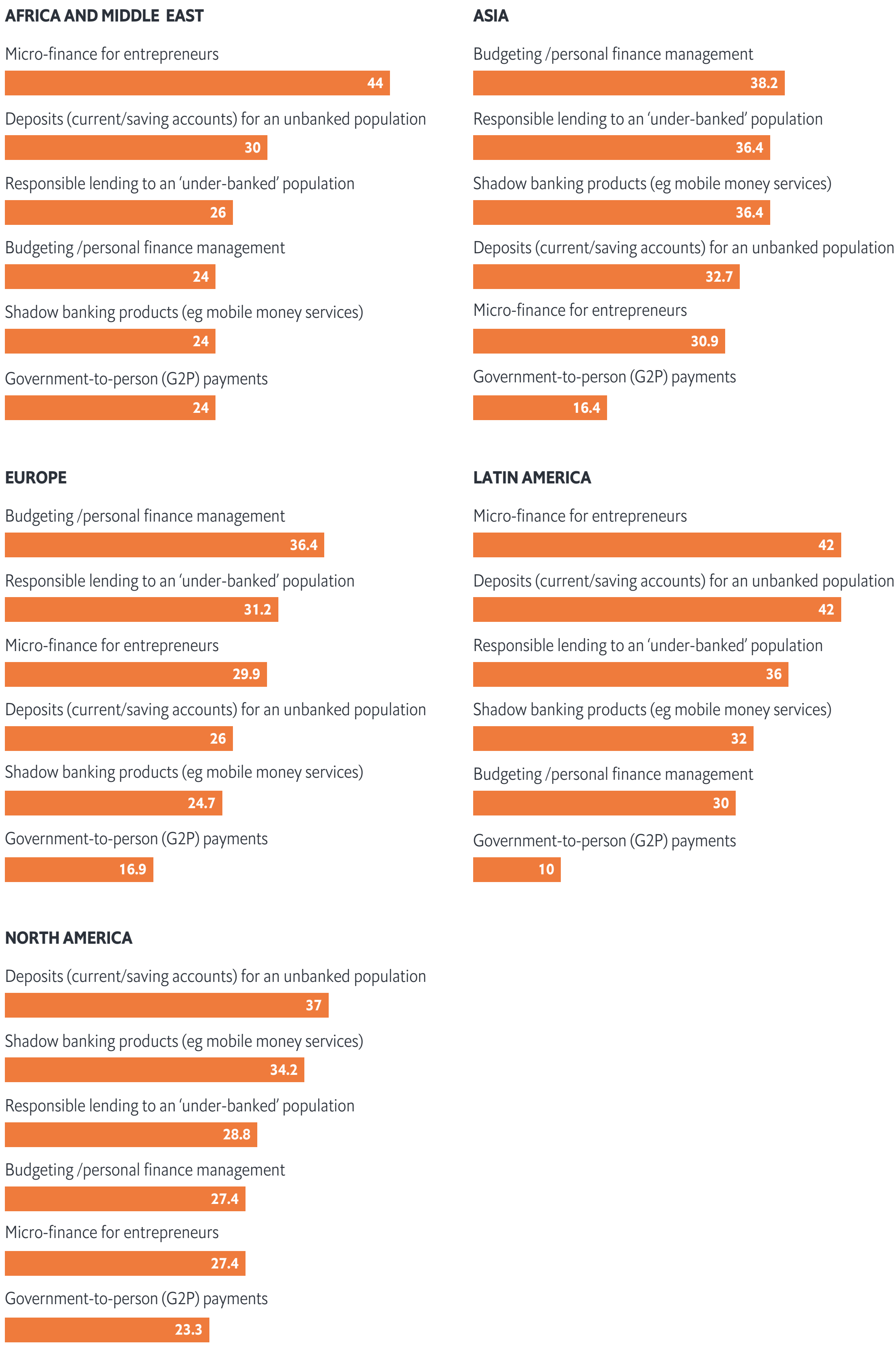
Despite the shuttering of physical shops, restaurants and entertainment venues during the pandemic, transactions processed by PayPal, a payments platform, leapt by 26% in the second quarter of 2020, to 3.7bn, as merchants moved online.

And online payment innovation is rife. "Buy now, pay later" (BNPL) services, pioneered by the likes of Affirm and Klarna, have exploded in popularity, driven in part by uncertainty around employment and personal finances. Algorithms use publicly available credit information and details of the size, type and timing of the purchase to calculate the chance of fraud, and offer extended-payment plans.

Many online retailers are integrating these services into their payment pages, and they cover the cost of the interest as if it was a sales discount. These services became very popular during the pandemic, with Klarna alone now claiming to have 90m customers. The firm is now the largest private fintech in Europe, valued at US$46bn—four times what it was worth in September 2020.[3] PayPal, which launched several BNPL offerings in 2020, such as Pay in 4x (in France) and Pay in 3 (in the UK), says that average order volumes more than double when compared with standard purchases. Nine months after launch, PayPal now has over 20m BNPL applications.

[2] https://thefintechtimes.com/digital-wallets-more-popular-than-debit-cards-for-online-payments-in-uk/
[3] https://theconversation.com/the-klarna-conundrum-why-treating-buy-now-pay-later-apps-like-banks-will-not-protect-consumers-162625

Figure 4. Which aspects of financial inclusion/empowerment is your company considering in the next 1-3 years, as a strategic, actionable business opportunity?
Select up to two.



What customers want

Consumers expect a great customer experience, but they are also increasingly demanding that companies, including their banks, are responsible and take a stand on issues that are important to them, such as combating climate change, and promoting diversity and financial inclusion. This is particularly true of younger generations. According to the 2020 Zeno Strength of Purpose Study, 70% of Gen Zers and Millennials globally believe that a brand should have a purpose that they personally believe in, compared with just 48% of Baby Boomers, and consumers of all age groups are four times more likely to purchase from a company that they believe has a strong purpose.[4]

This means not just giving token support to causes but actively integrating beliefs throughout the organisation—from changing products and services to increase inclusion; to improving diversity among employees, management and suppliers; to reducing carbon footprint.

At Fifth Third Bank, its inclusion initiatives include commitments relating to employees, customers and the communities in which it operates, focusing on equitable outcomes for all. “For example, we want to ensure the diversity of the Bank’s workforce reflects the markets it serves. We also expect 25% of new branches will be built in majority-minority tracts and low- and moderate-income communities. And we are increasing accessibility through innovation, providing wider access to business and consumer loans, expanding accessible tools for financial education and developing innovative banking solutions for the unbanked and underbanked.”

For survey respondents, microfinance for entrepreneurs, deposits for unbanked populations and responsible lending to under-banked populations are the top actions that they are considering in the next one to three years to promote financial inclusion and empowerment. In Europe and Asia, the focus is on budgeting and personal finance management applications for customers (see Figure 4).

Branching out?

As the world emerges from covid-19 restrictions, people are examining the pandemic’s long-term impact on every facet of life. While some are nostalgic for the good old days, anticipating a rush back to the office and in-person events, others say that there is no going back and predict that the convenience offered by digital will forever alter every aspect of life.

However, Ms Stevens sees a middle way for retail banking. “As a relationship bank, we believe in the future of branch-based banking,” she says. “However, we think it will continue to evolve. We’ve opened about 50 ‘NextGen’ branches in the past 18 months and plan to open another 50 in the next 18 months. We know how important the branch—and the human connection beyond just a phone call with a banker can be. We also know that digital banking remains important to people, too. They need a mix. They want to bank when they want, how they want and where they want. You cannot have a branch without strong digital presence and solutions.”

[4] zenogroup.com/insights/2020-zeno-strength-purpose