Smart Moves Banks Can Make to Prepare for a Post-COVID-19 World

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The pandemic has flipped almost every aspect of normal life on its head—and the banking world is no exception. With new and surprising trends emerging, how can and should financial institutions respond? The best financial institutions are—and have been—quickly turning to digital automation and transformation to meet these trends head on.

Unexpected change

While many rapid consumer and market changes defy expectations, the numbers don't lie. The United States, for example, has experienced 10 years' growth in e-commerce in three months. In the first quarter of 2020, e-commerce leapt from just over 15-percent market penetration to nearly 35 percent—about the same rate of change as that of 2009 until the end of 2019.[1] That growth in e-commerce was fueled by parallel growth in spending: In the US in August, while personal income and disposable income decreased by 2.7 percent and 3.2 percent respectively, consumer spending increased by 1 percent for a total of $141.1 billion.[2]

In the United Kingdom, the housing market recovered at a surprisingly rapid rate. According to Nationwide Building Society, the world's largest building society, home prices are currently growing at their fastest rate since the Brexit fallout of 2016, at a rate of 5 percent in September.[3]

While market performance may seem decoupled from the economic realities of everyday life, we see a clear picture of what is going on: COVID-19 has fueled incredibly strong growth in areas such as technology, as evidenced by the growth in e-commerce, as previously cited. Those who have benefited have done so disproportionally. Tech stocks—toward which many of the major indices such as the Dow Jones Industrial Average, DAX Performance-Index and Nikkei 225 are heavily weighted— have experienced fabulous growth. Amazon and Zoom Video Communications have been clear winners. Those that have done poorly have created ripple effects through industries and households around the world. Changing consumer behavior has fueled these two very different stories. It has left many wondering what happens next.

While many are experiencing either extreme financial gain or extreme financial distress, it's become clearer than ever before that banking is a community service. This is good news because banks are more stable than ever before. Now better capitalized and still able to support lending activity, banks are positioned far better now than they were in 2008. During that crisis, banks were fighting for their own lives—now, they can focus on fighting for their customers.

No matter what the institution's size, a bank is an essential service provider. Bankers have a responsibility to hear and respond to the needs of their customers, especially in trying times. Their customers and employees should be at the heart of every decision they make. Although these decisions may still largely be centered on business strategy, credit-risk assessments and technology, smart banks will come out of this pandemic stronger by listening, analyzing and making employee- and customer-centric decisions.

In an environment so rife with change and challenge, strategic decisions are daunting. There are numerous areas in which attention must be paid, but staying in a few specific lanes can make decisions easier. When I speak with bank chief executive officers (CEOs) to understand their most urgent challenges, three areas of strategic change come into focus again and again: digital transformation, operating cost and enterprise agility.

Digital transformation

Digital transformation may be an industry buzz-phrase, but it is the most critical piece of a smart bank's strategy for post-pandemic success.

Banks poured $1 trillion into digital transformation between 2015 and 2019.[4] But the investment hasn't paid off yet: The 20 largest tech companies gained $3.8 trillion of market value during the 2010s, while the 20 largest financial institutions gained just $410 billion. While 80 percent of them counted digital transformation as a top priority, only 25 percent believed banks' digital-transformation plans would work long term. Only 1 percent believed those plans were well articulated.[5]

The pandemic may be the tipping point for financial institutions to finally see a return on their digital investments, as an extended remote environment accelerates customers' adoption of digital services. For example, Citibank saw an 84-percent increase in daily mobile check deposits and a tenfold increase in customer use of Apple Pay in May.[6] Further still, data from an industry survey conducted by digital document-signing company Lightico show that 55 percent of customers plan to visit bank branches less often, and 26 percent will avoid face-to-face banking entirely.[7]

The massive investment from financial institutions combined with consumer readiness to adopt digital-banking solutions have created the perfect environment for accelerated digital transformation. Any bank that doesn't take advantage of this opportunity will surely find itself having missed a critical inflection point for our industry.

The automated teller machine (ATM) will continue to be a key piece of this digital transformation. ATMs are at an inflection point today because they sit squarely between the physical and digital worlds—they allow us to conduct multiple types of transactions with ease. However, we still have the physical attributes of a commerce ecosystem, such as cards, cash, checks and biometric identification, that need to be tied into the digital journey. The ATM is still the best way to access cash quickly and easily, without coming into contact with another person. Diebold Nixdorf expects ATM usage to remain resilient and return to pre-COVID-19 levels,[8] as 93 percent of consumers said they were still taking cash out of ATMs.[9]

The accelerated push toward digital has numerous advantages for financial institutions and customers alike:

- **Speed:** Physical-digital hybrid solutions can help make transactions faster and safer. For example, ATM transaction pre-staging allows the consumer to initiate an ATM withdrawal from his or her mobile banking app, thereby limiting the amount of time spent in line or nearby others to get cash from the ATM.
- **Agility:** API (application programming interface) connectivity allows financial institutions to innovate and integrate new services faster while providing lower costs for their customers. By opening up to a more flexible infrastructure and simplifying the terminal software market, speed and time-to-market delivery are increased.
- **Personalization:** Financial institutions can glean invaluable insights about customer preferences and needs by tracking their data through digital touch-points. This allows financial institutions to truly "know your customer" (KYC) and create personalized customer journeys that make banking more enjoyable and, therefore, "stickier" with each customer.

- **Security:** As financial institutions continue to gather data, ensuring security and identity becomes paramount for financial institutions. By embracing an agile approach, financial institutions can plug and play the right API or third-party service to ensure that data is protected.

Operating costs

Many large levers for cost reduction, such as branch-network optimization, were already in flight prior to COVID-19 and have now accelerated. To continue the reduction trajectory, new opportunities for cost transformation must be found. This will mean looking into new areas and looking through the lens of total cost of ownership (TCO). In the case of the ATM channel, we see meaningful opportunities for our clients to optimize operations while also providing the functionality needed to enable other initiatives, such as branch closures.

There is, however, another challenge on the horizon that is outside of banks' control: interest rates. Rates have reached historic lows, and some are waiting for the other shoe to drop and for rates to hit zero or go negative.

This is daunting for banks, as interest income is traditionally a bank's primary source of income[10]. Rates have already been low post-2008, and now they are expected to stay at these new extreme lows for a long time. It leaves bank leadership with the urgent challenge to discover and activate new sources of income while streamlining costs—two goals that must be effectively balanced.

This is important now, as the increasingly self-service world combined with a steady appetite for cash means that banks can no longer afford to maintain inefficient and unhelpful self-service systems that do not meet customer needs. When we talk about digital-transformation trends, we are talking about a subset of the population that holds one critical prerequisite: a bank account. For the "banked" population of the world, it's unquestionable that customers are demanding and leveraging more digital solutions.

We are far from a cashless society. In the United States, several major cities pushed back on cashless retailers. New York, San Francisco and Philadelphia have passed legislation banning stores from refusing cash, citing discrimination against low-income residents who were at higher risk of being unbanked prior to the pandemic.[11] Additionally, McKinsey & Company also saw cash-usage levels rise from May to June for those countries that began to reopen—most notably, Italy and the US saw a 7-percent increase while Spain saw an 8-percent increase in cash usage.[12]

Making smart decisions about self-service TCO can follow the structure of the traditional TCO-analysis model that some readers may remember from business school:

1. 1. **Acquisition cost**: Can the bank afford the initial investment in upgrading existing self-service cash systems and installing new, innovative ones? Bank leaders should ask themselves if that initial investment will pay for itself in long-term savings and increased customer retention and acquisition. If the answer is yes (which I often argue it is to bank CEOs), then the initial investment is not only worth it, it's strategically necessary.
2. **Maintenance cost**: An important part of determining the overall value of a cash-system upgrade is looking at the cost to maintain it over time. A key component is the flexibility of the software running these devices. Is it easy to upgrade? Is it open source, allowing the best solutions to come to light and be implemented? Is the management (physical and digital) outsourced, allowing for more cost efficiencies, responsiveness and reliability? The banking industry is creaking under the financial weight of technology debt. In fact, banks spend 15 to 25 percent of their total annual budgets on maintaining legacy technology systems[13]. For big banks, that can amount to literally billions per year. Banks can't afford to replace old technology with a "solution" that is just more of the same.
3. **Total value over time:** The first two factors should help bank leaders determine the total value of a self-service system over time. With the steady demand for cash and the increased need for self-service solutions, focusing on the TCO of a bank's ATM fleet and in-branch kiosks will help set them up for success now and in the future.

Agile banking

The shift toward digital transformation requires a transformation of how banks think about not only client service but also themselves. Some banks may consider fintechs (financial-technology firms) a threat, and sometimes this can be true. For example, fintechs that can take deposits (essentially, "digital banks") can threaten banks' market shares. But smart banks will understand that the fintech universe is vast and filled with hundreds of innovative service providers, the entire mission of which is to augment, enable and make more accessible the existing offerings of banks. Smart banks have an opportunity to become more agile, offer more services and reach more customers by partnering with these types of fintechs. Customers can gain access to a more robust set of services much faster than banks would be able to build them. With agility comes innovation and speed to which financial institutions can adapt and then navigate changing circumstances.

For example, an agile bank may deploy a video ATM solution to help customers stay connected to essential services during the global pandemic. From this solution, what percentage of customers who utilized a video teller did so a second time? What does that data teach about the customer experience using the new ATM? During the early months of the COVID-19 pandemic, the best-in-class financial institutions migrated almost 70 percent of deposits from teller to self-service, with slightly more than 50 percent occurring at an ATM. What those financial institutions do next with that data *should* determine their digital partnership strategy for the next one to five years—and *will* determine their success, whether they partner or not. The data provides more insights to banks to become agile and nimble in their approaches.

It's been proven time and again that the financial institution and fintech each provide huge advantages to the other that one cannot achieve on its own. For fintechs, financial institutions provide scale and market share that they've won over years of national expansion or service to their local communities. For financial institutions, fintechs provide a nimble, sandbox-like environment to experiment with new solutions, only selling the best ones that stand up to regulatory scrutiny and customer demand. According to a global retail-banking executive survey conducted by Capgemini, 58 percent of executives said banks that effectively cooperate with fintech or bigtech partners take less than a year to innovate and launch a new concept.[14]

No longer is branch transformation a box to check to prove that a bank is "innovating". The real purpose of branch transformation is to serve customers better continuously. Given financial institutions' limited resources to sift through data, they need experienced partners that can help them parse and action these treasure troves. In many cases, financial institutions have deployed new technology solutions but are not using them to their full potential. The way to solve this is by setting measurable digital-engagement goals and determining the leading and trailing metrics they need to track in order to make better decisions down the road. This is where analytics come in.

An agile bank highlights the very human side of banking, in that it is done by people for people. If those people do not become open to a new way of doing things and a new way of thinking about their jobs, they risk keeping themselves and their technology infrastructure closed to new opportunities—and closing off the path to growth.

In conclusion

We are at a pivotal moment in banking history. While the pandemic piles pressure onto bank leaders to quickly adapt to huge changes in customer demands, this immense pressure has the potential to create a diamond. After years of investment, the conditions are right for customers to adopt digital solutions *en masse*, creating an instant return on those investments in digital transformation.

But smart financial institutions need to be proactive about their digital strategies. Every bank is different because every community is different. Digital transformation is not one-size-fits-all. The long tail of cash will continue to challenge bankers to find ways to optimize costs while blending payment ecosystems, and the long-term value of those systems must be taken into account now, not later. Now is the time to become hyper-vigilant to customer needs and staff journeys. It is time to get serious about listening to direct feedback and data and to onboard the partners that financial institutions need to make smart decisions based on that data. It's time to take a stance, set a strategy, and implement and adjust as you go.

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