TSYS® People-Centered Payments

White Paper

Bank 1.0 and Bank 2.0 Success Entails Learning from Each Other's Best Practices

By John Goodale

Executive Summary

"Institutions who hold on to the belief that physical branches remain at the core of what the [banking] branch does will not adapt easily to the customer of tomorrow — the customer who rarely visits a branch or who sees no need for an over-the-counter transaction with cash or checks."[1]

This quote from Brett King's book *Bank 2.0* underscores the banking world's technological revolution, as smartphone applications and social media allow customers to interact and transact with banks in new ways. To avoid appearing stodgy and to meet customers' rising expectations, banks must keep innovating and embracing new technologies and channels. Not only will this evolution help banks better engage customers, but it may even help them overcome some of the consumer mistrust generated from the financial turmoil of recent years.

This report does not favour a branch-centric or a branchless approach; rather, it recommends banks adopt a customer-centric model that leverages the latest technologies for customer interactions in conjunction with the best practices of traditional banks.

This report stresses the importance of banks continuing to learn from and follow the lessons of traditional banking as they move toward the future. The most successful transitions will likely involve a hybrid approach: One that builds upon the best practices from the traditional banking model while integrating next-generation practices that consumers want and expect.

Some banks are already gaining a competitive advantage by introducing instant communication channels that enhance customer relationships, such as mobile applications. Bank transactions and communications are increasingly moving away from the traditional branch-, card- and paper-based systems, as more consumers gravitate toward banks that provide them with on-demand access to account information and can facilitate transactions through smartphones and tablets.

To better explain this changing landscape, this report will refer to banks in two ways: Bank 1.0 and Bank 2.0. Bank 1.0 is a financial institution (FI) with transactions primarily handled through traditional banking channels. Bank 2.0 is purposely built without the infrastructure needed to support traditional banking practices and a branch-centric model.

This report does not favour a branch-centric or a branchless approach; rather, it recommends banks adopt a customer-centric model that leverages the latest technologies for customer interactions in conjunction with the best practices of traditional banks. It will outline some of the best practices of Bank 1.0 and Bank 2.0, and will explore some increasingly critical elements that more traditional banks should adopt to maintain relevancy. The three critical factors explored in our roadmap for success include: 1) Building upon core Bank 1.0 practices; 2) Understanding today's consumer banking behaviours and preferences; and 3) Improving the customer experience with technology while gathering better insights.

Three Strategic Considerations for Evolving Bank 1.0 & Strengthening Bank 2.0

The financial crisis that started in 2008 had a harrowing effect on many banks' bottom lines. In the giddy days of the 1990s through the first several years of the new millennium, big European retail banks' costs relative to top-line revenue

Disruptions Affecting Bank 1.0

1970s/80s ATMs

- Withdrawing cash and completing basic transactions at the ATM
- Proliferation of ATMs in urban landscape

Impact: Masses are now accustomed to transacting with machines in lieu of humans.

1990s: Internet

- On-demand account access becomes available
- Security and user-friendly interfaces are ubiquitous

Impact: Eliminates need to leave home for many basic banking functions.

2000s – present: Smartphone / Apps

- 3G smartphones support basic banking transactions
- Apps allow for payments, transfers and account details
- Some banks offer deposits via mobile photo capture
- Apps provide ATM-locator function

Impact: Further decreased need to visit bank branch for basic banking.

growth have not improved more than 0.3 percent annually, according to Barclays investment analyst Simon Samuels.[2] This was not an issue when revenue was on a steady upward trajectory. However, over the last several years, profits in retail banking have taken significant hits due to the one-two punch of low interest rates and regulatory fervor. With interest rates so low in most of Western Europe, banks can't rely on the spread between current and saving account deposits, which currently pay little interest, and the rates charged to borrowers. McKinsey's Pedro Rodeia estimates that half of the accounts at the larger European retail banks are unprofitable.[3]

The financial strain on the banks, however, should be viewed as a wake-up call: They need to find new ways to generate revenue and control costs, and they can do so by capturing a wider consumer base, deepening engagement with existing customers and turning to alternative channels. Royal Bank of Scotland (RBS), for instance, recognise the need to rebuild trust with their customers and aim to be "Britain's most helpful bank" — as outlined in the RBS Customer Charter.[4] Both Bank 1.0 and Bank 2.0 can improve their competitive positions by trying to better understand today's consumer behaviours and by incorporating industry-wide best practices.

Strategic Consideration#1
Building Upon Core Bank 1.0 Practices

What can financial services firms learn from the Apple experience? Whether you're a Dell, Mac or HP computer user, you are probably aware that Apple is the most valuable brand of personal computers in the market today. As Brett King points out in *Bank 2.0*, Apple have learned that the brand needs multiple channels to interact with the various customer segments, and doesn't rely solely on one particular channel to engage its customer base.[1] In fact, even though Apple sells some of today's most technologically advanced mobile devices, such as the iPhone and the iPad, the brand still relies heavily on brick-and-mortar retail stores, which transact more revenue per square foot than any other retailer.[5] Along with the physical stores, however, Apple also maintains online and mobile channels. The brand has designed a range of relevant customer touch points that reflect customers' attitudes and behaviours in order to serve multiple customer types. And by doing so, Apple have become rightly famous for nurturing extreme loyalty among their customer base.

It's important for banks today to nurture their best customers (and potential customers) using a range of different channels — and they can't overlook the value of holding onto existing loyal customers. After all, it is far more expensive to acquire new customers than to retain existing ones. In fact, FIs that increase their retention rates could experience 8 percent improved margins for every 1 percent in retention rate improvement.[6]

Insight #1:
Bank branches strengthen customer relationships.

While bank branches are still important, there's growing evidence that customers are relying more on automated technology for basic banking tasks, such as deposits, withdrawals and account management. Recent estimates suggest at least 44 million people in the U.K. — or 72 percent of its population[7] — use technology for some type of banking. As reported by the Payments Council, "a quarter of [British] Internet users now log on to Internet banking every day, while a further two in five (39 percent) use Internet banking at least weekly." Contrarily, "only 13 percent of online Brits make a weekly trip to their local bank branch to manage their money."[8] Given this global shift toward online banking, a leading national U.S. bank, Bank of America, closed 600 branches in 2011, or about 10 percent of its total branches.[9] The *Wall Street Journal* reported, "the driving force for the closings is changing customer preferences."[10] In developed countries in the early 1990s, customers visited the branch a couple of times each month, on average. In recent years, that rate has contracted by about 90 percent to a mere two or three times per year.[11] Some banks, such as HSBC and RBS, are closing branches to cut down on network costs while expanding their online presence.[12] Given this trend and the fact that Bank of America are closing so many of its branches, why are leading banks like Wells Fargo and JPMorgan Chase expanding their branch presence?

The answer is complex and deserves exploration. The trend toward online banking highlights the need for a multi-channel, yet integrated and synchronised approach to serving customers. Solely providing customers with multiple channels for engagement is not the solution. Giving customers the option to engage with multiple channels continues to constrain each customer interaction to a single and isolated event versus the cumulative view of the customers' responses and pattern of interactions with the institution. While customers' preferences are indeed evolving, the bank branch still serves a vital role. A recent study conducted by the Direct Marketing Association (DMA) found that "Visibility on the high street is still an influential channel for prompting consideration of brand, with 47 percent agreeing this is important and 18 percent disagreeing."[18] Even some younger entrants to the market, like Metro Bank, recognise the importance of establishing a retail banking presence and are opening physical branches.[13] Another case in point are Virgin Money, known predominantly as an online bank, which have purchased Northern Rock in order to secure a network of branches.[14]

Insight #2:
The look, feel and purpose of branches are evolving.

Understanding the role of the bank branch and paper-based communications is essential to understanding how customer banking relationships are evolving. Bank branches have yet to be displaced by ATMs or online banking. The core value of a brick-and-mortar bank branch is fostering personal relationships with customers and conducting business that cannot be easily handled remotely. Many customers still prefer personal interaction for certain transactions, such as arranging a mortgage or depositing cheques into an account. Bank branches have the potential to create positive, negative or mediocre customer impressions, but the best ones strengthen customer relationships. Recently, RBS technical glitches resulted in a backlog of payments affecting about 100,000 customers.[15] In response, RBS determined the right solution was to keep branches open longer in order to meet customers' expectations and address the influx of customer queries. According to an RBS press release, "Our staff have already helped thousands of customers to access cash and we will continue to provide this service on a 24-hour basis while we work to resolve the problems."[15] Underscoring the importance of convenience to today's consumers, banks have even begun offering products and services through retailers and supermarkets. Tesco Bank, which has 6.5 million customers across the UK, are one of the largest to utilise such a setting. Following suit this summer, the high street retailer Marks & Spencer recently announced that it will launch 50 in-store branches backed by HSBC, which already has 3 million customers of their M&S Money credit cards, loans and savings accounts.[16]

Many executives realise that positive customer experiences at branches will result in higher customer satisfaction and, ultimately, higher revenue growth. It is vital for banks to carefully manage their branches in order to better engage customers. Today, there is an opportunity to reevaluate the role of in-branch services. For instance, the role of the bank cashier — someone who traditionally performed transactions — could evolve into a more customer advisory role. Once a customer's lifestyle, needs and goals were understood, an advisor could optimise his or her use of bank products. In the near term, the customer can save money, while over the longer term the bank can benefit from increased customer retention and cross-selling opportunities. Another example: specialty coffee is served at the new, bright orange ING Direct Café near San Francisco's Union Square to complement the company's well-known online presence.

The bottom line? Banks of all kinds find value in having physical branches, places where they can meet customers face-to-face, even as they continue to invest more heavily in new and emerging channels. At BNP Paribas, where the term "branch" is no longer in vogue, a concept store in Paris allows the customer to "see an advisor while having a coffee…it is designed to encourage more proximity, more interaction, more personal contact," says Nathalie Martin-Sanchez, who oversaw the creation of the branch. A similar approach is being pursued in Singapore at Citigroup, where the company hired Eight Inc., a firm that designed Apple's stores.[3]

Insight #3:
Paper-based communications remain effective.

While banks may close branches at their own discretion, they are still required in many cases to provide customers with paper statements. For example, interest-rate changes on consumer credit cards currently must be communicated by paper. But despite such regulatory matters, paper statements should not necessarily be cast aside as archaic. Studies have found that many customers view them as an indispensable and valuable touch point. In a recent paper, TSYS highlighted findings from an envelope open-ability study, which found that mail (not email) is still one of consumers' preferred methods of communication for content such as bills, bank statements, invoices, catalogues, brochures and coupons.[17] Furthermore, the study found that "18-34 year olds are more likely than 35-49 year olds to look forward to opening their physical mail." Another study focused on consumers' attitudes toward financial statements found that "70 percent of consumers aged 25-34 who receive bank statements read them on paper — even if they are heavy Internet users." After all, mail is more likely than email to be considered safe, private and delivered from a trustworthy source. A common solution banks use is to allow customers to select their delivery method and opt out of paper-based statements while continuing to send them to customers who value them. Although, banks do allow customers to select their preference and opt-out of paper based statements but continue to send them to those who value them.[18]

The critical takeaway for banks, whether 1.0 or 2.0, is that traditional Bank 1.0 delivery channels should not be displaced, but rather built upon. "Development of this new communication channel [social media] does not hold the possibility of providing the social and communications benefits of in-person banking that have eluded electronic delivery channels to date."[24]

Strategic Consideration #2
Understanding Today's Consumer Banking Behaviours & Preferences

Banks today often view emerging technologies through the prism of generational segments, such as baby boomers, "Generation X" and "Millennials." However, it is becoming even more relevant to consider clustering by customer behaviours. It is often assumed that younger customer segments — Millennials or Generation Y — are more likely to embrace emerging channels. Yet a recent survey conducted by the American Bankers Association[19] found that online banking is surging with the presumably more-traditional segments: In 2011, 57 percent of bank customers age 55 and older said they prefer banking online, compared to only 20 percent in 2010. The survey also found that 62 percent of all bank customers now prefer online banking to other methods of banking, compared to just 20 percent in 2010.[19]

An example of a bank responding to customers' evolving preferences and behaviours is Garanti Bank, one of Turkey's largest private banks. According to the Banks Association of Turkey, "one out of every four (people) using Internet banking in Turkey prefers Garanti Internet Banking." The bank is trying to steer customers toward using branchless channels by offering incentives such as lower transaction charges, electronic savings accounts with higher interest yields and online loans with interest rates lower than those offered offline.[20]

All across Europe, banks are innovating when determining how they conduct business. Poland has among the most competitive banking markets in Europe, and some of the industry's most innovative approaches to distribution and channel management originate here. One example is mBank, established in 2000 as a virtual bank that leverages technology to improve efficiency and coverage, thereby improving customer access. The company uses multiple channels, including mKiosks, virtual banking, ATMs and call centres to engage customers on multiple levels.[21] By responding to customers' desire for convenience, it has grown to more than 2.5 million customers to become one of the largest retail banks in Poland. This case study underscores how important it is for Bank 1.0 to incorporate elements of Bank 2.0, yet not completely abandon its traditional channels, such as branches and ATMs. In fact, 20 percent of U.S. customers still prefer banking at branches, compared with only one percent who prefer mobile banking.[19]

Bank 1.0 can also leverage today's plethora of mobile apps to better serve customers who, for instance, want to identify the nearest branch or ATM based on their current location. This is very basic functionality, but can help create a more holistic customer experience.[22] As customer behaviour shifts toward banking in the virtual world, banks will accelerate this trend by offering a more compelling user experience. Many banks still cannot sell effectively online and instead push their customers to the branch at every opportunity.[23] Those banks that crack the code on providing a robust online user experience will gain market share while decreasing costs.

Another study finds that customers who perform transactions or seek information via mobile or other online channels have higher engagement with social media.[24] A Mercator report about this study discusses how more networked customer segments hold higher expectations of their banking experience and are more likely to share their experiences in online forums. However, the report also notes that mobile banking users still value the Bank 1.0 offerings, such as ATMs and branches, and care about the overall reputation of their bank. The critical takeaway for banks, whether 1.0 or 2.0, is that traditional Bank 1.0 delivery channels should not be displaced, but rather built upon. "Development of this new communication channel [social media] does not hold the possibility of providing the social and communications benefits of in-person banking that have eluded electronic delivery channels to date," said the study.[24] Bank 1.0 should avoid alienating existing or slow-adopter customer segments by moving its focus too quickly on emerging technologies at the expense of existing and proven touch points. Moreover, banks must broach their customer relations through new technologies carefully and thoughtfully. After all, customers have grown accustomed to navigating their daily lives with smart phones, tablets and other connected devices, and this revolution is driving new expectations for communicating with their banks as well.

Strategic Consideration #3 Technology: Improving the Customer Experience While Gathering Better Insights

Garanti Bank leverages social-networking services to communicate with its more than 2 million active customers. According to its website, Garanti "carries out accurate and efficient analysis of demands and introduces its products and services on one hand, while maintaining active contact with users on the other hand."[20] Leveraging technology to better serve and engage customers is critical for Bank 1.0. New customer tools, such as mobile banking apps, enhance the customer experience by providing greater access to account information wherever customers happen to be. However, beyond stronger communications, emerging technologies can provide additional benefits to the bank: For one, these technologies allow banks to collect better customer insights, such as their usage habits, that can help with product development and communications strategies. Data collected from online platforms, such as social media or mobile apps, gives banks an unprecedented look at their customers' behaviours.

Take Facebook, for instance. The world's largest social networking site collects huge amounts of data on its users, sharing that information with other companies. The data and analysis Facebook provides can offer FIs rich insight into their customer base and specific segments. It's critical for FIs to not only understand which customers are the most profitable but also how customer segments are engaging with the institution. Using such data, FIs may be able to understand how losing one customer impacts the perceptions of his or her friends. Moreover, it can help banks better target ads and offers on Facebook that prevent churn and improve customer retention. Other insight that can be gleaned from social and mobile: Are customers responding to bank-initiated texts about overdue loan or credit card payments? Are there certain days and times of the week when bank customers or prospects are more receptive to cross-selling? Or, do single-use transactions take into consideration the knowledge of context and location to change the customer experience? These insights bridge the knowledge gap, creating a better experience for the customer and potentially healthier revenues for FIs.

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Beyond customer insight, mobile-facilitated transactions may even help FIs improve their security. Mobile applications can provide location and other usage data that help banks make real-time risk judgments by spotting potentially fraudulent transactions. A final example is using the new sensory data available from mobile phones to enhance security and at the same time improve the customer experience. Making customers' lives easier used to mean lowering security and risking more fraud. With increased amounts of location data and device history data from mobile phones, FIs can make real-time risk judgments of online transactions. In other words, having the right technology in place to collect and analyse data allows institutions to engage customers more effectively, efficiently and securely.

Collecting data via mobile devices also allows banks to apply some lessons from the retail industry, which uses shopper behaviour data to boost product sales. This data mining helps retailers understand correlations between products that would not typically be categorised or shelved together. For instance, a retailer might determine that women who buy

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paperback books often buy sweets at the same time. In this example, the store would leverage this knowledge by placing confectionary near or within the same aisle as paperback books — a common cross-selling technique. Similarly, FIs should understand correlations between various different transactions among their customers in order to effectively cross-sell products and services, such as marketing personal protection insurance to customers who predominantly bank online. Data mining can also arm FIs with the knowledge to effectively communicate with customers through their preferred method, whether by mail, face-to-face, online, mobile or the next generation of technology.

Consumers seek more access and the ability to manage communication channels.

While technology enhances an institution's knowledge, it also improves customer knowledge. Consumers have more diligently managed their personal finances in recent years due to the poor economic climate and tight credit environment. In doing so, they have turned to personal finance and analytical sites like moneydashboard.com or mobile apps that provide remote access to their information in a way that's most useful to them. For example, consumers may choose to receive fraud alerts by SMS texts, monthly statements via email and year-end documentation by standard mail. Giving customers the power to choose makes each channel work more effectively for both the bank and the customer. Typically, every customer wants information on different media — but why send the same communications four to five times when FIs can provide customers with a choice? This demand for better financial access has led to customers expecting such technologies from their bank. Utilising a full-channel solution, as opposed to a one-size-fits-all approach, makes it easy for customers to communicate and transact in a way that is most convenient and comfortable for them.

But it's not just account information that customers seek. They also increasingly want to be able to conduct transactions, such as payments, through online and mobile technologies. PayPal aspires to be "the world's most loved way to pay and be paid" by providing secure peer-to-peer payments on a global scale. One can use PayPal online via sites like eBay or directly paying for small business services, and most recently, it has offered retailers a way to use it offline in brick-and-mortar stores as well. Increasingly behind us will be the days of a friend borrowing money that is not repaid via solutions like PingIt, Barclays' smartphone application. PingIt supports peer-to-peer transfer of funds within 30 seconds by synchronising users' phones with their bank accounts, enabling them to transfer money using a mobile number.[26] Consumers also have access to a wider array of mobile-based payment technologies, such as near-field communication (NFC) or Square technology, which is essentially a debit/credit-card machine for smart phones. In order to defend against startups chipping away at their market share, more established banks need to embrace these technologies that are quickly becoming mainstream in order to stay relevant and meet consumers' evolving expectations.

UK residents own on average 1.33 mobile phones. It is projected that "22 million consumers aged over 13 will be buying mobile devices in the next year, and some 80 percent of them are expected to buy a smartphone."[26] Clearly mobile will not completely replace other channels — online or offline — but rather will enhance the overall customer experience by providing customers with options for how, when and where they choose to engage with their banks. The creation of a mobile-banking platform provides FIs two big advantages: First, it extends the reach of banking communications by opening up alternative communication channels — such as email or SMS alerts — for exchanging detailed account or payment information. Second, it allows banks to extend their reach beyond the branch and to better meet customer acquisition and retention objectives.

Regardless of where a bank falls on the 1.0 to 2.0 spectrum, today's services and offerings must work across a range of integrated channels and understand customers' various needs, expectations and preferences. And just as Bank 1.0 needs to embrace the technological advancements already featured in Bank 2.0, vice versa is true: Bank 2.0 must understand the advantages that Bank 1.0 offers — including perceptions of stronger security measures, face-to-face customer relationships and potentially better accessibility and brand-name recognition. Offering enhanced security measures, for instance, could be a true differentiator for a Bank 2.0.

Conclusion: Services & Channels Must be Developed to Work Across Bank 1.0 & 2.0

It's too early to completely displace branches and adopt a pure Bank 2.0 model. But both Bank 1.0 and Bank 2.0 can benefit from adopting and integrating each other's best practices. This would enable more-traditional banks to better position themselves to match customers' evolving preferences. Likewise, Bank 2.0 can take a lesson from the longstanding practices of Bank 1.0 to help ensure it isn't alienating customer segments by failing to offer communication and channel preference management — thereby empowering them to choose how they want to interact, whether via a customer service IVR system, an ATM or a brick-and-mortar branch. This allows every channel and interaction to serve a purpose and gives customers the authority to decide what that purpose is. While a customer may not switch banks because their current bank doesn't offer a mobile app, a mobile app could be an influential factor when initiating a new banking relationship. This isn't to suggest that banks should rush out to add new channels, but rather to point out that it's important to evaluate opportunities from a people-centered perspective in order to deliver a secure, reliable and seamless transaction experiences across any connected device. As banks add new communication and transactional channels, it's essential that they clearly communicate how these channels can work together to improve the customers' banking experiences. No one wants to receive the same message more than once, but a message sent through the wrong channel is a lost opportunity to enhance and strengthen relationships with customers.

BANK 1.0 Takeaways

- Disruptive technologies will continue, and Bank 1.0 must innovate and embrace elements of them.
- Customers today want the best of both worlds. Banks need to explore emerging channels while enhancing, not abandoning, traditional ones.
- Positive, personalised customer experiences can be created through emerging channels, including smartphone and tablet apps. These channels offer opportunities to interact and better serve a range of existing and prospective customers.

BANK 2.0 Takeaways

- Technology alone will not trump a solid reputation. Banks relying solely on new and emerging technologies must work to build relationships and trust with existing and prospective customers.
- Traditional touch points often still matter. For instance, most customers open and trust paper-based statements more than email statements.
- It's important to keep evolving. Peer-to-peer payments aren't yet mainstream, but are an example of a new channel positioned to grow.

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ABOUT TSYS

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TSYS' headquarters are located in Columbus, Georgia, with local offices spread across the Americas, EMEA and Asia-Pacific. TSYS provides services to more than half of the top 20 international banks, is a Fortune 1000 company and was named one of the 2012 World's Most Ethical Companies by Ethisphere magazine. For more information, please visit us at www.tsys.com.

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