

Branching out: can banks move from city centres to digital ecosystems?

Facing extinction on the high street, banks are doubling down on creating tech-enabled, inclusive ecosystems where customer experience is king.

- As the branch closures of covid-19 accelerate consumer shifts to online banking, 65% of bankers now believe that the branch-based model will be "dead" within five years, up from 35% four years ago, according to new research from The Economist Intelligence Unit.
- Four in five (81%) bankers believe that banks will seek to differentiate on customer experience rather than products. Mastering both customer experience and digital marketing are ranked as top strategic priorities over the next four years.
- The pandemic has jolted laggards into action, spurring a culture of collaboration and experimentation among previously complacent banks. A plurality (47%) expects their businesses to evolve into "ecosystems" over the next two years, which will involve partnering with banking and non-banking third parties.
- Incumbent banks and fintechs face a new financial inclusion imperative as the pandemic redefines the role of financial services in society. Bankers view microfinance for entrepreneurs (34%) and accounts for the unbanked (33%) as the most promising inclusionrelated business opportunities.
- Just under two-thirds (65%) of banks see new technologies as the greatest driver of change for the next four years, up from 42% three years ago. But as tech becomes more critical to competitive differentiation, the threat of competition from major tech and e-commerce disruptors is becoming existential.



Crunch time for banks

Bankruptcy comes two ways, Ernest Hemingway wrote: "gradually, then suddenly". Such has been high-street banking's fate at the turn of the decade. Justifying the axing of a fifth of Santander's branches, deputy chief executive Tony Prestedge told the BBC that branch transactions at the eurozone's largest retail bank had fallen by a third in the two years prior to the covid-19 pandemic—before they plunged by half during the lockdowns of 2020. "The pandemic has 'concertinaed' five to ten years of change into a year," said Mr Prestedge. The rapid collapse of branch-based banking is an acceleration of a trend that The Economist Intelligence Unit's global banking survey, now in its eighth year, has long seen coming. In the latest survey, conducted in early 2021, just under two-thirds (65%) of banking executives agreed that the branch-based model will be "dead" within five years, up from 59% last year and 35% in 2018 (see Figure 1). In 2018 69% of Europe-based respondents disagreed with the statement—today the same proportion agree.

This year's survey finds that branch closures and continued pressure from non-traditional competitors have triggered a wholesale rethinking of banking priorities and business models among banking executives.

About the survey

In February-March 2021 The Economist Intelligence Unit, on behalf of Temenos, surveyed 305 banking executives on themes relating to the digitisation of banking. The survey included respondents from retail, corporate and private banks in Europe (25%), North America (24%), Asia-Pacific (18%), Africa and the Middle East (16%), and Latin America (17%). Respondents performed different job functions within customer service, IT, finance, and marketing and sales. Half were C-suite executives. The survey is part of a worldwide research programme on banking in the post-covid era. It draws on in-depth interviews with retail, corporate and private wealth banks, regulators, international organisations, and consultancies.

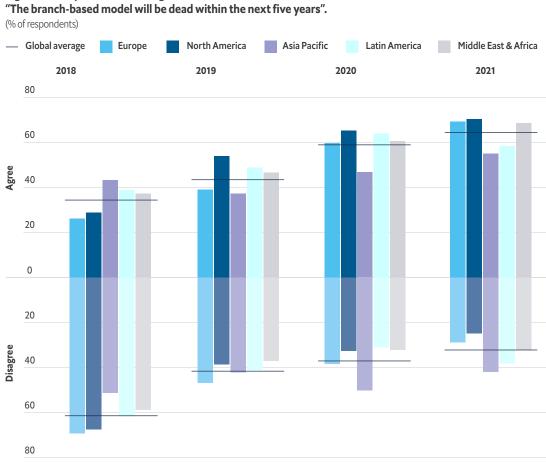


Figure 1. Today, most bankers agree with the statement:

Source: The Economist Intelligence Unit

Just under two thirds (65%) of bankers now believe that the branch-based model will be "dead" within five years, up from 35% four years ago. The rise has been sharpest in Europe and North America.

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Banks in 2021 face competition from all sides. New, nimbler competitors including fintech startups, payment players, superapp platforms and tech giants continue to gain market share from incumbent banks as more non-traditional players gain the ability to offer more traditional banking services. A number of youthful fintechs have landed banking charters in the past year, including Varo and Square, enabling them to take deposits and extend credit. The growth of capital markets and central banks' tentative experiments in digital currency further threaten banks' very *raison d'être*.

But banks are coming out fighting. The stumble of some consumer challenger banks over the course of the pandemic—firms such as Monzo and Revolut struggled with sharp falls in revenue and customer complaints over missing funds—has put smartphonefriendly, slick interfaces in sharp contrast with the dour reliability and brand recognition of established banks. Critically, customers appear to remain reluctant to trust digitallynative challengers with salary deposits. Many established banks, spurred by rapid consumer change forced by the pandemic, are hopeful that through strategic partnerships and investments in technology they can be the best of both for consumers: a trusted banking partner, and purveyors of whizzy, consumer-friendly banking experiences.

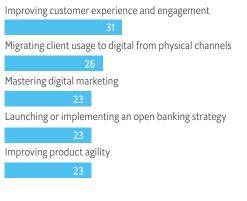
Customer experience: the currency of competition

This year's survey reveals a dramatic shift in priorities. Five years ago, as banking costs soared due to new regulatory requirements worldwide, banks were focused on cutting costs and boosting margins to maintain shareholders' return-on-equity. Today, customer experience and digital marketing are top priorities for executives (see Figure 2) as they strive to compete with challengers' frictionless onboarding, budget planning and perks such as free international payments.

Solution of bankers believe that banks will seek to differentiate on customer experience rather than products.

Figure 2. Improving customer experience and digital marketing are banks' top priorities in the next five years (% of respondents)

Europe



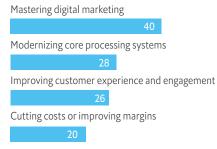
North America



Asia-Pacific

Improving product agility 35 Improving customer experience and engagement 34 Mastering digital marketing 27 Launching or implementing an open banking strategy 26 Migrating client usage to digital from physical channels 25 Modernizing core processing systems 24

Africa and the Middle East



Latin America

Migrating client usage to digital from physical channels

Improving product agility

Mastering digital marketing

26

Modernizing core processing systems

Improving customer experience and engagement

Your other bank

Founded in 2015, Lunar, a Danish appbased banking platform, offers investment products in addition to traditional bank accounts to its customer base of 200,000 users across Denmark, Sweden and Norway. In April 2021, the neobank acquired Swedish digital lender Lendify, having launched its own credit product in December 2020.

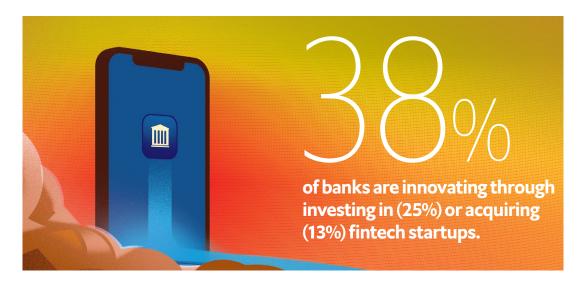
According to Morten Sønderskov, the firm's chief operations officer, Lunar,

which obtained its banking licence in August 2019, sees itself as a complement to, rather than a direct competitor to incumbents. That has allowed it to focus on customer experience. "When we introduced the investment products, we saw lots of best-in-class platforms, so we hooked up with them—but made sure the design and engagement was right," says Mr Sønderskov.

David and Goliath: winning together?

Burdened by physical branches and legacy systems, and with challengers offering attractive auxiliary products and often superior customer service, many established banks are opting to partner with fintechs. Some 38% of banks are innovating through investing in (25%) or acquiring (13%) fintech startups, according to this year's survey, while 24% report participating in sandboxes to test new propositions.

This past year has seen a flurry of partnerships. The UK's TSB partnered with ApTap to help customers manage utility bills and switch energy providers within their online banking dashboard; ING Belgium launched a similar capability in its banking app in March, powered by a partnership with a Swedish fintech, Minna. In the US, JPMorgan Chase has doubled down on its partnership strategy, declaring itself the "Amazon Web Services of payments"—meaning a platform of capabilities and services—and highlighting the allure of the bank's 4m merchant customers as a data set for fintechs to leverage for new product innovation.



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Just under half (47%; up 6 percentage points from two years ago) of survey respondents expect their business to evolve into true "ecosystems" over the next two years, whereby banks offer their own and thirdparty products and services to customers as well as other financial organisations. Respondents from Latin America (50%) and the Middle East and Africa (50%), where a large proportion of the population is unbanked or under-banked, are the most strongly convinced (see Figure 3). In both markets, access to banking has developed through non-banking fintechs such as mobile money operators, digital wallets or payment apps, and ecosystem thinking is mainstream.

Ecosystems are going global, and banks and non-banks are intent on being at the centre of them. The world's largest retailer, Walmart, is following a model pioneered in Asia by developing a "super-app" to package a suite of financial products and services with its retail offering, the first of its kind in the US.¹ Meanwhile, banks are opening up services and customer data to others: just under a third of respondents (31%) report innovating through open bank hub initiatives, giving customers the option to connect their bank data with third-party providers.

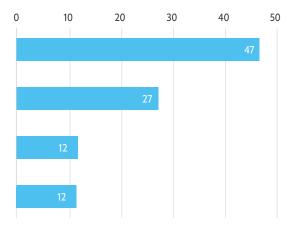
Figure 3. Banks see their business evolving into true digital "ecosystems" (% of respondents)

Acting as a true digital ecosystem (offering own and thirdparty banking and non-banking products and services to own customers as well as to other financial services organisations)

> Maintaining own product offerings and becoming an aggregator of third-party banking and/or non-banking products (PFM comparison websites, etc.)

Becoming an aggregator of third-party products and services only (PFM comparison websites, etc.)

Developing a niche proposition for own customers



Source: The Economist Intelligence Unit

Asked how they primarily see their digital business evolving over the next two years, just under half (47%) of the bankers surveyed expect their business to evolve into true "ecosystems". Ecosystem thinking is strongest in Latin America and the Middle East and Africa.

Culture shock

Aalishaan Zaidi, global head of digital banking at Standard Chartered, notes a shift in attitude and culture as a result of the pandemic. The crisis has jolted incumbents into action, spurring a culture of collaboration and experimentation.

"The big shift for us was our belief that we could change fast if we really wanted to," says Mr Zaidi. "We would have never done the partnerships we are doing now."

The bank's consumer, private and business banking division has now set up partnerships as a material global vertical business line. Bringing in co-founders of start-ups has provided valuable insights. The pandemic also broke long-held myths, such as the idea that call centres had to be centralised, giving management and staff the confidence to experiment.

"We are experimenting with multiple business models, because, frankly speaking, we don't know what the future business

The inclusion imperative

A year of branch closures, cashless transactions, consumer debt relief and government-backed loan schemes has shifted the perception and role of financial firms in society. As institutional investors pressure banks to boost the 'S' and 'G' of their Environmental, Social and Governance (ESG) plans, financial inclusion and responsible lending has been hoisted to the top of banks' agenda.

Much of today's disruption in finance and banking is rooted in the innovation of creative

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We are experimenting with multiple business models, because, frankly, we don't know what the future business models will be."

Aalishaan Zaidi, global head of digital banking at Standard Chartered

models will be," says Mr Zaidi. But the bank has set ambitious targets: more than half of future top-line revenues will come from new business models, even where revenue streams are not yet apparent.

Standard Chartered's new-found flexibility has resulted in the creation of a multicountry digital bank in Africa offering instant onboarding for the un- and underbanked, digital bank Mox in Hong Kong, and banking-as-a-service in Indonesia.

entrepreneurs, particularly in emerging markets, finding new ways to mediate trust, extend credit or facilitate payments among un- or underbanked populations—and innovation to this end is only increasing.

Microfinance apps, such as Tala, are opening up new prospects by allowing small-business owners to apply for loans regardless of their financial history. The app, which operates in Kenya, Mexico, the Philippines and India, uses alternative datasets such as daily-life smartphone data to determine a credit score and grant loans between US\$10 and US\$500 to a mobile wallet. Our survey respondents viewed microfinance for entrepreneurs (34%) and accounts for the under-banked (33%) as the most promising opportunities in this sphere. For incumbents and new players, being able to offer inclusive products and services profitably will mainly depend on the development of low-cost, scalable cloud (47%) and increased mobile coverage via 5G (26%).

Technology first

The emergence and adoption of new technologies is viewed by 65% of respondents as the trend that will have the biggest impact on the sector for the next four years, up from 42% three years ago. Respondents rank changing customer behaviour as a much less significant driver (see Figure 4), a reminder that consumers are lured by customer experience afforded first by innovation in new technologies.

Four in five (81%) report that unlocking value from AI will be the key differentiator

between winning and losing banks. Overall, a third of respondents are focusing technology investments on AI platforms, particularly to support better customer experience and product personalisation. The most common use is in digital advisors and voice-assisted engagement channels.

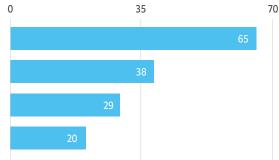
Although technology drives industry change, bankers are also mindful of the impact of its regulation—in data protection, digital taxation and the like. Regulation is the second most impactful trend that bankers identify in the sector (see Figure 4). As the European Commission sets out new regulation on what it regards as "high-risk" uses of AI-for instance, assessment of customer creditworthinessfirms adopting AI will need more in-house specialisation and monitoring. Banks can expect Europe's laws to influence global policymaking. How to balance the use of customer data to enrich customer experience while complying with regulation-without betraying customer trust—will challenge banks.

Figure 4. Bankers expect technology and technology regulation to have the greatest impact on their business in the next four years (% of respondents)



Chaning political, socioeconomic, or public health environment





Banking on the cloud

Adoption of cloud infrastructure—for additional processing capacity, service capabilities and to outsource data storage has accelerated since the pandemic as banks seize an opportunity to accelerate digital transformation projects, and technologies have matured such that they can meet the demands of regulators and financial institutions. Just over a quarter (27%) of survey respondents report focusing technology investment on cloud. Nearly six in ten respondents (59%) believe that bank-owned data centres may no longer be relevant, as banking will be cloud-based in the next five years.

But it is cybersecurity that understandably remains banks' top technological investment priority (cited by 36%), as threats grow in type, complexity and severity. Banks' focus on cybersecurity is consistent with other sectors. Since the pandemic, regulators have moved to tighten oversight of outsourced functions, which may leave services vulnerable to third-party system disruptions, spurring firms to tighten cybersecurity measures.² As technology becomes more critical to competitive differentiation, the threat of competition from major disruptors such as Google, Facebook and Alibaba is becoming increasingly apparent. Major technology players, despite so far only dipping toes in the market, have a depth of expertise that traditional banking institutions will struggle to match. More than a third (36%) of respondents say that non-traditional rivals will be top competitors—up from 27% two years ago.

Banks and major technology firms currently stand to benefit from co-existence, and collaboration is the spirit of the day. Google is introducing Plex as part of its Google Pay app, where users will be offered fee-free current and savings accounts by bank and credit union partners; in 2020, Barclays partnered with Amazon in Germany to offer credit to shoppers at checkout, with the two parties sharing consumer data and leveraging AI analysis to approve loans. But it remains to be seen whether major technology firms are content with partnership and co-existence—or stand to pose an existential threat to banks.

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