WHITEPAPER

Managing through and post COVID-19

Digital imperative for banks to reduce Op-Ex and improve CX

Introduction

At the time of this article, there are 2Mn Coronavirus cases, with 640k in the US alone. We are at week 6 of stay-at-home with various government bodies forecasting a further 4 weeks. Early impact on the economy is trickling in - leading news of employee furloughs, deferred bill payments and pay cuts.

Retail banks, traditionally at the cross-roads of mass-market economic upheavals, are expectedly preparing short-to-medium-term strategies to manage capital, liquidity, and risk.

We see four major factors impacting banks - each factor may evolve differently based on various COVID recovery scenarios.

COVID-19 impact on banks

Slowing demand for credit

We already see a 25% reduction in global card spending, with US and select markets in Europe showing a higher reduction. We expect similar declines in credit applications and approvals (due to tightening credit policies), partially offset by low-interest regimes.

Extended Low NIM scenario

The Fed has reduced interest rates to 0%, and the 10 year treasury yields have dropped to a record low. Historically, lower interest scenario is highly correlated with banking NIM.

Credit losses impact

Too early to predict, and highly dependent on recovery scenarios. Still, early metrics on deferred bill payments and loss of income for both consumer and small business segments are a cause for concern. Loss management will expectedly be the biggest focus for the near-medium term.

Spike in Operating Expenses

Predominantly driven by customer handling costs, we expect near term costs to increase by 25-30%. Spike in call volume by 60-70% is a major contributor, partially offset by a reduction in variable sales and marketing costs

Source: Fractal analyses of operating trends with global banking clients

We see reduced operating costs as a critical and addressable imperative for banks – the focus will be on extreme digitization in all customer-facing interactions.

"Digitize like a digital native"

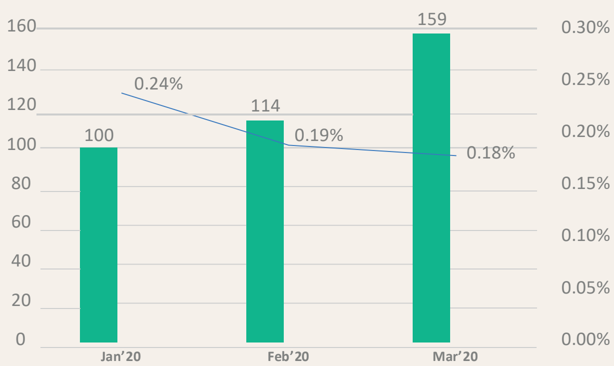
The current crisis has exposed the low level of digital preparedness of large banks to deliver client value (in the present scenario- handling issues, communicating implications, providing assurances, planning for exigencies). Most of the spillover from loss of branch banking has moved to the call center instead of digital self-service channels (Web, app, IVR). In the case of one large bank, we have seen digital activity only increase by 20% while call center volumes increased by 90% in one month alone.

These call center numbers are understated (and digital numbers are overstated) since a few large banks have significantly cut down call center hours and use IVR to direct customers to the web. Unfortunately, for several needs– digital interfaces are just not ready today, and customers would rather call back and keep calling.

Today's digital capabilities are not ready to easily migrate customers to self-serve channels - we observed that despite the uptick in digital activity (as measured in logins), the percentage of closed transactions online decreased significantly from steady-state numbers. Specifically, the percentage of digitally closed "purchase transactions (application for product/ credit)" decreased by 33%, while at the same time, the percentage of assisted "purchase transactions" remained flat. We did not observe a discernible difference in the reduction of digital close rates across existing vs. new customers. Mystery shopping with a Big 4 US bank revealed that even basic wire transfer could not be easily completed online till an agent came on the line two hours later, and helped navigate through the digital process.

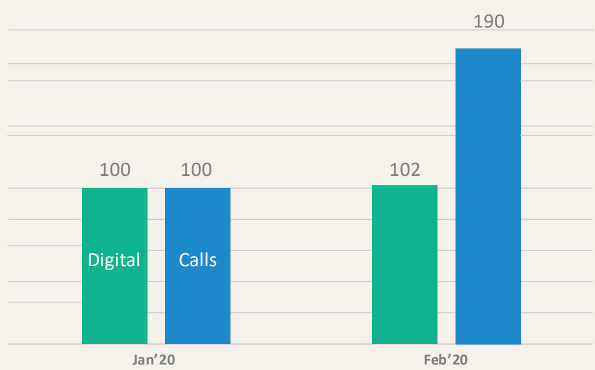
Purchase rates on digital

Y1 axis = traffic indexed to 100.
Y2 axes = %purchase close



Logins on digital vs. Calls to Call center

Indexed to 100



Source: Fractal analyses of operating trends with global banking clients

We expect strong persistence of customer digital expectations in the post-COVID world – and digital strength will become an even more critical source of competitive advantage than it was pre-COVID.

To be precise – all large banks have well-functioning web, mobile, and fairly sophisticated IVR ecosystems. They just do not have the experience synced up to rapidly-rising customer expectations – unlike what fintechs and digital-native banks can provide.

It is most critical to recognize that the **expected standards of digital are not to provide a set of tools and capabilities online but to provide an end-to-end frictionless, personalized and cognitive experience that ultimately replaces the need for human assistance.**

Our study identified three major categories of disconnect in the digital experience:

01 **Capability present but broken in parts**

Typically multi-step processes

- Application and document hand offs
- Eligibility for credit or promotions
- Dispute resolution and complaints

02 **Capability present but customers not aware or inclined**

Basic services including

- Statements
- Fund transfer
- Auto payments
- KYC

03 **Capability not present or rudimentary**

Mostly advisory and assurance services

- Overdraft
- Payment deferment
- Intelligent wealth and expense planning

Banks have an immediate call-to-action to drive Extreme Digitization - rapidly to immediately reduce ballooning operating costs and build for post-COVID competitive advantage. Digital natives have traditionally operated with the notion of “completely digital experience, no human intervention,” and that is the north-star that banks should strive for. The human factor should be deployed only further to enhance the appeal in complex/ behavioral selling interactions.

But before we go star-wars on digital transformation, we must realize that banks can already make significant strides in the short term with minimal new investment. However, the ones that have improved, did so by getting past organizational and operating roadblocks, and answering fundamental questions:

1. How to define the right target metrics

Bank’s siloed structures prevent an ability to define customer-cost metrics. Operating costs at a customer level, are rarely tracked, typically bundled into aggregate measures held by each channel.

2. Who should own and manage these metrics

Metrics look individually good (at a channel level), but collectively not so much (at a customer level). In these times, digital can proudly claim to handle 20% higher volumes, Call centers can claim to improve efficiency at spiked volumes – while the customer P&L itself looks negative. Few banks have organized teams and leaders responsible for customer P&L.

3. How to decide what to build, and how much to invest

While banks tend to be reasonably data-driven on investment decisions, the standards required to truly identify customer need is extremely high – requiring talent with highly sophisticated AI, technology and business expertise – a rare resource in most legacy banks.

4. How to drive eventual adoption by customers

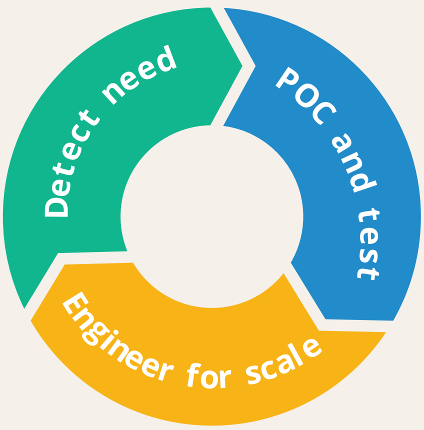
Probably, the often-overlooked challenge, because it is nobody's challenge in particular, is that of continually striving to help customers achieve self-service through a concerted application of education, incentives, and motivations.

Therefore, the biggest roadblocks are rarely the what or why, but the how. Large organizations tend to be individually smart, but collective slow and misaligned. The undercurrent theme we have observed is that improving customer cost and experience metrics is everybody's problem, but nobody's problem – it is in face widely distributed across channel teams. The imperative of pace necessitates that large banks create an agile cross-functional team that comprises a core team from the channels, marketing, analytics, IT, and extended support from Legal and CX (if any). Such a cross-functional SWAT team would typically report to the business head, maintain a virtual war room, and adopt an agile process and technologies to function efficiently.

Extreme Digitization team

Cross-functional team focused on rapid, agile deployment

KPIs: Reduction in assisted channels by customer need, increase in digital flow through



Detect need

- Apply rigorously high AI to identify need from calls, chats, inferring friction and intent from digital and non-digital behaviors - and prioritize based on the number of cases.
- E.g., the bank should know that wire-transfers to a specific recipient segment is broken, or that fees bundled inside mortgage escrows are a typical call reason for people who were looking for the same information online.

POC and test

- Agile methodologies used to design experiences - use insights to know where in the journey, and what specific experience to improve.
- Target a 3-day schedule to design new and test.
- Establish automated testing rhythm with few pre-designed metrics of digital flow through.

Engineer for scale

- Engineering (various applications, Pega, etc.) is core to keep a Continuous integration - Continuous Deployment flow.
- Big Data deployment of AI/ML algorithms is critical.
- Ensure alignment with specific legal and CX teams for rapid approval.

Marketing is critical, however – since customers need to be "educated and/or incented to make the behavioral changes and the leap to digital." Our analyses revealed that 30% of the customer base tends to be never-digital, further 60% are digital dabblers (e.g., such people would typically work digital and yet would continue with paper statements), and only 10% are truly digital natives.

90% of customers would need behavioral change to go completely digital, even if most are them are reasonable digitally savvy and already conduct some part of their banking transactions online

Therefore while banks work feverishly to advance their digital experience - a steady combination of awareness and incentive messaging to customers is important. A Big 4 bank is using its call center touchpoints to make people aware of all the cool online features, but that does not translate into customers executing on it. Behavioral sciences could further help, identifying any points of resistance that customers have, incentives they would care about – that could drive customers to go completely digital.

At the core, banking leaders must recognize that the expected standards of digital are not to provide a set of tools and capabilities online but to provide an end-to-end frictionless, personalized and cognitive experience that ultimately replaces the need for human assistance.

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