BANKS ARE FURTHER ALONG THEIR DIGITAL JOURNEY THAN WEALTH MANAGERS, BUT THEY ARE STRUGGLING TO GENERATE RETURNS ON DIGITAL INVESTMENTS. WEALTH MANAGERS' MORE CAUTIOUS APPROACH MIGHT BE PAYING OFF. **PAUL BRYANT** REPORTS

# Who's solving the digital puzzle in financial services?

'Digitalisation', defined by research house Gartner as "the use of digital technologies to change a business model and provide new revenue and value-producing opportunities", has been mooted as a massive opportunity for financial services companies.

It is more advanced than 'digitisation', which, according to Gartner, "takes an analogue process and changes it to a digital form without any different-in-kind changes to the process itself".

Global management consultancy Boston Consulting Group (BCG), in its 2017 report titled *Why aren't banks getting more from digital?* says retail banks that digitalise can achieve a 20% revenue boost and a 30% reduction in expenses. It cites an example of a North American bank that achieved this level of cost reduction by redesigning and digitalising its credit lending function. By automating processes – such as applicants submitting information electronically that then feeds directly into back office systems – the time from application to funding was halved, client satisfaction was boosted, and the number of exceptions requiring manual intervention reduced.

For wealth managers, BCG's *Global wealth 2018: seizing the analytics advantage* report estimates that digitalisation has the potential to grow the top line by 15%–30% and drive efficiency gains of 10%–15%.

It is also key to protecting existing business. In a November 2017 research presentation on attracting and retaining wealth management clients, Compeer finds that more than 50% of wealth management clients who consider websites, client portals and mobile applications in need of significant improvements are likely to look for another provider if changes are not made.

## Banks' digital difficulties

Most banks have been struggling to make money from their digital investments. In a July 2018 paper on banks and the 'digital flywheel', McKinsey reports that 21% of financial institutions say their digital investments are generating negative returns. Nearly 50% say returns are below their cost of capital, which McKinsey says is around 10% for banks.

Tim Jones CBE, former CEO of retail banking at NatWest, offers an explanation: "The blunt reality is that for an incumbent bank, the vast majority of the most valuable customers are older. And many of them just don't care about digital. The 'silver surfers' – the older generation that do embrace digital – are often in the minority. So, because the majority of valuable customers prefer the way things are done now, like using telephones and paper forms, banks have to keep the infrastructure to service them, and digital investments end up adding to banks' costs. And these investments don't bring in much additional revenue either. Digital banking services are more attractive to a younger demographic, and younger people generally have less money than older people. For a bank, people with less money are less profitable. Therefore, banks' digital investments lose them money!"

While these new digital customers will eventually become the most valuable customers of a bank, and it will make sense to remove the old infrastructure then, that point can be 20 to 30 years away.

BCG's *Why aren't banks getting more from digital?* report flags difficulties with project execution: "In the majority of cases, implementation results are disappointing. The pace of delivery is slower than initially expected; it is difficult to scale digital

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>> solutions across the bank ... or the impact on the bottom line is insufficient."

It finds that the number one cause of digital failure in banking is related to the complexity of dealing with legacy IT systems; followed by data architecture problems; key talent gaps; and organisational resistance to change.

Tim can testify to some of these issues: "It is often not a case of migrating from a single legacy system. Older banks will typically have separate technology platforms for retail banking, credit cards, mortgages and for other products. So, it's absolutely heroic to think that you're going to take all of that functionality and put it on a single, more modern platform, without major difficulties.

"It's also true that there is normally very significant resistance to change. Digital transformations usually reduce employee numbers at a bank and turkeys don't vote for Christmas. This is a very tricky management problem, but the way these barriers are overcome is to appoint the right lead executive team, and to make it very clear to everyone that the change is simply not negotiable."

Banks' record on appointing the right leadership teams is not a good one, however. A 2015 survey by Accenture, *Bridging the technology gap in financial services boardrooms*, finds that only 6% of board members and 3% of CEOs in leading banks have professional technology backgrounds, while 43% of banks don't have any board members with professional technology backgrounds. In a recent blog – 'Ten chairs: How to change the bank' – financial services commentator Chris Skinner says not much has changed since then.

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McKinsey has identified common characteristics of banks generating the highest returns from digital investments.

First, they were not treated as 'one-off' projects, but as a continuous, ongoing transformation of the organisation.

Second, once these banks implemented a digital project, they would move quickly to capture productivity gains and then reinvest the savings into the next project. If a new app moved some customer activity from branches to online, the number of tellers or branches would be cut, freeing up cash. These banks had overcome, or at least partially overcome, the cost duplication problem flagged by Tim.

Third, they had a bigger focus than digital underperformers on productivity and cost reduction. For example, if a new app did migrate more customers online, the bank would move quickly to sign them up for digital-only statements, reducing paper statement spend.

## Wealth managers lagging in digital

Banks and insurers are generally more advanced than wealth managers in their digital journeys. McKinsey senior partner and 'Digital McKinsey' global leader Paul Willmott says that the highest proportion of digital sales in financial services takes place in car insurance, followed by credit cards, home insurance, savings accounts, then current accounts. Wealth management, excluding online stockbroking, has one of the lowest digital penetrations.

In the UK, the number of people purchasing car insurance online has now reached around 23 million, according to Finaccord, compared to only 2.5 million people using online-only investment platforms, according to FCA figures. In banking, no direct comparative data to these online-only purchases exists, but the use of digital is very advanced, with around 37 million people managing their current accounts online, according to UK Finance.

Much of this difference has to do with the length of time these financial products have been available online. "The simpler and more commoditised nature of some banking and insurance products made it easier to take them online earlier," says Paul. "And with any shift in technology, very little takes place in the short term, but in the medium term, an awful lot happens. If you look at retail banking, it's taken 10–15 years to reach today's levels of 50%–60% sales online. In comparison,

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a product like robo-advice only really got going a few years ago."

Another factor is that wealth is skewed towards older demographic segments, where the digital take-up is lower. But Paul says that once you digitise the sales channels, and customers start moving online in bigger numbers, it accelerates the move to a more digitally-advanced back office.

## Keeping the 'human touch'

Wealth managers have started to play catch up. At the upper end of the market, the Coutts Invest digital platform was launched in April 2017. Nick Johnson, head of digital investing at Coutts and NatWest, says that clients can view their portfolio details online; receive digital reminders of their regular and more straightforward financial transactions; and execute a simple online transaction without seeing, and incurring the costs of, a wealth manager. He says: "In 2018, about 20% of our new investment assets into the group will come from digital channels, and we're only at the start of the journey."

Nick acknowledges the move to digital is not for everyone and some will expect a personal service, which is still available.

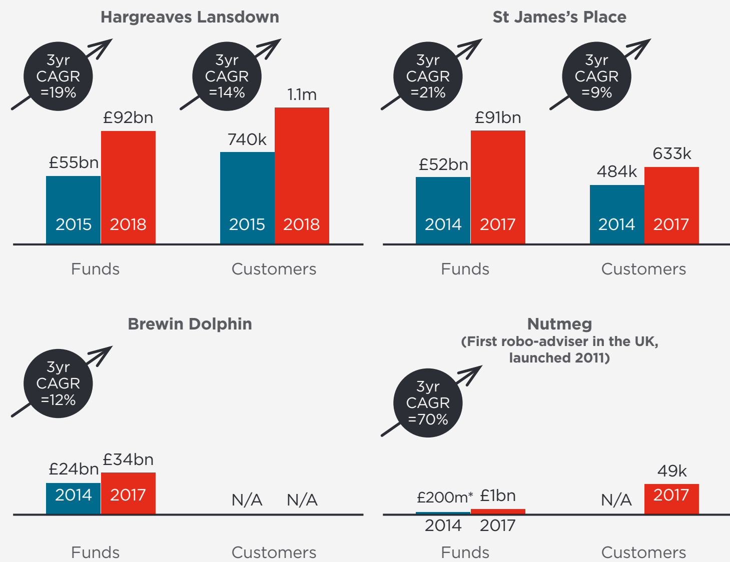
Gareth Johnson MCSI, head of digital channels and investment solutions at Brewin Dolphin, says their approach to digital has been to design initiatives around customer needs, resulting in a non-advised, online only investment channel, Brewin Portfolio Services (BPS), and a 'hybrid' channel, which is much larger.

He says BPS allows the company to service customers at lower cost and target customers with relatively small investment pots (minimum £10,000). BPS now makes up £0.1bn funds under management.

But Gareth adds: "We find that people with more complex needs want more human interaction. A client with £1m invested is thinking about their own future, as well as their children and grandchildren, and that requires a level of planning."

## Cost cutting

Sometimes digitalisation is about efficiency. Philippa Fielding, Chartered FCSI, manager of capital markets at Accenture Consulting, says the cost savings potential is huge: "We have seen the move to digital reduce wealth managers' total costs by as much as 30%. In areas such as digital onboarding and client profiling, there are cases where the amount of 'manual labour' has been reduced from over seven hours to as little as ten minutes. This will involve automating things like anti-money laundering checks and risk profiling."




*Source: Company annual reports and websites, * = estimate by Numis Securities*
*Funds = funds under management or administration*
*CAGR = compound annual growth rate*

Wealth managers' more cautious approach to digitalisation appears to have gone down well with investors and clients. The three largest stand-alone wealth managers in the UK have outperformed the banking index over a three-year period, shown respectable growth, and have hardly been impacted by new 'robo-attackers' (see above).

But wealth managers will need to keep advancing their digital offerings as competition from online-only and hybrid channels increases and consumers get more comfortable with digitalisation.

Penetration of robo-advisers is still very low and there have been some high-profile failures, such as UBS launching its SmartWealth platform in March 2017 and then closing it to new investors and selling it 18 months later. Despite this, it's probably too early to write off the robo-threat. McKinsey's Paul says because of the technological shift for consumers being in its infancy, it is "misguided" to say that robo-advice is a failure.

Hybrid competition is also intensifying. In 2017, Aviva acquired a majority stake in robo-adviser Wealthify, Barclays launched its Smart Investor platform and Investec launched its online platform Click and Invest. These are credible online offerings, with powerful wealth management businesses to build on.