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Distribution 2020

The Next Big Journey for Retail Banks



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Distribution 2020

The Next Big Journey for Retail Banks

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AT A GLANCE

With distribution representing approximately 50 percent of retail banks' total costs in developed markets, it is clear that banks must broadly rethink their distribution assets in order to adapt to the "new new normal" environment.

MORE INTERACTION

In our view, best-practice distribution in 2020 will be characterized by higher-quality, higher-frequency interactions between customers and their retail banks. This trend will be enabled by evolving direct-channel technology, more highly tailored offerings linked to customer preferences and value, and the increasing integration of multiple bank channels.

HIGHER RETURN ON EQUITY

A disciplined program to enhance distribution capabilities can improve ROE by 6 to 8 percentage points, but a wide range of levers must be used. Solely reducing the branch footprint is not the solution.

IN THE WAKE OF the financial crisis, profitability pressures and changing consumer behaviors are driving a fundamental review of retail-bank distribution assets. Return on equity (ROE) in the banking industry has dropped sharply from approximately 20 percent in the years leading up to the crisis to just over 10 percent now in developed markets. With distribution representing approximately 50 percent of total costs in these markets, it is clear that retail banks must broadly rethink their distribution strategies in order to adapt to the evolving landscape and changing customer needs.

And customers' needs—as well as their banking habits—are indeed shifting. First, interactions with banks increasingly reflect the broad global trend toward more online and mobile communication. Customer contacts with branches are decreasing at an annual rate of about 1 to 3 percent in most developed markets. Second, customers continue to grow more sophisticated and demanding, influenced not only by their interactions with banks but also by their experiences in other industries.

A recent study by The Boston Consulting Group, as well as our experience advising leading financial institutions, shows that “Distribution 2020” is a top-three topic for many banks, particularly in response to changing client behavior, and it has highest priority in developed markets. Banks need to think *now* about what retail banking will look like in 2020 and navigate their way toward a better distribution model.

Making a New Pledge to Customers

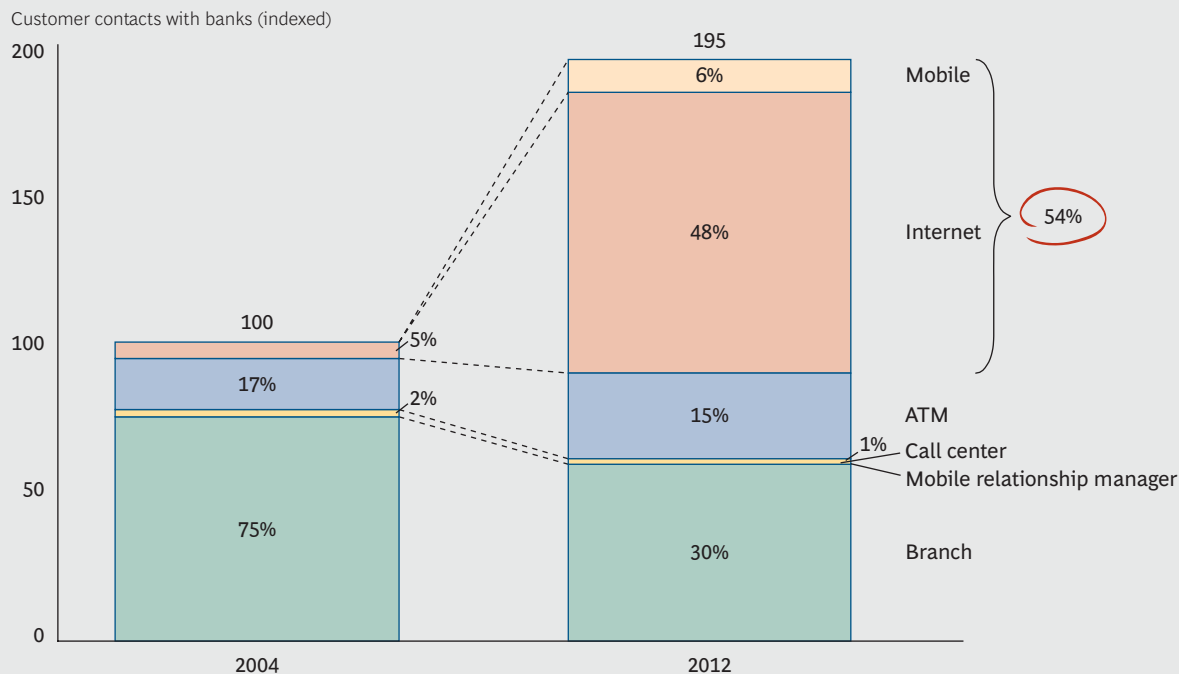
Best-practice distribution in 2020 will be characterized by higher-quality, higher-frequency interactions between customers and their retail banks. This trend will be enabled by evolving direct-channel technology, more highly tailored (de-averaged) offerings linked to customer preferences and value, and the increasing integration of multiple bank channels.

A look back shows that the annual number of customer contacts with banks nearly doubled from 2004 through 2012, driven by a dramatic increase in online and mobile touch points—from 5 percent to more than 50 percent of the total. During the same period, the number of contacts with branches eroded as simple service transactions such as balance inquiries and transfers moved to digital channels. (See Exhibit 1.)

Most of this online growth stemmed from service (as opposed to advice) interactions. By 2020, roughly two-thirds of all service and transaction activity will likely be handled through online channels, but branches will still be critical for what we call moments of truth—interactions that determine whether a customer will buy a

Banks need to think now about what retail banking will look like in 2020 and navigate their way toward a better distribution model.

EXHIBIT 1 | Amid an Explosion in the Number of Customer Contacts, Branch Traffic Has Decreased



From 2004 through 2012, contacts with branches declined by a CAGR of 3 percent

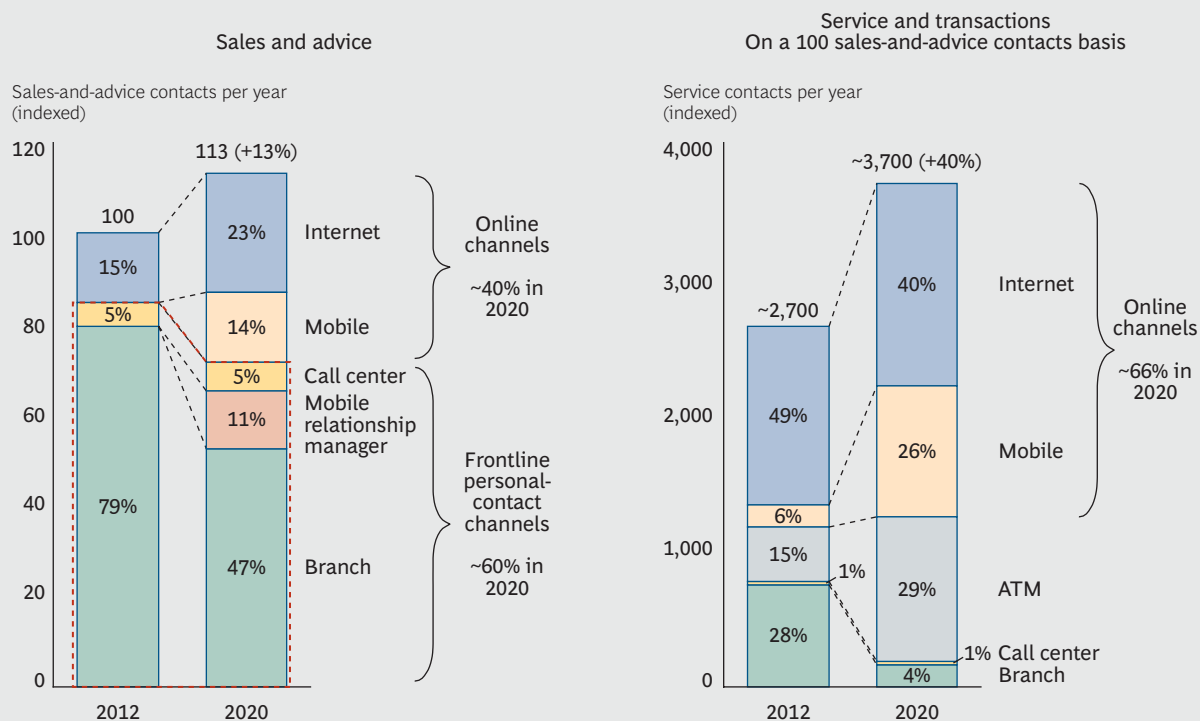
Sources: Council on Financial Competition; estimates based on BCG case work.
 Note: Because of rounding, totals may not equal 100.

certain product or, at the other extreme, switch banks. We estimate that frontline face-to-face and voice-to-voice channels will handle about 60 percent of all sales-and-advice interactions by 2020, primarily advising customers on investment products they perceive as complex, as well as on lending products such as mortgages. (See Exhibit 2.)

Another element of evolving best-practice distribution is achieving a higher level of channel integration that leads to a richer customer experience. Above all, multi-channel excellence is about providing clear value for both the customer *and* the bank. By enabling natural pathways for customers and letting them choose their preferred channel for each step in the sales cycle, the bank can reduce revenue leakage and increase retention. At one bank, we observed that the conversion rate of personal loans fell below 10 percent when the process was restricted to the call center. But when the bank proposed that customers visit the branch to sign the contract—signaling multichannel cohesion and adding the face-to-face touch that branches offer—the conversion rate increased to nearly 20 percent.

A primary goal of the new pledge to customers is to make interactions across multiple channels simple—not disjointed or constrained by internal organizational boundaries in a way that leads customers to dead ends. Channels should support

EXHIBIT 2 | By 2020, Most Service Transactions Will Be Conducted Online



Branches will still be important for key “moments of truth” and value-added sales and advice

Source: Estimates based on BCG case work.

Note: Because of rounding, totals may not equal 100; the CAGR for branch sales-and-advice contacts is -5 percent.

each other, not compete. Banks need to place strong emphasis on governance and create an incentive system that enhances cooperation between direct channels and the branch staff. And not every function for every product needs to be available in every channel 24-7. The key, given the huge cost and complexity of integrating multiple channels, is to find a smart balance of available functionality and cost that maximizes each channel’s value for each product and customer segment.

Meanwhile, it is worth noting that in some Western markets—those in which online banking has not been prevalent—the growth of direct banks has ranged from around 10 to 30 percent over the past few years. By contrast, in Western markets characterized by deep penetration of online banking, such as the U.K., direct banks have actually lost share in deposits. In an interesting twist, some purely direct banks have begun to develop limited branch networks in major European markets in order to broaden their offerings.

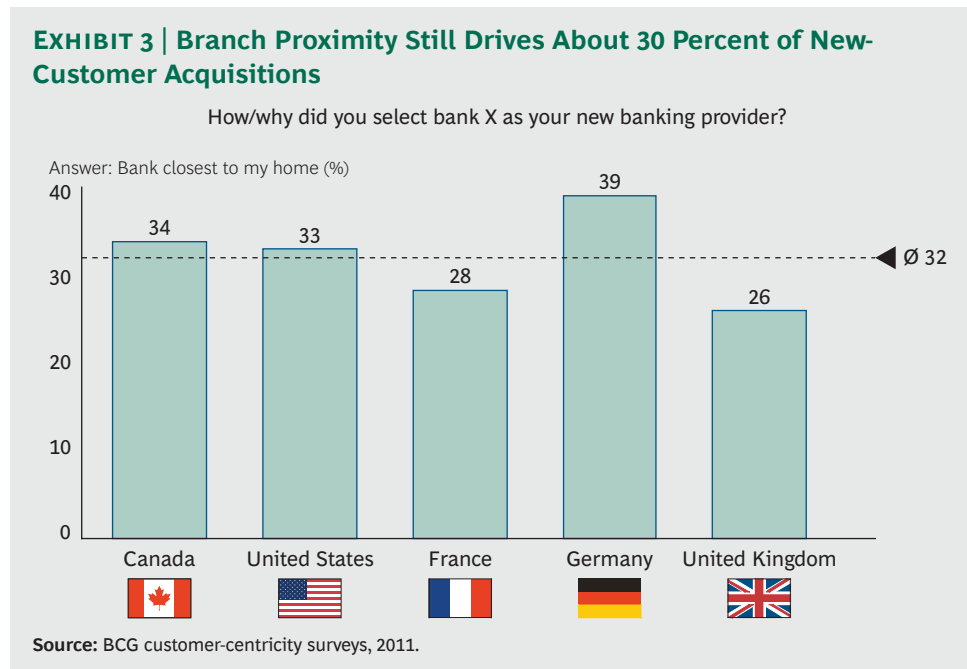
Optimizing Branch Footprints and Formats

Clearly, branches will still constitute a critical element of distribution in 2020. But their roles, density, and formats will evolve and adapt to what we call the “new new normal,” which encompasses the need for greater customer-centricity, the shifting

roles of products and channels, the necessary revamping of end-to-end operating models, and, of course, the need for improved sales-force effectiveness.¹

The branch, and the face-to-face contact it provides, will remain the primary channel for acquiring and deepening customer relationships, as well as for interactions about products that customers perceive as too complex to comprehend or complete without guidance. But there is a significant opportunity to optimize the branch footprint. In selected markets where branch density is particularly high, this may imply reducing the footprint. But optimization is really not about reducing presence—it is more about changing formats, relocating, and increasing productivity per full-time equivalent. In many local and regional markets, it is not uncommon for 80 to 90 percent of revenues to be generated by 50 to 65 percent of the branches.

Leading banks in most developed markets have already begun to optimize their physical networks. Permanent closures have been limited so far, with banks concentrating on relocations and format changes. About 30 percent of new-customer acquisitions are still related to branch proximity. (See Exhibit 3.)



To be sure, with the role of branches increasingly centered on complex-product sales and highly customized advice, providing a winning customer experience—being truly customer centric—will be crucial.² Furthermore, branches will remain important for serving small-business clients, whose need for cash and check handling (in some markets) is less affected by the push toward online and mobile banking. Branch excellence will be a matter of superb execution in a handful of critical service interactions—the all-important moments of truth. The share of pure service interactions conducted in branches is expected to drop from roughly 30 percent today to less than 5 percent by 2020.

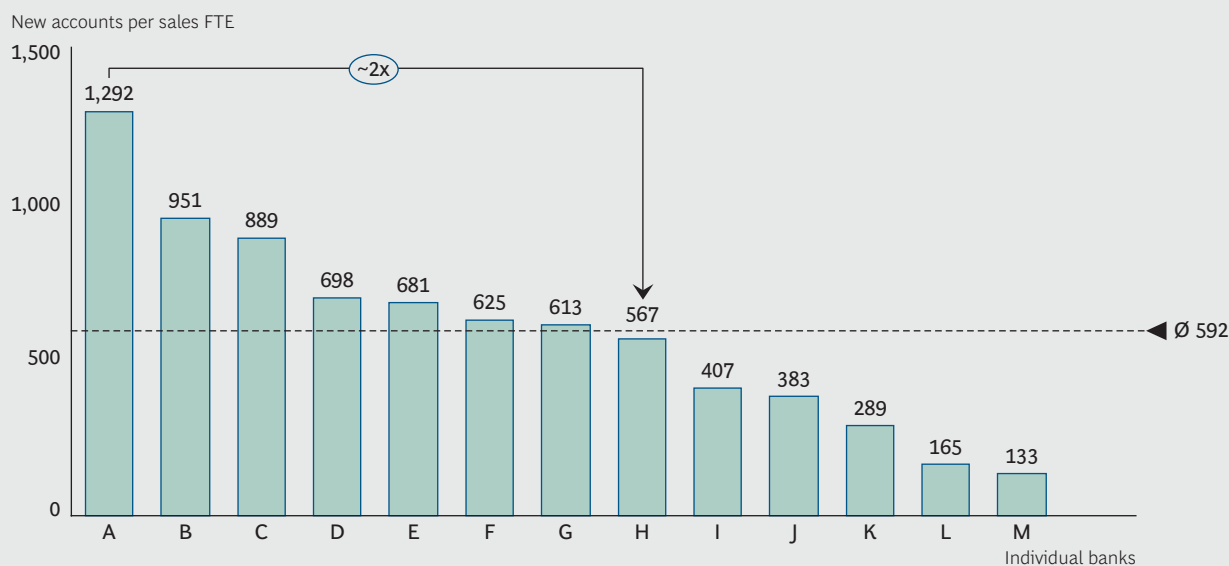
Going forward, we expect to see much greater variety in branch size and format—such as transaction-only, advisory, “lite,” full-service, and flagship—and greater variation in both hours of operation and staffing profiles. We will also likely see redesign initiatives aimed at making branches more informal and customer friendly. Some branches may be highly specialized, focusing on certain products such as automobile financing or mortgages, while others may choose to adapt to the needs of specific segments.

Also, more banks will adopt the hub-and-spoke model in which large, full-service advisory hubs support smaller, specialized spokes. A higher level of differentiation in the spokes will be enabled through such means as digital signatures, paperless services, remote support from specialists through videoconferencing, and mobile interfaces. Branches will take on an increasingly modular design that will help them maintain flexibility and keep operating costs to a minimum.

Enhancing the Sales Force’s Role

A key point remains: closing branches without first instituting a sales-force-effectiveness (SFE) program is not a solution to the ROE challenge that banks face today. Branch closures must go hand in hand with SFE. And, in order to help fund the journey toward more efficient and effective overall distribution, SFE itself must be tackled before any branches are actually phased out or moved. BCG case experience shows that closing even 10 percent of a given network’s branches provides close to zero improvement in ROE. By contrast, in our study, one leading bank that had established an SFE-improvement program posted more than twice the sales productivity as those at the median level. (See Exhibit 4.) Overall, it is crucial for

EXHIBIT 4 | The Sales Productivity of the Leading Bank, Driven by an SFE Program and a Multichannel Strategy, Is More Than Twice the Median



Source: BCG Operational Excellence in Retail Banking survey, 2012.
 Note: SFE = sales force effectiveness; FTE = full-time equivalent.

banks to benchmark their SFE performance against that of their competitors and to launch improvement programs for the most important SFE levers.

To thrive in the new new normal, banks will need to begin by carrying out an in-depth review of the sales force's role, level of expertise, and ways of working. The goal is to dramatically improve both efficiency and productivity in a world where traditional banking paradigms will be shifting significantly.

A large percentage of banking customers will continue to need the services of a physical sales force, even though most customers will interact through online and mobile channels as well. For affluent customers, access to an experienced relationship manager (RM) is critical, particularly when it comes to dealing with products they perceive as highly complex or difficult to cancel once they have committed (such as mortgages).

The problem is that in most banks today, the sales force is underperforming its potential. The banks in our study averaged roughly three customer meetings per day for each RM, compared with the best-practice level of more than six. Successful lead conversion varied widely among institutions. Looking ahead, we expect more RM time to be freed up as a result of fewer client meetings for transactions and sales of simple products—activities that are shifting to direct channels.

These dynamics lead to a fundamental question: Should banks reduce their physical sales forces in line with the growth of direct channels, or should they identify new useful activities for current RMs in order to fully exploit their expertise and experience? The likely answer is some of both.

Obviously, HR has to carefully manage the evolution of the sales force's role over a long time horizon, as there will be a growing need for highly specialized capabilities—especially concerning new and innovative products. As specialists move among branches for customer appointments, more mobility will be needed as well. Many banks will extend their hours and will, therefore, have a need for RMs and other staff willing to work flexible shifts.

Moreover, changes such as these—along with the channel integration necessary for delivering the new customer pledge—may well result in a decoupling of sales force management from branches. Some banks may consider a partial externalization of the sales force, using dedicated agents. So far, most banks are keeping a critical mass of sales force personnel as they rationalize their branch networks. Of course, these trends are true primarily of developed markets. In emerging markets, we have seen (and will likely continue to see) measurable growth in both branches and sales force personnel.

We expect the fundamentals of overall sales-force excellence to remain constant through 2020—and beyond. Banks need to zero in on specific measures such as booking appointments electronically, capturing customer data early, creating more effective sales scripts, and managing customers' early tenure carefully. Institutions that take these actions create a self-reinforcing service-and-sales culture. Such an environment includes a recruiting and talent model, clearly defined practices and

Not every function for every product needs to be available in every channel 24-7.

norms for key roles, product training and certification, coaching programs, and performance recognition—as well as mystery shopping and customer surveys that capture the voices of customers and bank employees. This model is reinforced by targets and incentive schemes that focus on driving the frontline to meet customer needs. Winning banks also develop customer-relationship-management systems that facilitate workflow. Offer management systems identify the next logical product, and leads are embedded in processes at the teller window and elsewhere.

In best-practice banks, a can-do service-and-sales culture permeates the air. Service and sales colleagues are energized by the knowledge that they are providing value to customers, that each day's calendar is full of promising appointments, and that the more they do for customers, the more they are doing for themselves.

Indeed, banks can create a virtuous circle. Excellent customer service creates positive word-of-mouth referrals, which, along with clear marketing messages, drive traffic to branches, to the website, and to the call center. This traffic drives leads, sales, cross-selling, and loyalty, which, in turn, mean more positive reviews and higher traffic.

Managing the Journey

Of the many insights into today's retail-banking industry revealed by our study, one of the most important is the clear need for banks to actively manage their journey toward Distribution 2020—providing sufficient resources, setting clear goals, closely monitoring progress, and ensuring that top management is fully involved and supportive at every stage of the process.

The winning banks will be those that take the following actions:

- Develop a clearly defined target that is shared throughout the organization.
- Formulate a comprehensive, far-reaching distribution strategy for 2020, and tackle each element of that strategy in parallel—with energy and dedication.
- Achieve consistent and diligent governance and steering, starting at the top and cascading down through the bank.
- Launch a series of “no regrets” initiatives—for example, retraining the sales force to focus on needs-based selling—to kick off the program and get the momentum going.
- Target already-existing “inefficiency pools” to extract additional profitability from the branch network.
- Apply a “test and learn” approach to distribution innovations—through, for example, pilot programs aimed at specific regions or client segments.
- Use traditional levers—such as creating a leaner overall organization—to fund part of the journey.

BCG case experience shows that closing even 10 percent of a given network's branches provides close to zero improvement in ROE.

- Build flexibility into the organization—both to prepare for potential market scenarios that could develop between now and 2020 and to leave options open for future strategic distribution choices.
- Clearly and candidly assess the strong and weak points of the organization, draw a detailed roadmap of how to fortify the areas in need of improvement, and set realistic goals and milestones to follow on the path toward Distribution 2020.

IN OUR EXPERIENCE, a disciplined program for enhancing distribution capabilities can improve ROE by 6 to 8 percentage points. But a wide range of levers must be used. Solely reducing the branch footprint is not the solution.

Strong improvements in sales force effectiveness, including both greater efficiency and heightened productivity, as well as developing leaner end-to-end processes, will provide the most significant impact—around 3 or 4 percentage points of ROE restoration. Lifting revenues through the enhancement of channel functionality and a higher degree of channel integration—providing natural pathways that deliver true customer satisfaction—will also bring a sizable ROE lift of 2 to 3 percentage points. The partial conversion of branches to low-cost formats could add an additional percentage point of ROE growth (in a scenario in which 30 percent of branches are being converted).

Ultimately, the winners in the race to Distribution 2020 will be banks that manage the journey rigorously.

Ultimately, the winners in the race to Distribution 2020 will be banks that manage the journey rigorously—keeping their focus, anticipating barriers before they become troublesome, and finding their way around those barriers without breaking stride. The program must be comprehensive—not a piecemeal effort that addresses just one or two issues.

In an industry that is changing rapidly and in which the rate of change will certainly accelerate, retail banks should realize that the best way to deal with market uncertainty is to take a proactive approach. If they fail to take the first steps toward achieving distribution excellence now, 2020 may come and go with little import: they will already be out of the race.

NOTES

1. See *The “New New Normal” in Retail Banking: How Banks Can Get Back on Course*, BCG report, August 2012.
2. See *Customer-Centricity in Retail Banking*, BCG report, March 2012.

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3/13



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