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How to prepare for Asia's digital-banking boom

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A generation of digital-banking customers is rising across Asia. They will want full digital access to the latest offerings and a more personalized set of products and services.

As has been evident for the past decade, Asian consumers have flocked to digital technologies, with adoption rates for some devices, especially mobile phones, outstripping Western rates. ATM usage has skyrocketed in Asia, and across age segments the “consumer decision journey” has increasingly moved online. The pattern for most purchases now is that they are researched online and concluded in the branch, but we are beginning to see online purchasing as well. A significant constraint on the progress of this trend is the state of regulation in many countries, which require purchases to be finalized by customers signing documents in branches, in the presence of branch employees. Meanwhile, larger numbers of Asian consumers, especially younger ones, are expressing a preference for interacting through nonbranch channels. This is significant for Asia, where even older customers can be first-time bank users, cautious of physically surrendering their money, and traditionally reassured by a brick-and-mortar establishment.

The story will only accelerate as a young, digitally savvy generation matures. This will be the disruptive generation when it comes to banking trends. They have already taken to mobile technology and are comfortable with making payments digitally. Four shifts in consumer behavior signal that the time of the premier digital bank is approaching:

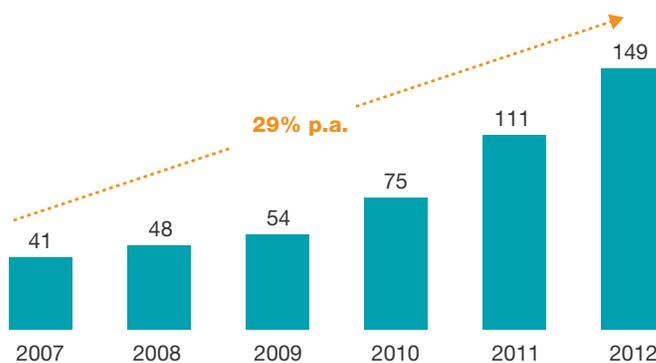
- **Increasing digital usage across Asia.** This includes higher penetration of mobile, Internet, and smartphones across markets. The increase in technology usage is changing consumer behavior, including buying behavior, with social networking, peer reviewing of products, and online research becoming the norm. Digital payments are becoming significant in Asia, and the evidence of the digital disruption is mounting in industry after industry.
- **Channel-preference shift.** Channel preferences in banking have shifted significantly among younger and wealthier segments toward nonbranch channels. About 40 percent of Asian mass-affluent customers now prefer online or mobile banking; among those under 40 years of age,

around half prefer digital banking. The Internet is making headway in the generally older affluent and mass-affluent segments, where ATM usage is the norm; for younger generations of Asians, on the other hand, the Internet has become a preferred channel.

- **Multichannel consumer decision journey.** The path toward purchase—from awareness to research, subscription, and maintenance—has already become a multichannel journey for Asian consumers. In the awareness stage and especially the research stage, most buyers are consulting multiple channels and returning to multichannel usage in maintaining their products after purchase. Evidence from Europe indicates that banks will be able to boost flagging customer loyalty and increase share of wallet by offering an integrated and seamless customer experience across channels.
- **Digital sales.** With the right regulatory environment, more sales of deposits and loans are expected to shift to direct channels, in line with shifting consumer preferences and behavior trends in e-commerce, similar to what has occurred in more mature Western markets (Exhibit 1).

Exhibit 1 More sales of banking products are expected through direct channels, in keeping with e-commerce trends.

Online business-to-consumer sales in Asia, \$ billion



Online share of total retail market, %

	2007	2008	2009	2010	2011	2012
Asia	1.6	1.6	1.8	2.2	2.8	3.5
United States	4.6	5.1	5.9	6.4	6.8	7.2

Source: Euromonitor; Forrester Research

Implications for banks

McKinsey analysis has demonstrated that the advent of digital banking will create as well as destroy significant value, with 30 to 50 percent impact on profits or losses, depending on the bank's starting point and how it responds to these digital trends (Exhibit 2).

Channel-based segmentation to identify consumer readiness in Asian markets makes it plain that most consumers are already using or are interested in using alternative channels, including ATM, online, mobile, and phone banking. Yet few Asian players have developed low-cost comprehensive service offerings focusing on self-directed customers.

Given these trends, we estimate that while the digital-banking opportunity in Asia is small today it will likely grow rapidly, at twice the rate of other bank-revenue pools, especially as the number of Asian consumers coming on line rises (Exhibit 3).

Exhibit 2 Disruptive technologies will emerge as both an opportunity and a threat to banks.

Impact from digital, % of net profit

Digitization is a threat to traditional banking models but can also be an opportunity for banks that respond

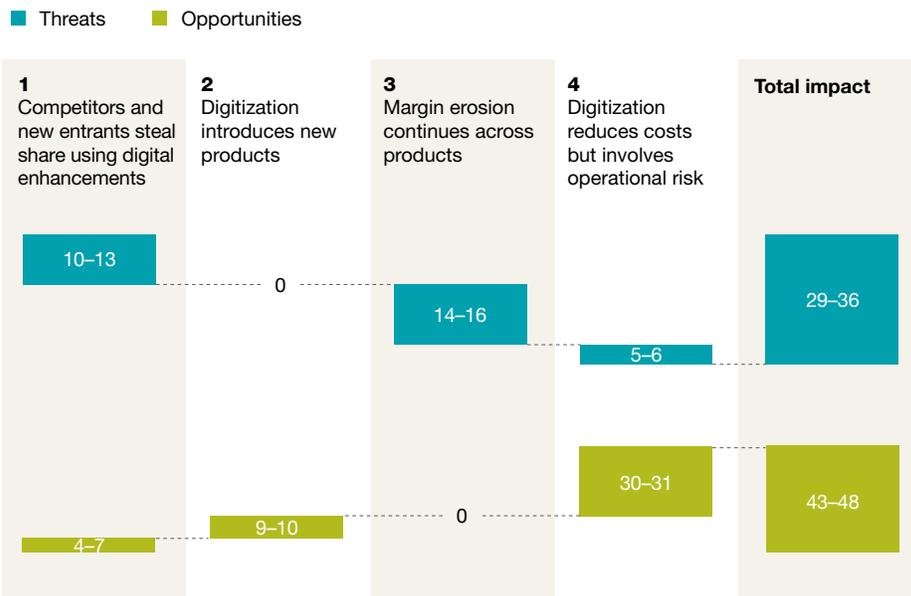
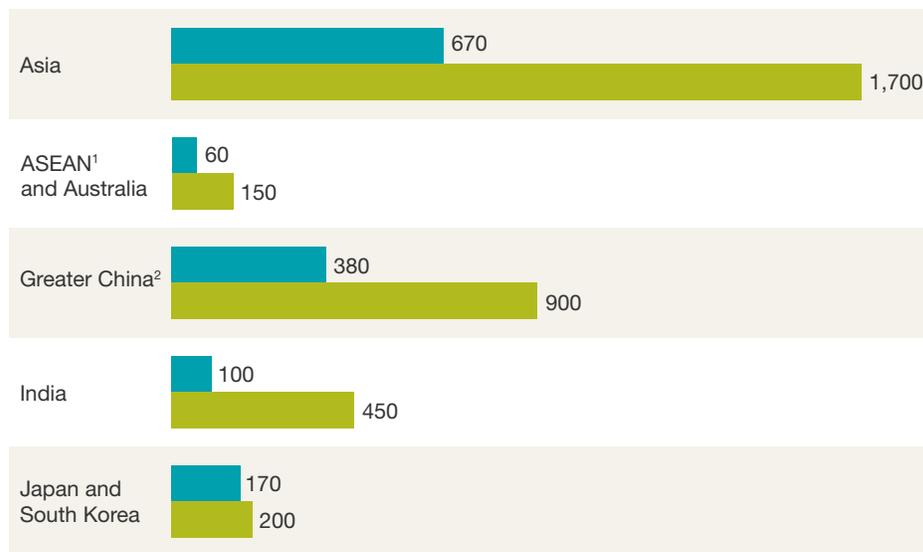


Exhibit 3 In Asia, the number of potential digital-banking consumers could rise to approximately 1.7 billion by 2020.

Millions of people

■ 2012 ■ 2020



¹Association of Southeast Asian Nations; data for the following ASEAN countries only have been included: Indonesia, Malaysia, Singapore, the Philippines, and Vietnam.

²Data include China, Hong Kong, and Taiwan.

Getting the bank ready

As technology adoption continues to reshape consumer habits as well as business models, the consequent rapid change in the dynamics of several industries has become a top-of-mind theme for banks across Asia. Our conversations with Asian players reveal that many are struggling with the implications of this trend and the choices it demands. Banks can minimize the potential value-destroying effect of the coming digital disruption by fostering digital awareness in their top leadership and by building a digital strategy that is integrated into their overall strategy, regardless of the bank's starting point. Market and competitive factors will determine whether the bank's digital strategy will involve creating new digital customer propositions now or digitally enabling the current model for the time being.

Pursuing digital enablement of the current business model

Banks can support the digital adaptation of the present business model in a number of ways. These include a few important cost levers: improving the channel mix to reduce distribution costs,

reducing administration and operating costs through automation, and optimizing IT spending through use of the cloud and agile development. Revenue levers use technology to increase effectiveness across a few elements of the sales process:

- **Improved value per customer through consumer insights and analytics.** Banks can use analytics for microtargeting by aggregating data to form a single, enriched customer view. A robust analytics engine can generate “next product to buy” offers and present customers with prefilled application forms.
- **Manage consumer interactions across multiple channels.** Banks must integrate across channels: this entails generating digital demand with smart tools, intuitive product choices, and use of direct channels for customer self-service.
- **Increase frontline productivity and multichannel productivity for fulfillment.** Deliver leads to sales staff through mobile devices; calculate and customize offers, including using digitally enabled pricing optimization; and provide payment solutions and technology-enabled rewards.

Creating new digital customer propositions

Ultimately, banks will need to adopt new propositions that serve their savviest, digital-friendly customer segments. The preferences of these constituents will eventually become the new normal. Whether the move to a fully digital-banking model is made sooner or later will depend on the nature of the bank’s business today and the degree to which early movers and nonbank attackers are threatening the bank’s customer base. Several banks have already launched digitally focused models competing in the same market as their owner, as well as independent banks competing in other countries than their owner, with varying levels of success.

We have identified a number of consumer segments whose constituents are educated, increasingly digitally aware, and already involved in multichannel banking:

- **Digital rich.** These affluent consumers have an undergraduate college education or above and constitute the professional talent of leading Asian companies or multinational corporations. Some members of this group are also second-generation entrepreneurs, who are more educated and computer literate than their pioneering parents.
- **Digital middle.** These upper-mass and mass-affluent consumers have at least a college education and provide the professional and middle-managerial talent in Asian and multinational companies. The group also includes service entrepreneurs.
- **Generation Y.** Asia’s future digital-banking customers are now 15 to 30 years old; they are students and young professionals, some in their first jobs, and they are exceedingly digitally savvy. They will form the preponderance of the base for the digital bank of the rapidly approaching future.

- **Digital SMEs.** The number of small and medium-size enterprises (SMEs) that are using the Internet and other forms of digital technology will only increase across Asia. These nontraditional SMEs will eventually become the norm and will be looking to use a digital-banking platform designed to serve their needs.

Each of these segments has unique characteristics that must be considered when developing the offer. The fundamental ingoing thesis is that significant unmet needs can be addressed through an innovative digital proposition.

Strategic positioning

Channels and offerings

To position itself strategically in its market, each bank will need to find a value proposition targeted to the segment the digital bank is trying to address.

A digital bank could enter the market with a simplified core offering of four or five relatively simple products and have one or two “hook” products such as a competitively priced deposit or strong trading platform. Banks may want to present customers with an “Apple-like” experience, offering an intuitive interface and a no-defect and no-customer-leakage culture, with real-time processing capability and a test-and-learn environment.

In addition, banks can offer a personalized web experience, so that customers can receive recommended products based on their digital data (such as browsing behavior). A social and mobile-centric dimension could make sense for some banks, in which the latest digital technologies and platforms would be used to enhance their reach and offering. Banks could also offer customers “immediate satisfaction” on their websites, with rich content management, paperless real-time transacting ability, and self-directed analytics.

For some banks, integrated multichannel access will become a core feature of their value proposition, including a light physical presence and agents to enhance the customer experience, as well as to promote trust and branding. Compelling cross-category offerings can be developed, for example, which might blur the line between retail banking and retailing. The digital bank can and should be a highly creative space, fostering affinity and loyalty with fun ways to engage younger customers (such as selectively “gamifying” aspects of the banking experience). A cross-partner ecosystem allowing for creative collaboration and the formation of heterogeneous communities and integrated applications will be important for the maturing social-media generation. The point is that digital creativity will become an attractive customer proposition as digital adoption increases across customer segments.

Three strategic archetypes

In our experience, banks have positioned themselves to take advantage of the digital opportunity with three main archetypes. Banks have chosen these models according to the conditions governing their market, including where their market is along the digital-development curve and the vulnerability of their base to competitive pressures:

- **Branch-centric, product-focused model.** A follower strategy in digital. Most incumbent banks have retained branch- and product-centricity because the traditional universal-banking value proposition is strongest for them. Their sales-and-servicing model remains branch-based, with direct channels used as a complement and mostly for servicing. This model represents the follower strategy in digital and relies on a broader customer base across all segments and higher price premiums for value.
- **Multichannel client-centric model.** A leader strategy in digital. This intermediate model is still branch-centric, but it deploys sophisticated online and mobile offerings. Direct channels are used to serve customers; for most banks that have developed this model, direct channels also acquire growing relevance for sales. This strategy is the aspirational model for digital banking; it derives value from a higher market share of tech-savvy customer segments but without price loss; it offers higher cross-selling success and higher share of wallet with lower cost to serve.
- **Self-directed digital-centric model.** A shaper strategy in digital. Some highly innovative European banks have adopted this very low-cost but comprehensive service offering focusing on more self-directed customers. The model relies on innovative direct channels for sales and uses a complementary light “showcase” physical presence for customer acquisition. Of the three archetypes, it has the lowest cost base for acquiring and serving customers. It is the model used by leading digital banks today, and its prevalence will expand as more countries move along the digital-development arc. The model represents the attacker-acquisition strategy and has taken a disproportionate share of Generation Y and tech-savvy customers to date.

The time to move is now, but in which direction?

The evidence that increasing use of technology is changing consumer behavior is everywhere in Asia. One of the observed changes that is affecting banking is that the consumer decision journey has become increasingly multichannel. While Asian countries may be at different stages of evolution toward complete digital-banking readiness, most consumers in Asian markets are already using or interested in using alternative channels to interact with banks. We estimate that the number of potential digital-banking consumers in Asia will grow to approximately 1.7 billion by 2020.

The digital future for banks, which will soon be confronted by the rising tide of maturing digitally savvy Generation Y customers, will come in the form of the end-to-end digital bank. But right now, competitive pressures and market forces demand a near-term digital strategy. This could involve creating those new digital customer propositions sooner rather than later, by which the bank will digitally remake its traditional banking offerings, channels, and processes. However, the “no regrets” move for most banks is a less radical shift, in the digital enablement of the current business model. In this near-term strategy, technology is deployed to reduce costs and increase effectiveness across elements of the sales process.

Top managers are giving thoughtful attention to getting the digital strategy right in the here and now, since they are aware of digital’s disruptive potential. Our analysis of the impact suggests that, depending on the starting point, digitization can create or destroy value of 30 to 50 percent of total profit or loss. Already, three basic strategic approaches along a continuum from branch-based to digital-centric models have emerged. Most incumbents have understandably retained a branch-based approach—a prudent follower strategy that takes account of the preferences of and investment in the existing customer base. The impetus for the end-to-end digital bank that is now being pioneered by innovative attackers will, however, only become stronger as the young digital generation gets older and wealthier. Satisfying their expectations will eventually become the inescapable market paradigm. □

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