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*IBM Institute for Business Value*

# The paradox of Banking 2015

Achieving more  
by doing less

Banking



## **IBM Institute for Business Value**

IBM Business Consulting Services, through the IBM Institute for Business Value, develops fact-based strategic insights for senior business executives around critical industry-specific and cross-industry issues. This executive brief is based on an in-depth study by the Institute's research team. It is part of an ongoing commitment by IBM Business Consulting Services to provide analysis and viewpoints that help companies realize business value. You may contact the authors or send an e-mail to [iibv@us.ibm.com](mailto:iibv@us.ibm.com) for more information.



# The paradox of Banking 2015

## *Achieving more by doing less*

### Executive summary

Any serious discussion of the future of the retail banking industry eventually raises a basic question: will future customers still need retail banks? The answer, it turns out, depends on banks themselves. With technology and non-bank businesses providing new options for safeguarding and managing their finances, customers will continue to depend on banks only as long as banks can provide service and value that cannot be found anywhere else.

There are already signs that customers are questioning the ability of banks to look out for their financial well-being. Only 36 percent of consumers believe what banks tell them, according to a Forrester survey.<sup>1</sup> A separate survey also indicates that over 60 percent of U.S. households conduct their own research before buying financial services products.<sup>2</sup> As a result, banks have begun to rethink what, where and how they serve an increasingly informed and demanding customer base. At the same time, a confluence of industry developments, including consolidation, regulation, industry specialization, changing workforce needs and new technologies are putting additional pressure on banks' operating models and raising questions about traditional strategies for growth and value creation.

So, what will the future look like? How will banks continue to grow revenues and remain profitable? What will it take to create and maintain advantage in this highly competitive industry? An examination of the forces shaping the industry reveals that the future will require superior efficiency and operational excellence from all banks, while industry leadership will be attained by those institutions most adept at harnessing product, service and process innovation to anticipate and meet customer needs. Ultimately, to deliver on these imperatives, banks will have to focus on their core strengths – those activities in which they excel – and partner with best-in-class specialists for everything else: achieving more by doing less.

On the surface, the competitive landscape of the retail banking industry in 2015 will not look much different than it does today. Mergers and acquisitions will likely have reduced the total number of banks, especially mid-tier regional banks, and industry specialists and non-bank banks will play a more prominent role. But most of today's players, including universal banks, community banks, industry specialist banks and non-bank banks, will still be vying to differentiate themselves in a crowded marketplace. However, traditional approaches to creating value through growth and efficiency will no longer be enough. Advantages gained through acquisition, new market entry and reconfigured product offerings will be fleeting at best, while partnering and outsourcing will make efficiency a basic requirement for all.

Through market research and interviews with industry executives, the IBM Institute for Business Value identified five major industry trends that will impact the retail banking industry. By 2015, the combined implications of these trends will create an environment in which nothing less than sharp focus and excellence in day-to-day operations will be acceptable, and banks will have to generate growth through continuous innovation or be left behind:

- *Customers redefine the rules of the game* – Pronounced shifts in demographics, attitudes and behaviors, in addition to ubiquitous information, are giving customers the power to demand much greater responsiveness and transparency from their banks.
- *Universal banks and ultra-focused niche players thrive* – Large players will generate higher aggregate profits by reaping the benefits of super scale, while niche players will aggressively pursue the most desirable customers by addressing their needs in distinct ways – those in the middle will get squeezed.
- *Changing workforce composition dictates new approaches* – An older and increasingly mobile and diverse workforce will raise management complexity and require flexible approaches to compensation and performance management.

- *Regulatory burdens intensify* – Heightened requirements around privacy, security, partnership risk and operational risk will require banks to take a more proactive, enterprisewide approach to managing compliance issues.
- *Technology improves inexorably to enable breakaway value* – Advanced technologies will allow banks to infuse their legacy operating models and infrastructures with unprecedented functionality. Emerging technologies such as grid computing, service-oriented architectures, virtualization of data and storage, and predictive intelligence will cause entrenched insourcing philosophies to perish in favor of a partnership model where specialized enterprises thrive.

Of these trends, the first two – increasingly powerful customers and intensifying competition – stand out as the most significant forces that will drive industry change over the next decade. The other three trends – changes in managing human capital, regulations and technologies – will strongly contribute to and reinforce the effects of intensifying competition and customer empowerment on banks' strategic choices.

In this emerging environment, innovation will take many forms, including advances in products and services, markets, operational processes, customer intimacy, and new channel and diversification strategies. But innovation will not be possible, nor will it have the desired impact, unless banks create the requisite conditions for innovation development. There are four strategic imperatives banks must follow to cultivate innovation and position themselves for sustainable growth:

- *Focus on core strengths and partner for everything else* – Leading banks will optimize their performance by becoming specialized enterprises, managing only strategic, differentiating business components internally and partnering with best-in-class specialists for those capabilities that do not drive competitive advantage.
- *Optimize the potential of each customer relationship* – Rather than attempting to be all things to all people, industry leaders will use superior customer insights to offer the most appropriate and profitable products, tools and services to targeted segments.

- *Harness the potential of the workforce through effective performance management* – Banks will need to realign skills and set the right performance metrics to motivate a changing workforce to continuously pursue innovation.
- *Recognize that technology will be a critical element of success* – By making technology a central component of the strategic decision making process, banks will be able to tightly align their business and technology initiatives, and will be able to differentiate their offerings and seize market opportunities with greater agility.

## **Dominant banking industry trends**

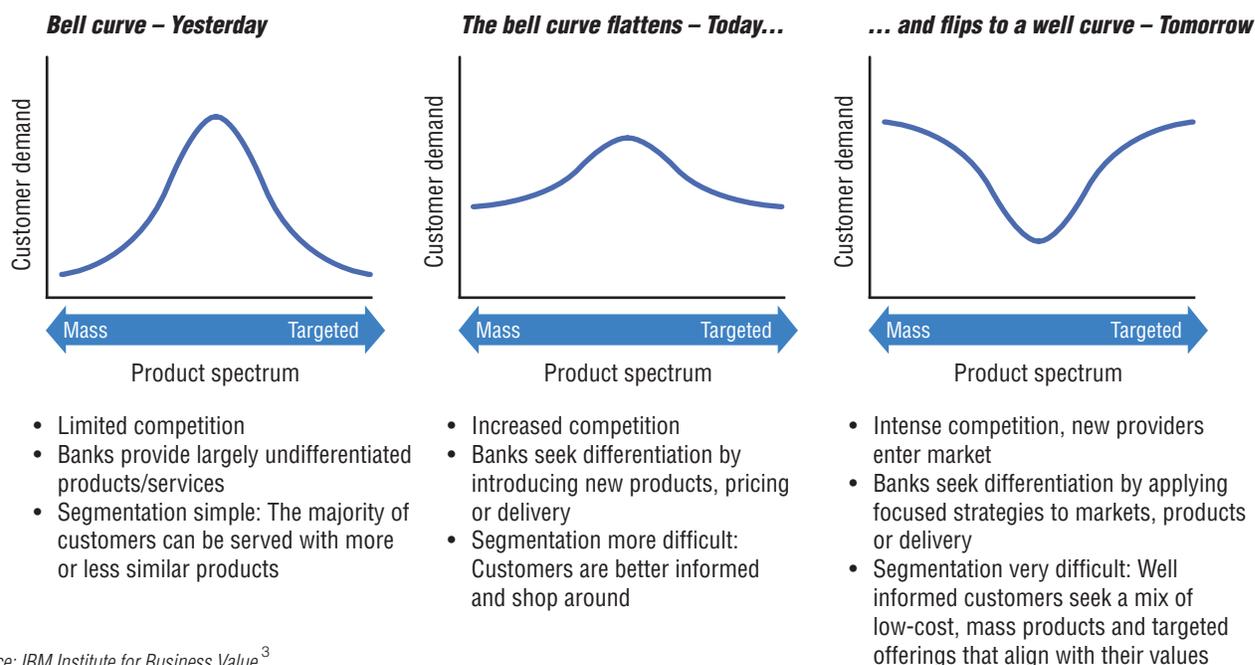
### ***Customers redefine the rules of the game***

Over the next ten years, the retail banking industry will be forced to adapt to rapidly changing customer expectations. Customer diversity and individualism will pervade buying behavior, and how customers perceive value will change as a result of pronounced shifts in demographics and value systems. "Norms" will become increasingly rare.

Population growth will increase the relative numbers of both the oldest and youngest customer segments, posing significant new challenges and opportunities for banks. While older customers tend to require more high-touch service but are generally more loyal, youthful customers are fickle, technology savvy, and highly inclined to research and negotiate the best deals. And across all age groups, long-standing life stage patterns are becoming more unpredictable. People are marrying later, divorcing more, having second families, and starting second and third careers. These changes are leading to unprecedented diversity in the financial needs of households.

Customers' decision patterns will become more complex. Value-oriented buying, based on the price-quality dynamic, is becoming increasingly influenced by personal views and the desire to express those views outwardly. Customers will demand low prices for basic goods but pay premiums for products and services that matter more to them personally (see Figure 1).

**Figure 1. From “bell curve” to “well curve” – Customer demand is polarizing.**



Overall, banking customers are becoming more hands-on and more mistrustful – trends that are even stronger in younger generations. Banks are experiencing defection rates reaching as high as 30 percent as customers are less inclined to think that banks act in their best interest.<sup>4</sup> Less than one-third of the customers of top 10 U.S. banks (32 percent), for example, consider their banks to be advocates.<sup>5</sup> More importantly, about as many (31 percent) believe that their bank does what is best for its bottom line at the expense of customers.<sup>6</sup> And as time progresses, technology and competition will continue to make it easier to research, compare, and form and break relationships – driving switching costs toward zero.

So, what are the implications of these trends? By 2015, better-informed, more discerning customers will redefine the rules of the game by demanding greater advocacy and control in their banking relationships. To be sure, banks will need to develop (or attain) the capabilities necessary to sense and respond rapidly to their customers' increasingly eclectic demands and unpre-

dictable patterns of banking behavior. To delight their customers, banks will need to provide greater perceived value relative to their competition. Having the ability to offer greater choice and personalization of products and services in the future will be critical – and yet not enough. Becoming a true customer advocate will require banks to use information about customers to anticipate and proactively suggest banking solutions that meet their life and lifestyle needs.

What's more, in 2015, bank customers will demand relationships with greater transparency – there will be no tolerance for “fine print” with vague terms and conditions. Banks will have to simplify their fee structures and implement trusted processes that help customers avoid unnecessary fees.

Our research across the banking and retail industries, including discussions with senior executives worldwide, reveals that extraordinary service and a superlative customer experience are the most sought-after capabilities, yet also the most difficult to scale and replicate

consistently. In the future, retail banks will have immense opportunity to use service and experience to decom-moditize their offerings and to encourage and reward customer loyalty (see Lexus example).

**Lexus – Demonstrating passionate commitment to service**<sup>7</sup>

Luxury car manufacturer Lexus designs customer experiences that personify its brand statement and support its customers' aspirations, "Lexus, the passionate pursuit of perfection." For example, dealerships maintain spotless service bays and they operate on the Lexus principle of *kaizen* - Japanese for "continuous improvement."

Lexus has designed Express Service areas to provide routine maintenance for six cars at a time. Service that formerly took 45 minutes now is done in 7 to 12 minutes. When necessary, customers are provided loaner cars that expose customers to new Lexus designs. Lexus also invites targeted customers to special events where they can test drive cars at race tracks. Collectively, these efforts are designed to continuously bolster customer loyalty and envelop customers in the Lexus experience.

The fact that customers are experiencing the kind of treatment described above in other areas of their lives should be a wake-up call to banks. Businesses such as Lexus are raising the bar for responsiveness and increasing customers' expectations. Lexus has seized the need for repairs as an opportunity to use information it has accumulated on customers to suggest additional models or driving solutions. Banks, similarly, will have to develop the ability to use customer information in real time to devise truly differentiating banking experiences and solutions. There are a number of cues that banks can take from retailers to support their move in this direction:

- Thorough understanding of the needs and buying patterns of segments they aspire to serve and delight
- Extraordinary service standards and follow through
- Strong emphasis on people empowerment
- Extensive client associate training
- Reward structures designed to elicit desired behaviors with clear, measurable goals.

We are already beginning to see banks moving toward rewarding customers for their overall relationships and reducing their focus on individual products and transactions – a trend that should rapidly pick up steam in the coming years (see Citibank example). Loyalty building initiatives, however, are only part of what it takes to provide a truly differentiating customer experience.

**Citibank – Taking a total view of the customer to increase loyalty**

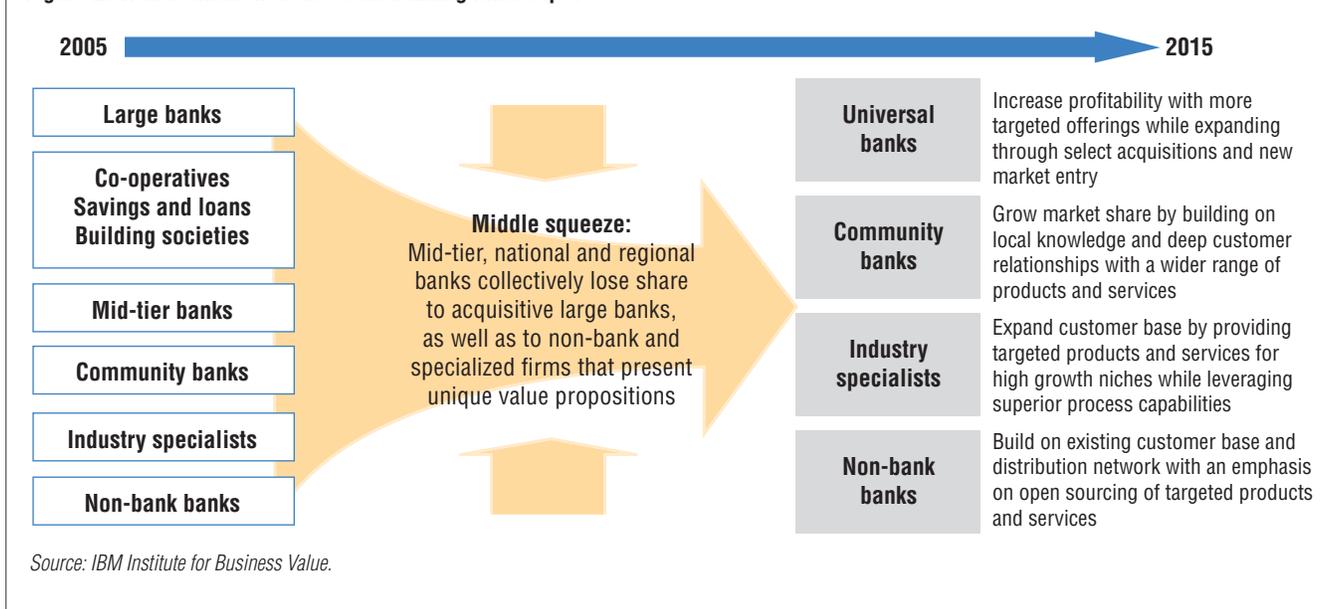
Through its no-fee Thank You network, customers receive points every month for their aggregate banking activity: checking and savings accounts, loans, mortgages, online bill payments, direct deposits, and debit and credit card purchases. The greater the number of products and services used, the faster these points accumulate. As customers wish, points can be redeemed for a host of gifts, including concert and movie tickets, golf passes, and dining coupons.<sup>8</sup>

Launched in April 2005, the program has already generated indications of increased customer loyalty. Citibank reports that participation levels are way up and attrition levels way down. The bank believes it has increased customer retention for those who have held accounts for at least ten years, from 90 to 95 percent.<sup>9</sup> Citibank is also considering a long-term customer reward program that awards extra points on a customer's ten-year anniversary with the bank.

**Universal banks and ultra-focused niche players thrive**

By 2015, the results of two prominent competitive forces will be clearly visible: a "middle squeeze" of traditional banks, and the emergence of far greater numbers of industry specialists and non-bank banks – each with distinct competitive growth strategies (see Figure 2).

Figure 2. Transformation of the retail banking landscape.



The industry will witness consolidation at its middle as it continues to be affected by large banks spreading their reach, and the emergence of specialized banking players that will set new cost and service level standards. Acquisitions led by large banks, however, will continue to be less attractive until the acquirer and potential target valuation gap narrows. Currently, acquirers (as represented by large banks) are valued at approximately ten times 2006 earnings, while potential targets (as represented by regional banks) are valued at 13 times 2006 earnings.<sup>10</sup> More likely, regional banks will look to consolidate among themselves or will seek investors from outside their home countries to grow into more powerful players in the market.

Non-traditional participants in the banking ecosystem, including specialized banks, specialist service providers, and non-bank banks, will have a significant impact in altering the competitive dynamics of the industry as well. Specialized banks, for example, will continue to enhance their market differentiation and will be well-positioned to offer greater choice and personalization to customers (see Square 1 Bank example). These banks are expected

to compete aggressively with traditional banks to control select, more-profitable market segments. A good number will also become attractive acquisition candidates for larger banks looking to target specific markets, customers or products.

#### **Square 1 Bank – Coming on strong as a specialized bank<sup>11</sup>**

In August, 2005, a group of California bankers launched Square 1 Bank in the Research Triangle area of North Carolina. The bank specializes in lending to emerging companies in the life sciences and other technology fields. Rather than requiring hard assets to guarantee its loans, Square 1 makes loans in exchange for partial stakes in the companies being funded.

According to Square 1's founder and CEO, Robert Casey (the former head of Comerica Ventures and Comerica Capital Advisors), "the difference with us is that the whole bank is focused on taking care of venture capital firms and the companies they fund. They have special needs, and we know how to go about lending to very young companies that have yet to attain revenue." Having raised US\$105 million to launch the venture this year, Square 1 aims to have US\$2-3 billion in assets within five years.

Specialist service providers, however, will have a very different, but no less powerful, impact on the industry. Through superior capabilities in operational functions, customer intimacy, and/or risk and capital management, these firms will at least partially offset the current scale and efficiency advantages enjoyed by larger players. Emerging players, moreover, will be able to ramp up operations faster than ever before (see Bridge Bank example).

**Bridge Bank – Focusing exclusively on banking, leaving the technology work to others<sup>12</sup>**

Bridge Bank, a four-year-old, US\$500 million Northern California start-up business bank has chosen to aggressively compete with Silicon Valley Bank and Comerica for the region's technology lending market. Its two-pronged strategy: emphasize that a "neighborhood bank knows you better" and outsource virtually all of its technology needs.

Six months prior to the bank's opening in May 2001, Bridge Bank conducted interviews with, in most cases, between five and ten vendors for each type of technology it needed. Today, the bank uses twelve vendors operating from nine different states, including Fidelity Integrated Financial Solutions for core banking systems, and item and image processing, S1 Corp for online banking needs, and Bankserv for wire processing, among others. The only capability that is not outsourced completely is network administration.

According to Dan Myers, president and CEO, "The end result is that our clients enjoy the services that those top-tier providers give to the bank, and also the knowledge that as the next evolution of banking technology comes around – in our industry about every 18 months or so – that Bridge Bank and its clients are going to be first in line to enjoy those advancements."

Another competitive category, non-bank banks with desirable brands and deep pockets, also possesses potentially formidable advantages. Not only will a number of these firms be able to compete aggressively on price and convenience, but many have quality customer

service reputations, as well as national and international physical distribution networks. The list of non-bank players will lengthen and already includes car makers such as Toyota and Volkswagen, the captive finance businesses of GE and Caterpillar, and retailers such as Target and Tesco, among others.

**Is the end nearing for traditional banks?**

Some industry observers believe that non-traditional competitors have the resources, superior value proposition, technological savvy and customer goodwill to wipe out traditional banks altogether in the near future. While this is an intriguing notion, we believe that, collectively, the following market conditions will help banks maintain their prominence in the industry:

- Regulatory hurdles will persist in the near future, making expansion by non-banks into banking difficult unless they are willing to place themselves under greater regulatory scrutiny
- Expansion of industry value networks will give banks access to best-in-class specialists and provide them with the flexibility and range of capabilities necessary to compete against new entrants
- While there is certainly room for banks to improve customer advocacy, customers do trust traditional banks to provide security and privacy more than companies in other industries – issues that will only become more pressing in the future.

As competitive forces within the industry intensify through 2015, it is clear that banks will have to become far more responsive to changing market conditions and emerging competitive threats, not to mention a more empowered customer base. They will need to take dramatic steps to redefine their business models to assemble the best capabilities in the market, to become specialized enterprises that focus on critical, differentiating business components within the firm, and distribute non-core tasks to external specialists that can provide functionality in open, flexible ways.

**Changing workforce composition dictates new approaches**

As banks redefine their business models to become specialized enterprises, the skills required to compete effectively in the marketplace will also evolve. The challenge will be two-fold: optimizing the productivity of employees within internally managed components of the business (retaining superior expertise to drive strategic efforts) and effectively managing the human capital aspect of external partnering, which will require greater focus on managing vendor relationships than on actually running the operations themselves.

At the same time, demographic trends, such as the aging of the population, will also significantly impact how banks source labor in the future (see Westpac example). Large numbers of baby boomers – the backbone of today’s executive ranks – are beginning to retire. What’s more, banks will find shortages of workers in labor pools from where they would normally draw younger employees – all fueling increased competition for available workers. In the U.S., for example, from 2000 to 2010, the number of workers in the 25-34 age group is projected to grow only 8 percent, while the 35-44 group will actually decrease 10 percent.<sup>13</sup> The number of workers ages 55-64, however, will expand by 52 percent, and the age 65+ group will grow by 30 percent<sup>14</sup> While increased globalization and workforce mobility will allow banks to gain access to a broader talent pool in the future, managing workers from that pool will require a new set of skills.

**Westpac – Leveraging the potential of mature workers<sup>15</sup>**

Recognizing the potential shortage of skilled workers created by retirement and smaller incoming labor pools, Westpac recently trained approximately 900 recruits over 55 years of age who were looking to establish a second career. The bank has noted that older workers have become an important asset because they relate well with older customers, who often feel that younger staff are not experienced enough to address their financial concerns.

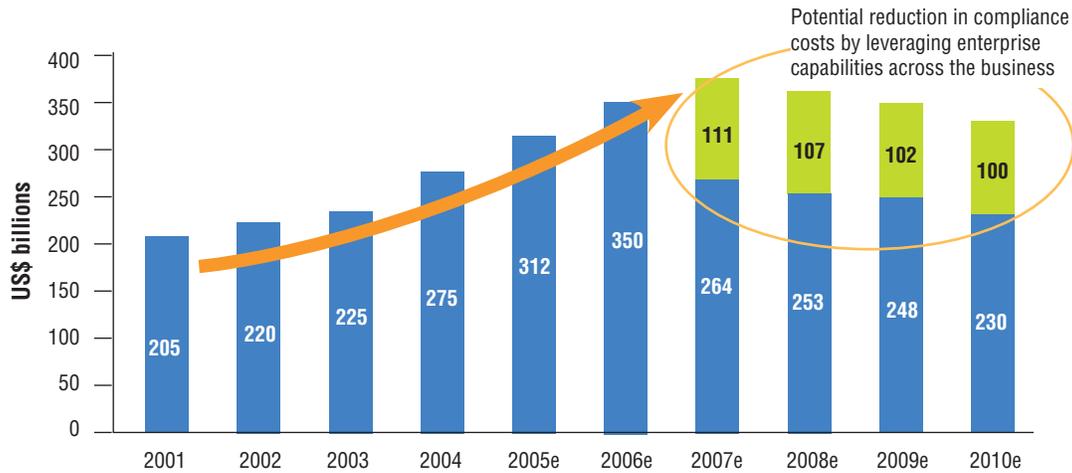
In addition to realigning skills, banks are shifting their focus onto performance management programs in an effort to optimize the productivity and effectiveness of their employee base. When asked why employee performance is less than optimal, 49 percent of retail banking executives surveyed cited misaligned incentive schemes as the top response.<sup>16</sup> Thirty-six percent of these executives stated that incentive schemes are too difficult for employees to understand.<sup>17</sup> Harnessing the full potential of employees in the future will require intense focus on redesigning incentives and performance metrics that take into account how quickly competitive and customer demands are changing.

**Regulatory burdens intensify**

Demands for transparency from the market and supervisory pressures from regulators will only increase in the foreseeable future. As industry globalization expands and further consolidation takes place, regulators are expected to continue seeking to provide a level playing field and prevent excesses. Greater transparency will be critical – not only as markets are given a greater role in the burden of supervision, but also because of the increased use of alternative suppliers.

Leading banks will focus on two objectives regarding current and future investments in regulatory compliance: leverage compliance investments enterprisewide and utilize these assets to help manage their business more effectively. While the expense of compliance is expected to rise, an enterprisewide approach can help reduce these costs. (see Figure 3).

**Figure 3. Total compliance costs (IT and administrative) for global financial services.**



Source: Tower Group.

**Specialization is expected to fuel additional regulatory concerns**

The increased use of specialist suppliers and partners will create a whole new set of risks and regulatory concerns for banks. Regulators will more closely scrutinize how these relationships are structured and how capable and financially viable partner companies are – which will come to have much greater implications for capital adequacy requirements in the future. To reduce the associated risks, banks will have to expand their vendor due diligence and audit programs, and enforce strict performance and reliability measures, as well as disaster recovery policies.

**Technology improves inexorably to enable breakaway value**

Advances in global connectivity and computing power will both create and support market conditions that foster specialization in the next ten years. Communication networks, supported by broadband and wireless technologies, will continue to make digital connectivity faster, more affordable and more pervasive, thereby making the connection with partners and customers nearly seamless.

Existing core bank systems are currently fragmented and could impair the leap to more agile business structures in the future. Service-oriented architectures will be leveraged to a far greater extent to enhance business flexibility by enabling faster software development and modification to meet changing business demands. What's more, information technology will continue to evolve with consolidation of the enterprise software market, proliferation of business integration software and the emergence of common solutions across the business environment.

The quantity of available data will continue to increase rapidly. Advances in storing, tracking, analyzing and protecting data will allow organizations to differentiate themselves by how well they can extract value from multiple sources by correlating structured and unstructured information to improve customer service. Increasing demand will drive IT investment in customer analytics. Customer data will be gathered at collective and individual levels, enabling deeper and more relevant communications. Advanced technologies, such as grid computing, will enable banks to make better use of existing resources to cope with the increased demand to perform all of this analysis.

Widespread digitization will increase security and business continuity threats. Emerging technologies, however, can provide more personal security and better customer authentication. Security-rich and resilient infrastructures can help banks protect against insider fraud, malicious attacks, and other security threats and vulnerabilities. Greater use of autonomic computing can further make the underlying infrastructure more resilient, flexible and efficient.

All of these technologies will also spur the creation of niche banks and infomediaries (exchanging electronic information between businesses and consumers), with nothing but brand and customer experience being their own – all other business functions will be managed by third parties (see Zopa example).

#### **Zopa – Leveraging technology to further disintermediate banks<sup>18</sup>**

Zopa.com's big idea: letting people who have spare money lend it directly to people who want to borrow it. "No bank in the middle, no huge overheads, no unethical investments."

To reduce risk, the money each lender puts in is spread among at least 50 borrowers (and likewise, each borrower gets money from a number of different lenders). Zopa is, therefore, "for people who want to be a part of something new, who want to join a community of like-minded individuals and lend to them and borrow from them in a trusting but secure way." As a result, Zopa claims to offer a better return because its interest rates aren't squeezed by middlemen (the banks).

#### **Asian economies: Becoming a much larger force**

While we expect these trends – powerful customers, intensifying competition and changes in human capital, regulations and technologies – to affect the industry on a global basis, the influence of particular trends will vary across regions. The Asia Pacific region is one of great diversity and immense importance to the banking industry. To better understand the opportunity presented by this dynamic region, we took a closer look at two of its key markets: India and China.

##### **India**

Poised to become the world's fourth largest economy within four decades, India is providing many with real purchasing power.<sup>19</sup> While India remains characterized by extreme wealth and poverty, a middle class is emerging, with absolute demand for products and services on the rise. With one of the most under penetrated retail lending markets in Asia Pacific, India offers great potential for the future of banking.

- Industry executives estimate that India's retail lending has grown by 30 percent a year in the past few years, and mortgages, which make up half the total, have been rising at an even brisker pace.<sup>20</sup>
- According to a study sponsored by Visa International, the number of credit and debit cards grew at an annual rate of 55 percent in the seven years to 2004. Indian citizens now hold 44 million cards, 14 million of which are credit cards.<sup>21</sup>

##### **China**

Many are betting that China's financial system is finally undergoing long-needed repairs. Top bankers see tremendous potential for banks to make lucrative loans, for the local bourses to take off, and for a bond market to develop in the coming years. What's more, Chinese customers are beginning to realize the value of credit cards, mortgages and personal finance.

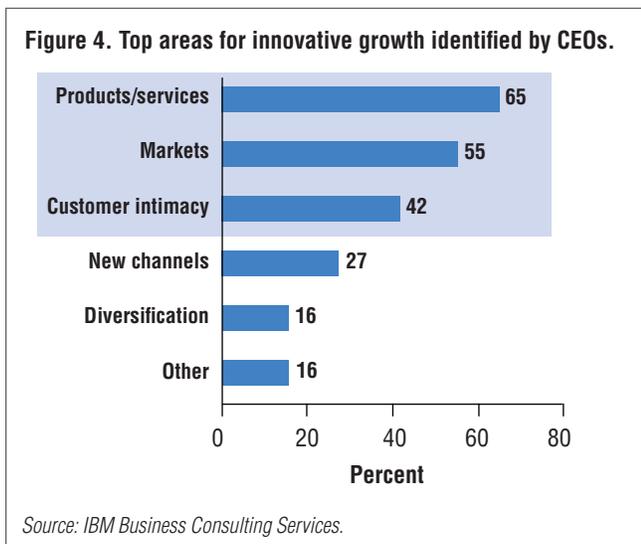
- Loans have grown nearly 16 percent from 2000 to 2004, and deposits have grown by 18 percent per year.<sup>22</sup>
- Lending to consumers, which only began in 1997, has exploded – increasing 123 times to more than US\$250 billion in seven years.<sup>23</sup>

As many banks are facing tight competition in mature home markets, innovative expansion strategies in Asia can fuel substantial growth. Continued focus on differentiating "local innovations" will be critical to realizing this growth potential – different markets will require very different strategies. Regardless of whether acquisitive or organic growth is pursued (or a combination of the two), product and service designs must enable the tailoring of standardized products to meet local market needs and business standards.

## Opportunities for innovative growth

While specialization is becoming imperative to compete in the retail banking marketplace of 2015, innovation is expected to remain a powerful, continuing source of competitive advantage and growth. In a 2005 survey of more than 100 financial services executives, 88 percent of participants stated that organic growth through innovation had become essential to success in the industry.<sup>24</sup> Sustainable value can be created by focused banks that combine product, service and process innovation with execution excellence to meet targeted customer needs.

In the 2004 IBM Global CEO study, a survey of over 450 CEOs worldwide, revenue growth was identified by 83 percent of respondents as the top focus area for strengthening financial performance over the next three years.<sup>25</sup> And new products and services, new markets and customer service were identified as the top areas for innovative growth (see Figure 4).<sup>26</sup>



Combining the results of the IBM CEO survey with market research and interviews with industry executives, we have identified five key areas of ongoing innovation that have the potential to fuel enormous growth for the retail banking industry: retail payments, mortgage loans, account and product integration, global expansion and the customer experience.

*In 2006, the IBM Institute for Business Value will publish an executive brief on the impact that innovation will have in fueling growth opportunities for the retail banking industry through 2015.*

## Strategic imperatives: Cultivating innovation

Astute banks will focus on four key imperatives now in order to gain optimum competitive advantage by 2015: focus on core strengths and partner for everything else, optimize the potential of each customer relationship, harness the potential of the workforce through effective performance management and recognize that technology will be a critical element of success. Each of these imperatives centers on optimizing the results of innovation initiatives.

### ***Focus on core strengths and partner for everything else***

Successful execution of specialization strategies will require banks to take a component-based view of their businesses and assess each component to determine where and how it should be managed. Banks will need to identify which components (or business modules) are truly differentiating and strategic, as opposed to those components that would be better served by leveraging best-in-class specialists.

Specialization will help ensure that banks invest and focus their innovation efforts on strategic components. If, as Bridge Bank determined (see earlier example), certain information technologies are not considered strategic in nature, firms may choose not to invest heavily in IT innovation. Rather, as that bank has done, they should partner with best-in-class specialists to attain IT proficiency, and invest instead in product, service and process innovations that enable real differentiation.

***Optimize the potential of each customer relationship***

To help ensure that they can be highly responsive to the changing needs and purchasing patterns of their empowered customers, banks will have to transform themselves into customer-centric firms. Cultivating a truly customer-centric culture requires getting to know customers and continually improving the customer experience. In doing so, banks will be able to identify who their most profitable customers are and can focus on building the right relationships with the right customers – rather than attempting to be all things to all people.

Pushing innovation in the areas of customer analytics and service techniques will become more and more important as a means of getting closer to customers and differentiating a bank from competitors, both traditional and emerging. Process innovation, including the use of incentives and rewards as part of employee performance management, will be essential to successfully executing these customer-centric strategies.

***Harness the potential of the workforce through effective performance management***

According to one survey of financial services executives, 88 percent of their firms believe talent is a very important or important contributor to business performance, and 92 percent believe that talent management is one of the top three sources of competitive advantage.<sup>27</sup> Despite this widespread recognition that an organization's people are critical to business results, banks will need to drastically change their existing talent development programs to better take into account projected industry trends and to establish effective incentive and performance management strategies.

Additionally, banks will have to focus on optimizing the collaboration of workers, both inside and outside the organization. Facilitating the exchange of knowledge among individuals and teams can fuel innovative ideas and generate new capabilities. Accompanying organizational design changes should include initiatives such as streamlining vertical line management structures, developing knowledge and talent marketplaces, and deploying teams to explore innovation opportunities.

***Recognize that technology will be a critical element of success***

Forward-thinking banks will leverage advanced technologies that can support the three previously-mentioned strategic imperatives. Most importantly, banks must conduct a technology capability assessment to prioritize areas of technological investment and to determine how best to leverage business process outsourcing for non-core functions.

Clearly, investment in advanced technologies can contribute significantly to optimizing the return on a bank's innovation investment. Use of service oriented architectures, open standard applications, advanced computing power and enhanced global connectivity can all help speed the pace of innovation development and reduce the time to market.

**Conclusion**

2015 will present tremendous challenges for the retail banking industry. Customers will become increasingly individualistic and, at the same time, more controlling in their relationships with banks. Ubiquitous information will empower customers to compare offerings across the market and transact increasingly on their own terms. For banks, traditional segmentation approaches and go-to-market techniques will become obsolete.

How retail banks compete in the marketplace will also change dramatically. Universal institutions will compete directly with community banks offering unique value propositions to targeted groups of customers. A flood of industry specialists and non-bank banks will both compel and enable traditional banks to become specialized enterprises themselves.

On the flip side, 2015 will present tremendous opportunities for retail banks, particularly with respect to harnessing product, service and process innovation to serve customers better, to differentiate themselves in an increasingly crowded marketplace, and to de-commoditize current products and services. Moreover, advances in technology will enable unprecedented levels of global connectivity, IT functionality and the ability to realize the enormous potential of data.

By 2015, success will depend on banks' ability to serve the specific financial needs of their target customers. Leading banks will make only highly strategic acquisitions focused more on reaching specific targeted customer segments (and in areas of their strategic focus) than on acquiring additional capabilities. As the open networked economy allows banks to strike alliances quickly with nimble service providers, capital will be freed up for ongoing reinvestment in strategic capabilities. Ultimately, banks can benefit tremendously from the industry paradox: achieving more by doing less.

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## About the authors

Kimberly Hedley is a Senior Consultant in the IBM Institute for Business Value, Financial Services Sector. Kimberly can be reached at [khedley@us.ibm.com](mailto:khedley@us.ibm.com).

John White is a Managing Consultant in the IBM Institute for Business Value, Financial Services Sector. John can be reached at [jmwhite3@us.ibm.com](mailto:jmwhite3@us.ibm.com).

Cormac Petit dit de la Roche is a Managing Consultant in the IBM Institute for Business Value, Financial Services Sector. Cormac can be reached at [cormac-petit@nl.ibm.com](mailto:cormac-petit@nl.ibm.com).

Sunny Banerjea is the Global Banking Industry Leader in the IBM Institute for Business Value, Financial Services Sector. Sunny can be reached at [sbanerjea@us.ibm.com](mailto:sbanerjea@us.ibm.com).

## Contributors

James (Rusty) Wiley, Global Banking Industry Leader, IBM Business Consulting Services

Mark Greene, Vice President, Strategy and Business Development, Financial Services Sector

Shanker Ramamurthy, Practice Area Leader, Strategy and Change, Financial Services Sector, IBM Business Consulting Services

Daniel W. Latimore, Executive Director, IBM Institute for Business Value

Saul Berman, Global and Americas Business Strategy Leader, IBM Business Consulting Services

Jeurg von Kaenel, Senior Manager, Human Centric Tools, IBM Research

Emeric Van Waes, Managing Consultant, Financial Services Sector, IBM Business Consulting Services

Eiko Heffer, Senior Consultant, Financial Services Sector, IBM Business Consulting Services

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With business experts in more than 160 countries, IBM Business Consulting Services provides clients with deep business process and industry expertise across 17 industries, using innovation to identify, create and deliver value faster. We draw on the full breadth of IBM capabilities, standing behind our advice to help clients implement solutions designed to deliver business outcomes with far-reaching impact and sustainable results.

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Somers, NY 10589  
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