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Digital Banking in Asia: What do consumers really want?

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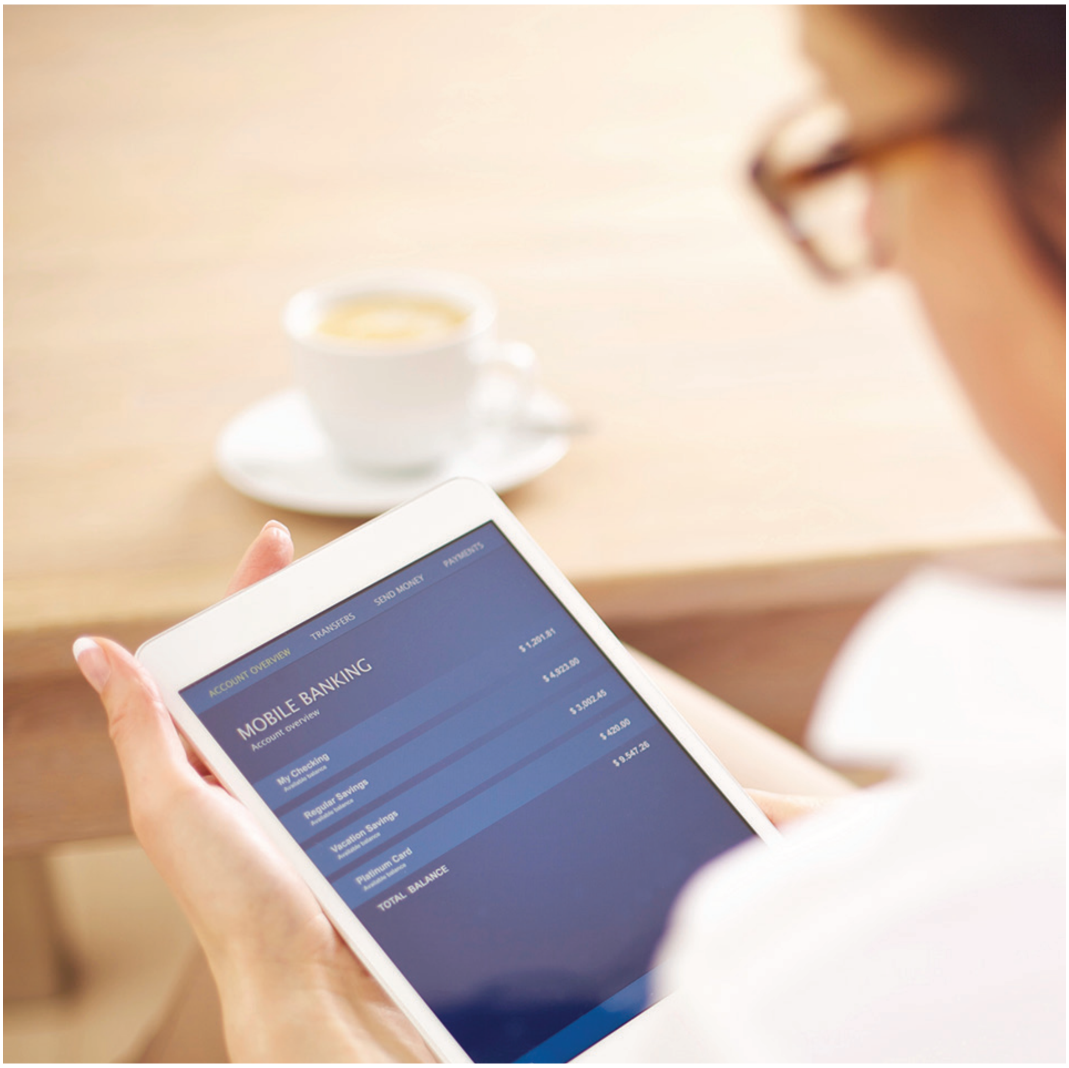

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Digital Banking in Asia: What do consumers really want?

Asian consumers are moving quickly into digital banking, McKinsey's latest research shows. Incumbents and new entrants alike should plan for the implications.

Since 2011, digital banking has soared across Asia. A McKinsey study [1] shows consumers of financial services are turning to computers, smartphones, and tablets more often to do business with their banks, while visiting branches and calling service hotlines less frequently. Despite some structural obstacles, the shift is likely to continue, and incumbents and entrants alike should prepare for the consequences.

To understand the dynamics of this change in more depth, McKinsey in 2014 surveyed about 16,000 financial consumers across 13 markets in Asia on their banking habits. The study, conducted online and through in-person interviews, is part of a continuing effort to track personal-finance trends in Asia that began in 1998.

The most recent research shows drastic shifts in behavior compared with a similar survey in 2011. In developed Asian markets, Internet banking is now near universal and smartphone banking has grown more than threefold since 2011. In emerging Asian markets, the trend is similarly dynamic, with about a quarter of consumers using computers and smartphones for their banking.[2]

The rise of digital banking in Asia has been anticipated for many years, but several factors have combined recently to accelerate this trend. Among the most important changes is the presence of a much stronger ecosystem to enable digital banking, which includes the rapid increase in Internet and smartphone adoption and growth in e-commerce, resulting in the demand for digital banking moving from early adopters to a broad range of customers.

For incumbent banks, the stakes are particularly high. Among the consumers we surveyed in developed Asian markets, more than 80 percent said they were willing to shift some of their holdings to a bank that offers a compelling digital proposition. In emerging Asia, more than 50 percent of consumers indicated such willingness. Many types of accounts are in play, with respondents saying generally that they could shift 35 to 45 percent of saving account deposits, 40 to 50 percent of credit-card balances, and 40 to 45 percent of investment balances such as those held in mutual funds.

Despite the allure of digital offers, our survey also shows that physical—branches and ATMs—will continue to play a major role in banking across Asia. Incumbents and entrants alike will have to balance needs of consumers and regulators for a physical presence against the cost and reach advantages of digital services.

1 McKinsey's Asia Personal Financial Services Survey was conducted over three months from July through September 2014.

2 For our analysis, developed Asia comprised Australia (700 respondents), Hong Kong (750 respondents), Japan (750 respondents), Singapore (750 respondents), South Korea (750 respondents), and Taiwan (800 respondents). Emerging Asia comprised China (3,500 respondents), India (4,000 respondents), Indonesia (1,100 respondents), Malaysia (700 respondents), the Philippines (700 respondents), Thailand (750 respondents), and Vietnam (700 respondents).

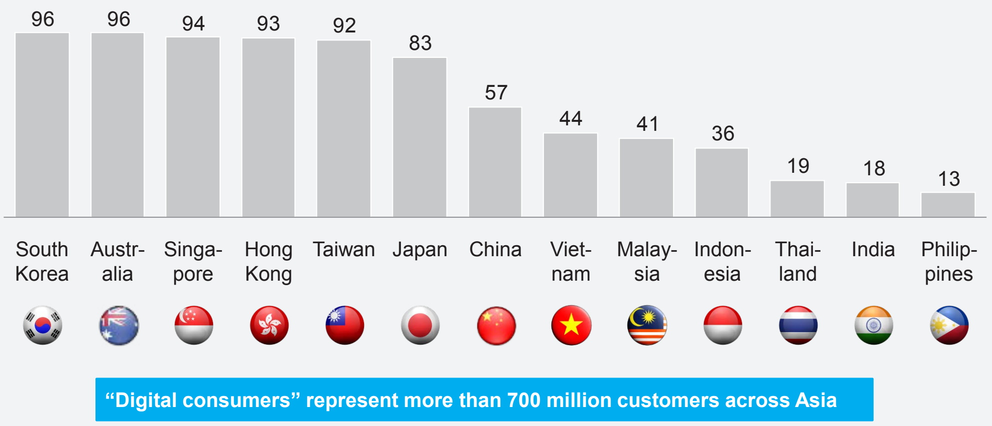
Embracing digital banking

We estimate that across Asia, more than 700 million consumers use digital banking regularly, with a significant portion in fast-growing countries like China and India (Exhibit 1).

In our last survey in 2011, digital banking was more prevalent among consumers in developed Asia. Our latest findings show that in both developed and emerging Asia, digital banking through desktops, smartphones, and tablets has become much more common (Exhibit 2).

Exhibit 1. Digital consumers represent a sizable population in most markets

Digital-banking penetration[1] (2014)
Percent

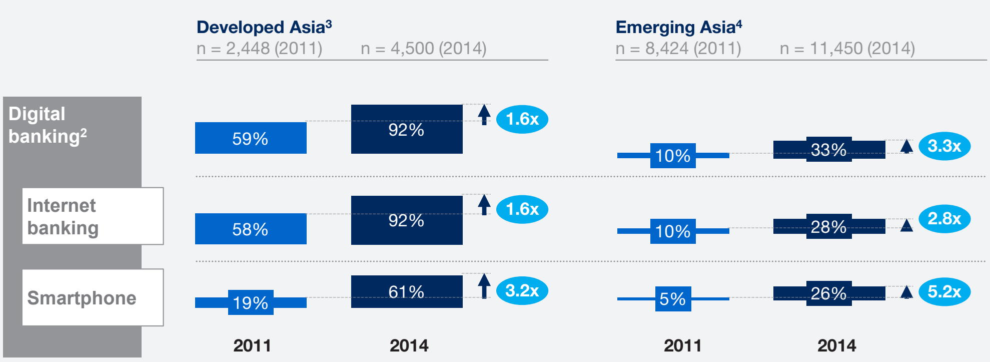


1 "Digital banking" penetration is defined as the number of users of internet or smartphone banking divided by total banking consumers in each country; only urban consumers are included

SOURCE: McKinsey Asia Personal Financial Services Survey, 2014

Exhibit 2. There has been a significant increase in the use of digital-banking channels

Penetration of banking channels[1]



1 Penetration based on whether respondent uses the following channels or not.
2 Digital-banking penetration refers to respondents who say yes to either using Internet banking via PC or smartphone.
3 Australia, Hong Kong, Japan, Singapore, South Korea and Taiwan.
4 China, India, Indonesia, Malaysia, Philippines, Thailand and Vietnam.

Source: McKinsey Asia Personal Financial Services Survey, 2014

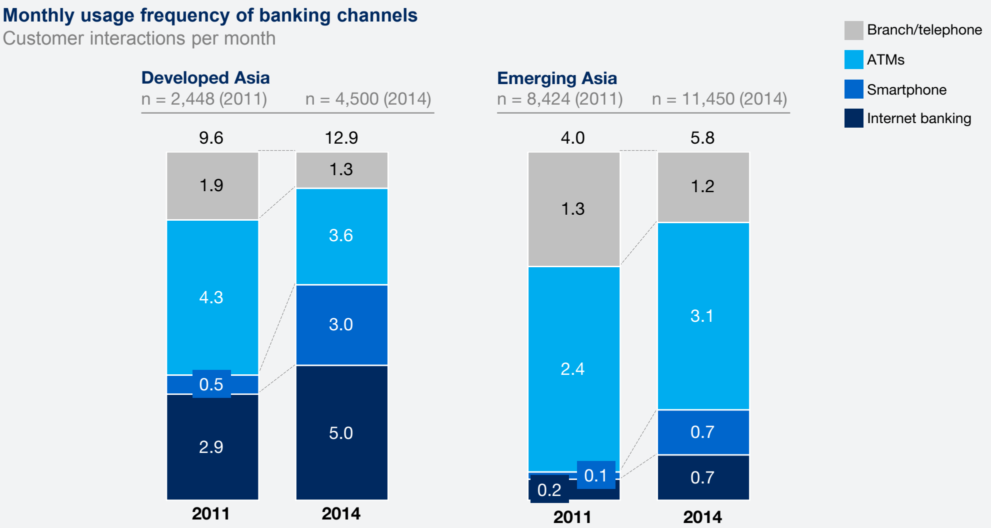
In developed Asia, 92 percent of respondents in 2014 said they had used Internet banking, compared with 58 percent in 2011. Also, 61 percent had accessed banking services using smartphones, more than three times the penetration seen in 2011. Behaviors in emerging markets showed a faster shift, although from a much lower base. Internet-banking penetration in these markets rose from 10 percent in 2011 to 28 percent in 2014 and smartphone access from 5 percent in 2011 to 26 percent in 2014.

Further, customers across Asia are using digital banking more frequently. In developed Asia, customers connect with their banks over the Internet or via smartphones more often each month than over traditional channels (Exhibit 3). In emerging Asia, these traditional channels, especially ATMs, still dominate, but customers are using Internet and smartphone banking almost five times more often than in 2011. Across Asia, consumers made fewer branch visits and calls in 2014 than in 2011.

The study also shows that the consumers most comfortable with digital banking—digitally savvy customers—are more attractive to financial institutions than other consumers. They are more educated than other segments, have account balances that are two to three times higher, and interact with their banks almost three times as often. They also hold multiple banking products—almost six per customer in developed Asia and three to four in emerging Asia—and are very active in online shopping.

In developed markets in Asia, our survey shows penetration at near-saturation levels across all the income groups we canvassed, ranging from 90 percent among households at median-income levels to 95 percent among the affluent.[3] Most age groups included in the survey also showed penetration levels at more than 90 percent, with consumers older than 50-years old—at 87 percent penetration—slightly less likely to use digital banking.

Exhibit 3. Consumers are shifting towards more frequent usage of digital channels



Source: McKinsey Asia Personal Financial Services Survey, 2014

3 Affluent consumers are defined as those who qualify for priority banking services, such as Citigold or HSBC Premier services, in their markets.

In Asia's emerging markets, however, our study shows that digital banking is most popular among the affluent and the young. Penetration among higher-income groups was nearly 40 percent compared with about 30 percent among lower-income groups. At the same time, about 40 percent of consumers from 21 to 39 years old that we surveyed in these used digital banking, compared with a little more than 20 percent of customers between 40 and 64 years old.

The trend toward digital banking is unlikely to stop, even as factors such as regulatory obstacles and, for some consumers, a personal affinity for physical branches work against it. In one indication, across developed Asia, more than 80 percent of the survey respondents have purchased goods or services online, yet only 58 to 75 percent have bought banking products online, depending on the country. In emerging Asia, we see a similar gap. Online purchases of general products and services range from two times higher than purchases of banking products in China to six times higher in Indonesia.

In addition, a large portion of the Asian consumers surveyed said they were open to using an online bank with no physical branch system, at least for some of their business. In developed Asia, 72 percent said they would consider using a pure online bank, and in emerging Asia, 44 percent.

Digital access to financial information also exerts significant influence on customers in developed and emerging Asian markets. Most of our respondents in developed Asia and about a third in emerging Asia said they researched banking products and services online before making a final decision to purchase. Most importantly, 20 to 30 percent of those who conducted online research said the information they found changed their minds about their purchases.

Bank branches remain necessary

The rapid shift toward digital banking might suggest the demise of the bank branch, but several factors assure that branches will retain an important role in Asia for the foreseeable future. For example, consumers are using multiple channels, rather than turning solely to online or branch services. Even in developed Asia, where digital banking is near universal, about a third of our respondents visited branches at least once a month.

Three factors, in particular, point to the continued relevance of branch networks:

- *Sealing the deal:* Across Asia, the majority of banking customers polled said they seek personal advice and apply for products either in person at branches or through call centers. While purchases of some products, like credit cards, are becoming more common online, customers are still seeking personal advice on more complex products, such as mortgages, investments, and life insurance, even after conducting initial research online.

- *Regulatory necessity:* In many instances, national-banking regulations mandate personal contact for specific transactions, especially for first-time customers. Almost all national regulators have stringent know-your-customer and anti-money-laundering rules, as part of the international effort to curtail money laundering and terrorist financing, which require identity verifications. Although some countries are open to digital means for complying with these rules, such as using online video or transmitting biometric data over smartphones, others continue to require face-to-face meetings with a bank employee for customers opening a deposit account.

- *Sense of security:* Banks once erected impressive buildings to give customers a much-needed sense of permanency and security for their deposits. Today, although branches are less grandiose, they provide the same sense of security that is difficult for an online bank to match.

What do customers want from digital banking?

Digital-banking consumers want more than an online presence, even one that is best in class. Our research shows that in developed Asia, four attributes are more important to customers than the quality of digital channels: the quality of basic services, the strength of the financial products, brand reputation, and the quality of customer service and experience (Exhibit 4). Among these desired attributes, the survey also shows that banking customers in developed Asian markets are typically least satisfied with the financial products and customer experience. Survey results from emerging Asia were less conclusive, indicating these markets are at the early stages in digital banking.

These results suggest that banks should use online platforms not just to present selected products and services, but also to create improved customer experiences across the full product portfolio by taking advantage of online technology. One bank in China, for example, started a digital-banking proposition for the young, "digital mass" segment, centered on simple products with attractive returns, a convenient customer experience across mobile and online banking, and safety. Besides managing savings, customers could also link credit cards to the account for real-time money management and spending analysis.

To facilitate customer acquisition, the bank introduced a paperless account-sign-up process that only took two minutes to complete and linked the account to the customer's identity card and mobile-telephone number. Additional features could then be activated post sign-up by uploading pictures of the customer holding his or her identity card, and linking the new account to other bank accounts. The bank used internal and external channels

Exhibit 4. A compelling proposition for digital consumers has to go beyond digital channels

Attributes important to digital consumers when selecting primary bank
Developed Asia,[1] n = 4,212

Attribute	Sample statement	Derived importance[2]	Satisfaction
1. Basic service	"The company rarely makes mistakes with my account"	7.1	40.3
2. Products	"They offer a full range of financial products and services"	7.0	33.0
3. Trust in institution	"The company is a leading brand in the market"	6.2	38.0
4. Customer experience	"The company is willing to go out of its way to help me"	6.0	31.3
5. Digital channels	"Its Internet banking platforms are the simplest and easiest to use"	5.5	44.2
6. Physical network	"The ATMs are in convenient locations"	2.9	41.0
7. Pricing	"The fees and charges are reasonable"	2.1	17.9

- Digital consumers are looking for **more than just a superior digital-channel** experience
- Attributes like **basic service, products, and trust in institution** also important
- **Opportunity to win** over consumers in terms of **products and customer experience**

1 Values derived using a simple average across markets; only digital consumers have been included in this survey.
2 Derived using correlation analysis against "I would recommend this financial institution to a friend or a colleague" and "I would continue to use it as my primary or secondary financial-services company."

Source: McKinsey Asia Personal Financial Services Survey, 2014

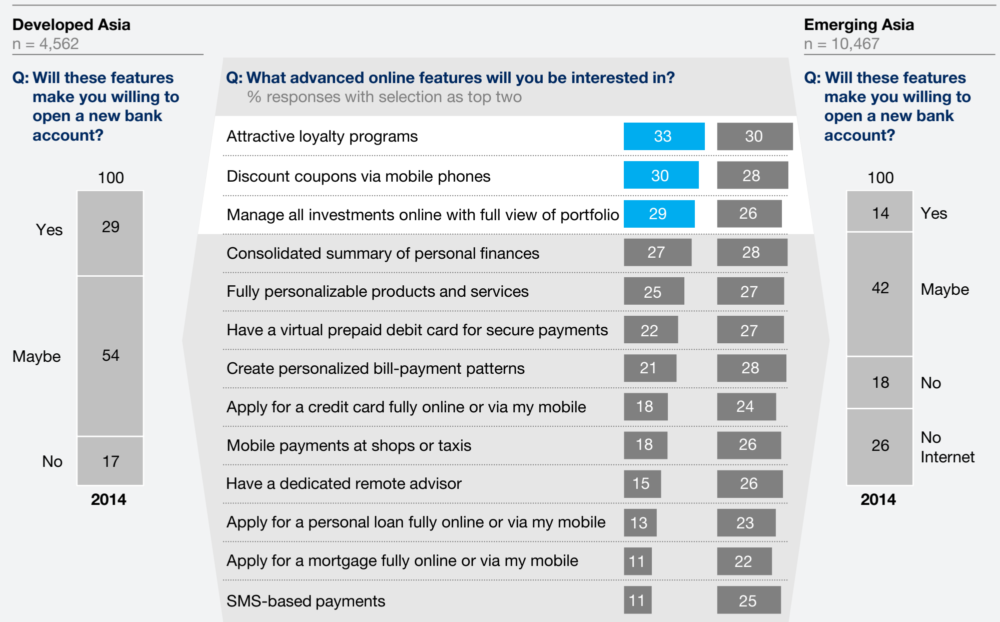
for customer acquisition, signing up some 200,000 customers in the first two months after launching the process.

Digital customers in developed Asia are especially certain of the specific features they want—notably, loyalty programs, discounts offered over mobile devices, and complete online access to their portfolios—and 83 percent of the respondents said, at a minimum, that these features might influence their choice of banks (Exhibit 5). In emerging Asia, there is much less certainty over the features that matter most, which is characteristic of a nascent market in which consumers are not yet familiar with the potential advantages of digital banking.

Our findings also show that simplicity and security are crucial aspects for online offerings. Of banking customers who have not made any online purchase of banking products, 47 percent in developed Asia and 35 percent in emerging Asia said the primary obstacle was that the products are so complicated that they needed a person to explain them. At the same time, security concerns stopped about 56 percent of the respondents in emerging Asia and 44 percent of those in developed Asia from purchasing products online.

The study found clear differences in how customers in developed Asia and emerging Asia should be approached, an important consideration for banks trying to shift customers to lower-cost digital channels. In developed Asia, more than 60 percent of the respondents tried online banking either out of curiosity or because of a tempting offer. They generally seek the convenience of 24-hour access to their accounts. In emerging Asia, customers first tried digital offerings after they were shown how to use them by banks, family, or friends. While convenience is also important to these customers, they were more interested in the flexibility of accessing banking services through mobile phones.

Exhibit 5. Consumers in developed Asia have a clear view of what digital features they are seeking



Source: McKinsey Asia Personal Financial Services Survey, 2014

Responding to the change

The rapid shift toward digital banking in Asia presents far-reaching consequences for the entire financial-services industry. Incumbent banks could transform their existing businesses by taking advantage of advances in technology to increase revenue and customer engagement and make processes more efficient. Attackers could potentially use digital banking as an innovative way to capture market share. Digital banking also opens opportunities for companies outside the financial sector to offer what traditionally have been banking products and services.

Irrespective of the current starting position, banks can focus on building a set of digital capabilities that are core to enhancing customer engagement and adding value. These include:

Revenue growth through advanced analytics: Asian banks have learnt a big lesson about the value of data and advanced analytics from non-banking institutions such as Alibaba, the Chinese Internet giant that has used its analytics capability to analyze transactions of retailers on its marketplace and offer micro-loans successfully. Companies can use the treasure chest of data and information to which they have access, including customer demographics, transaction and product usage, and credit behavior. For example, one Asian bank had a lot of customers but found that it was lagging behind competitors in cross-selling new products. To address the gap, the bank built a next-product-to-buy propensity model underpinned by advanced analytics. The approach, which included redesigning the customer decision journey in product selection and fulfillment to enable sales across all the bank's channels, helped increase product take-up rates by three times.

End-to-end process digitization: Technological change is providing an opportunity to make dramatic improvements in process efficiency and customer experience. For example, a European bank redesigned its mortgage process to take advantage of digital technology. By enabling the acceptance of digital signatures, automating payouts and data matching with property registries, and digitizing archives, costs of processing mortgage applications were cut in half and mortgage offers were completed in as little as 15 minutes, compared with two to five days before the redesign.

Digitization offers a way of re-imagining processes and engaging the organization in innovation. For example, one Asian bank set up a "hackathon" that, in 24 hours, helped design a best-in-class account-opening process. The hackathon brought together a cross-functional team, including front-line managers, product managers, risk management, operations, legal, and compliance supported by designers and agile developers.

User-centered design to create an outstanding customer experience.[4] Innovators such as Apple, Airbnb, and Uber have shaken up the competitive landscape in a variety of industries through innovation in customer experience. As consumers become increasingly multi-channel in their decision-making process, banks have an opportunity to better understand sources of dissatisfaction to develop new ways to promote engagement. One Asian bank is employing a user-centered approach to re-imagine its mobile and online banking experience. Using the insights from a panel of target-segment customers, the team identified needs (for example, one tap to see balances across accounts and to make transfers easier) and concerns (for example, secure yet convenient access) of its customers.

4 Prashant Agarwal, Mahin Samadani, and Hugo Sarrazin, "What every executive needs to know about design," mckinsey.com, November 2014.

The team then developed a prototype of a mobile banking application and refined it in several iterations with customers. This approach was crucial in creating a compelling customer experience, while also significantly reducing drop-offs during the sign-up process.

Setting up a two-speed IT architecture.[5] As consumer expectations rise, traditional organizations weighed down by legacy back-end systems struggle to provide the desired customer experience. Competing in the digital environment will require moving toward a two-speed architecture that accommodates a rapid customer-centric front end running alongside a slower speed, transaction-focused legacy back-end. Software release cycles for the customer-facing elements should be modular and enable quick deployment. On the other hand, core systems designed for high reliability and rigorous data quality management will inevitably lead to longer release cycles.

Banks with a large customer franchise can focus on value creation through the capabilities mentioned earlier. An alternate strategic approach appealing to attackers is to use disruptive, low-cost business models that make unnecessary extensive branch networks and design products and processes specifically for digital channels. Our analysis indicates that entrants without a legacy branch network can achieve lower cost-income ratios of 40 to 50 percent within four to five years, compared with around 60 percent at a traditional, branch-oriented retail bank. Attackers can also focus on a limited set of three or four high-value products, reducing the complexity of their product range and ignoring products and services with unattractive returns or that are more difficult to offer online.

However, attackers should find creative ways to offer customers a sense of security and to work past regulatory obstacles. Many entrants are using extensive marketing efforts to compensate for not providing the sense of security offered by branch networks. Marketing budgets for online banks, for example, are typically about 15 percent of total expenses, compared with less than 5 percent for incumbents. Strong deposit-insurance programs are also being used to add a greater sense of security for customers.

Digital banking is also allowing companies outside the financial sector (for example, Alibaba and Tencent) to offer payments and other services that have traditionally been the province of banks. These companies, generally from the e-commerce, high-tech, and telecoms sectors, are often more innovative than incumbent financial institutions and are not held back by legacy computer systems and entrenched corporate attitudes. Their most difficult challenges are overcoming regulatory barriers, such as prohibitions against accepting deposits, and gaining customer trust.

□□□

Financial-services customers in Asia are primed to use digital banking, and indeed our latest survey findings show that a large portion are already using computers and smartphones to access their accounts. The recent rapid growth in digital banking is likely to continue, and incumbents and entrants will be moving fast to stake their claims.

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5 Oliver Bossert, Chris Ip, and Jurgen Laartz, "A two-speed IT architecture for the digital enterprise," mckinsey.com, December 2014.

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