Will the banks control **on-line banking?**

Sandra Boss, Devin McGranahan, and Asheet Mehta

The indifferent performance of virtual banks in converting the public to on-line banking would seem to hand the advantage to their traditional competitors. Yet most incumbents have been slow to meet the on-line needs of their customers.

When people write a check or take cash out of an automatic-teller machine, few of them stop to think whether the computer system handling their transaction might crash and their savings disappear. But when customers of Internet banks sit at their PCs and move thousands of dollars between accounts, they must wonder, if only for a moment, if such a catastrophe could occur. So far, only the rare individual entrusts all of his or her financial affairs to a virtual bank (Exhibit 1, on the next spread). Given these reservations, it would seem that the solid, reliable image enjoyed by established banks should give them a special opportunity to lead in the on-line world. Have they taken it?

In one sense, they have. In other industries, incumbents roused themselves to exploit their natural advantages only after pure-play attackers brought enormous numbers of customers on-line. In banking, the opposite is true: while Telebank and NetBank are having trouble notching up their first 100,000 customers, Citibank, Wells Fargo, and Bank of America can boast

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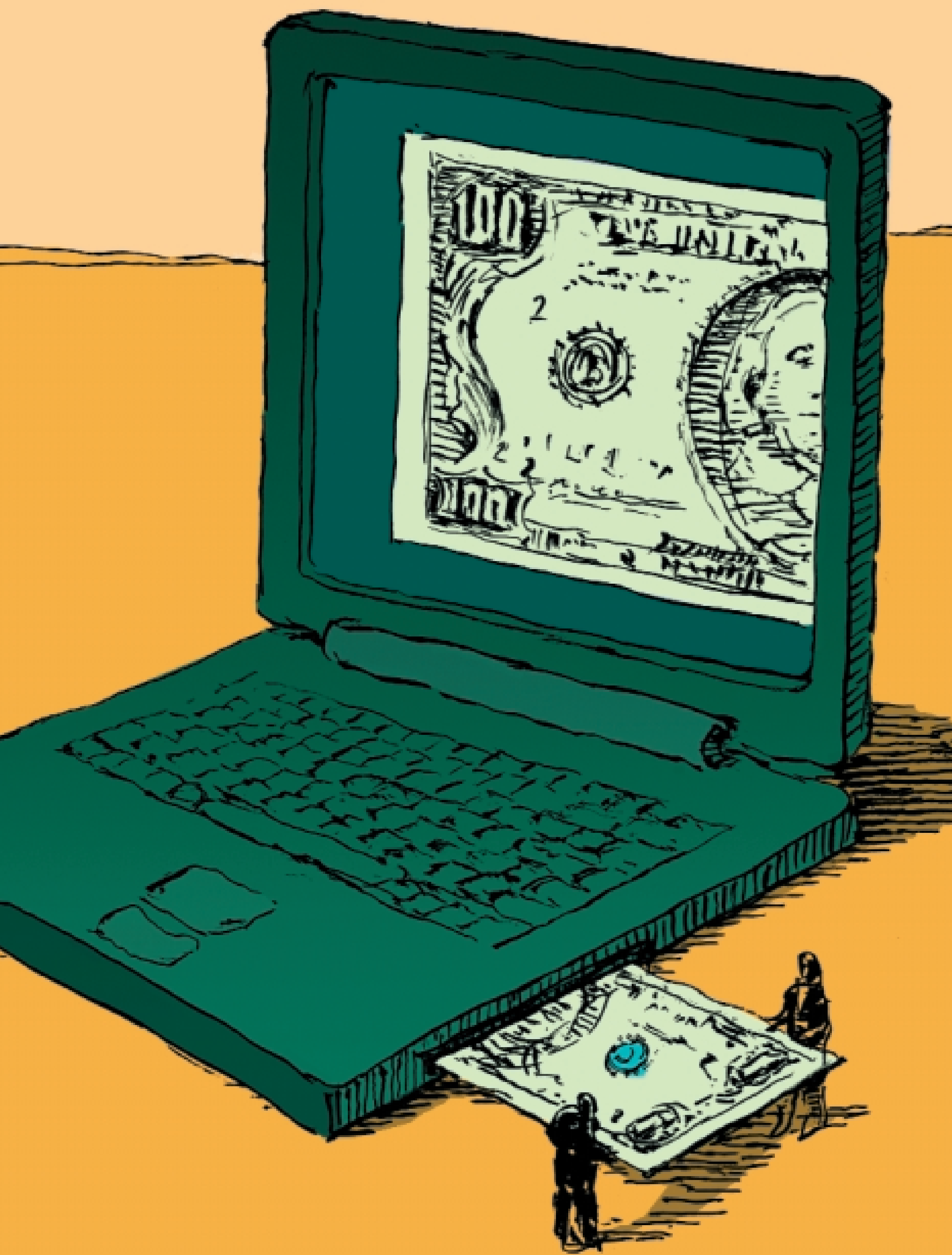


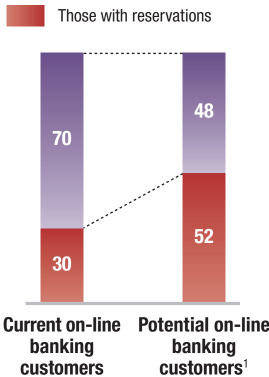
JANUSZ KAPUSTA

EXHIBIT 1

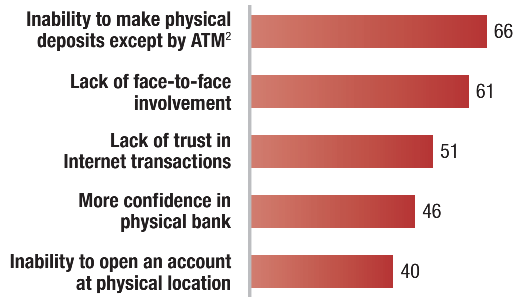
Virtual banking, real doubts

Percent

Consumers have reservations . . .



. . . and they cite these top reasons



[1]Customers indicating they plan to open an on-line bank account in the next 6 months.
[2]Automatic-teller machine.
Source: McKinsey proprietary consumer financial research, 1999

hundreds of thousands, if not millions, of on-line accounts (Exhibit 2). Indeed, so indifferent has been the performance of Internet-based institutions that CompuBank, the first purely virtual bank to receive a charter, recently announced plans to scale back business-to-consumer (B2C) activities in favor of business-to-business (B2B) alternatives.

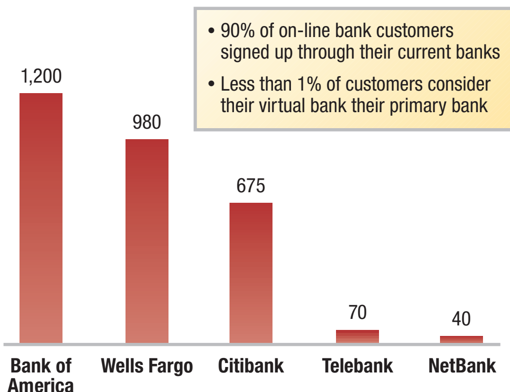
What is CompuBank walking away from? Quite a lot. On-line banking will grow to embrace more than 25 million households by 2003, and the first six to ten million of those households will typically have annual incomes of around $65,000—an attractive population (Exhibit 3). Attractive demographics mean attractive economics; the bottom-line benefits of moving an Internet-savvy traditional banking customer on-line include improved retention, higher balances, and broader relationships. Unfortunately, most incumbents risk this potential by failing to meet the customers' on-line needs adequately.

The majority of the banks that provide the most satisfactory on-line experience for customers (as mea-

EXHIBIT 2

Big banks are also big on-line

Thousands of on-line accounts[1]



• 90% of on-line bank customers signed up through their current banks
• Less than 1% of customers consider their virtual bank their primary bank

[1]As of second quarter, 1999.
Source: Faulkner & Gray; U.S. Bancorp Piper Jaffray

sured by standards such as ease of use, access to help, and security) are attackers; they also offer better pricing and greater choice. Incumbents, meanwhile, often fail to meet such basic consumer requirements as news and information, tools to manage finances, and even uninterrupted access to the incumbents' World Wide Web sites.

Some established banks, it should be said, do have promising efforts under way. Bank One, Huntington, Wells Fargo, and others have all appeared in the top ten list of the Gómez Advisors' Internet Banker Scorecard, a respected independent index of on-line banking services. Citibank has aggressively built alliances and partnerships with leading electronic-commerce operators. But too many players have done much less.

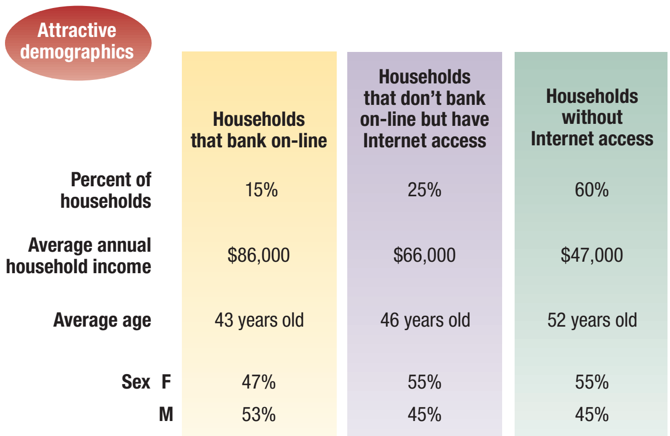
Given the diminished threat from virtual banks, how much does the slowness of the established banks' response matter? Actually, a lot—because incumbents face other, more powerful threats. To fend off the attackers, most banks will have to mobilize a more formidable set of on-line services than they have put forward so far.

The real threat

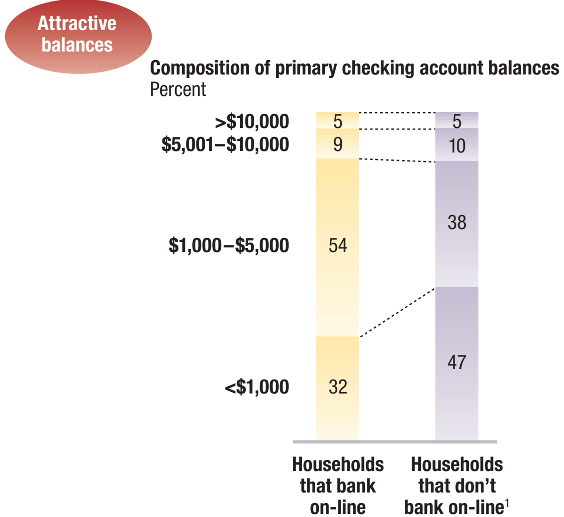
A majority of the leading on-line brokers are beginning to offer banking products and services as part of their overall offers. They are actively seeking to capture "excess" balances in existing checking and savings accounts by offering better rates. And they generally

EXHIBIT 3

On-line customers are attractive


Attractive demographics

	Households that bank on-line	Households that don't bank on-line but have Internet access	Households without Internet access
Percent of households	15%	25%	60%
Average annual household income	$86,000	$66,000	$47,000
Average age	43 years old	46 years old	52 years old
Sex F	47%	55%	55%
M	53%	45%	45%

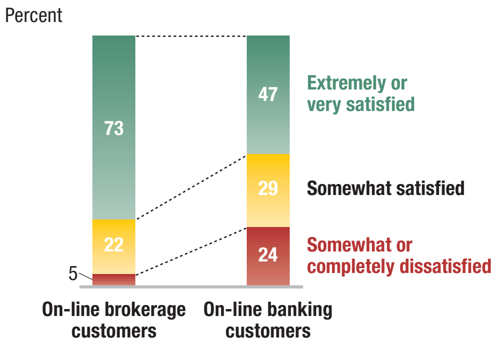


[1]Includes households without Internet access.

Source: McKinsey proprietary consumer financial research, 1999

EXHIBIT 4

On-line brokers keep customers happy



Source: McKinsey proprietary consumer financial research, 1999

claim high levels of customer satisfaction—almost 50 percent higher than the established banks' on-line services can—and a lower churn rate (Exhibit 4). According to McKinsey's recent on-line financial-services survey, almost 75 percent of on-line banking customers said that they would be at least "somewhat likely" to transfer funds into brokerage accounts that offered check writing, bill payment, and money market rates on excess cash. And 65 percent of those willing to transfer money said that it would most likely come from an existing bank account or savings account.

There are other threats to banks as well. Several leading systems providers have developed "bank-in-a-box" solutions—unbranded, electronic, full-service, virtual-bank systems—that can be bought, branded, and offered to consumers by any authorized company that wishes to provide banking services. A host of insurance companies and retailers have applied for banking licenses. Many of these entrants see banking less as a profit center than as a tool to retain and acquire customers for their core business. They are thus likely to market and price their banking products very aggressively indeed (as they have in Europe, where retailers such as Tesco have begun to offer branded banking products).

Most conventional banks have not adequately anticipated the potency of these threats. Instead of developing a technologically advanced service that exploits the capabilities and resources of the Internet, they have simply "e-enabled" their existing products by attaching a Web front end to their legacy IT systems. As a result, many products and services of such banks are less sophisticated than those of their brokerage competitors.

An on-line service that merely mimics an off-line one has a second problem as well: it doesn't give customers an adequate inducement to move a significant portion of their banking on-line. As a result, most customers tend to treat on-line banking as no more than an extra channel to check their balances and transaction histories, and they continue to do the rest of their business at the ATM or the teller window. A vicious cycle ensues. Because customers use teller and ATM services as much as ever, the new offerings increase the banks' total costs. This makes the banks reluctant to make further large investments in the on-line channel, which thus does nothing to

move customers away from tellers and ATMs. Banks draw an analogy with the introduction of ATMs, which were supposed to cut bank costs by reducing the need for tellers. In fact, consumers didn't stop using tellers to the extent that banks had hoped, but they also used ATMs so frequently that the reduction in cost per use was more than offset by the higher volume of transactions.

What is to be done?

To prevent on-line banking from remaining an expensive additional channel that does little to retain footloose customers, banks must act quickly. The first and most obvious step they should take is to see to it that the basic problems fueling dissatisfaction have been addressed. Almost a third of the customers we surveyed said that they couldn't always gain access to their on-line banking service; a quarter found it difficult to get customer support.

Banks must act quickly or on-line banking will continue to be an **expensive additional channel**

After repairing these basic deficiencies, banks must ensure that their service is competitive. Obviously, it should include checking, savings, and brokerage services, which anchor customers to the institution. In addition, to meet the challenge of on-line brokers and other new entrants, banks would need to add "supermarkets" selling products such as mortgages, mutual funds, and insurance.

Build a customer relationship capability

In a future of lower search costs, Internet-driven disintermediation, and the rapid development of minibranch networks by aggressive attackers, incumbents will need to hold the customer close. But merely putting existing services on-line won't help tighten their embrace.

Instead, banks must learn to aggregate their customers' different on-line financial-services relationships (*see* "Click and save," in the current issue). The purpose of aggregation is not to engage in blatant cross-selling or to achieve "100 percent share of wallet" but rather to develop a picture of the consumer's entire balance sheet. Any institution that gains such a view can provide superior convenience and advice.

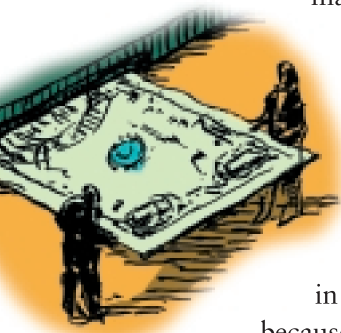
Of those people we surveyed who said that, given the right offer, they would be willing to consolidate their financial-services relationships, 75 percent said they would choose to do so at a bank—an endorsement that reflects the trust banks inspire. The kind of savings afforded by aggregation would

cement this loyalty. Many banks, however, are a long way from having the technological ability to make all of this work: some can't even aggregate information about their own various relationships with customers, let alone integrate third-party data.

Lacking technological command of the customer relationship, banks are at risk of losing it. Brokerages—which, in addition to standard banking services are starting to offer the kind of aggregation and personalization that will permit them to play this role—are a particular threat. J. P. Morgan, for example, helps customers create a picture of their entire financial situation regardless of which institution "manufactures" the products in their portfolios. It is only a matter of time before others offer this level of service more broadly.

Migrate old customers and go after new ones

In building an on-line business, a bank's off-line customer base is a huge asset, for it will be harder for competitors to pick off the bank's current customers than for the banks to get them on-line. But to do so, banks must make one-time offers (a number of on-line financial-services companies give away products like Quicken TurboTax to those who sign up) and then constantly provide incentives such as free services (for example, bill payment and on-line trades) for increased balances.



Banks must also move swiftly to acquire new on-line customers. Most of the early attempts to do so, carried out in partnership with Internet portals, have flopped—largely because the banks failed to offer any differentiation in pricing or any other very compelling lure. Yet here, too, banks have an advantage. Despite significant increases in revenue from on-line relationships, credit card companies and brokerage firms have spent so much money building their on-line customer base that some would question whether they will ever profit from these efforts. Most banks already have a powerful retail distribution network that should allow them both to migrate their customers and to acquire new ones at much lower cost.

Move beyond traditional banking

In addition, traditional banks must seize the opportunities offered by the Internet to create entirely new businesses. So far, the banks haven't been especially alert to these possibilities.

On-line brokerage is one example. Traditional retail banks tried for years, with relatively little success, to launch and build discount-brokerage capabili-

ties. When the Internet arrived, trading was the obvious candidate to take on-line, yet no bank sought to become a leader. On-line payments are a second area in which banks must do better. Two leading banks are participating in recent innovations: an e-mail-based payment system and person-to-person credit card payments and escrow services.

Banks will have to reinvent their role and the way they deliver value—leveraging new technology as well as their existing assets—to remain their customers' financial institution of choice. MQ