

Setting objectives and measuring digitalization in Financial Services

It's time to re-examine the facts and adjust the course



Financial companies are investing in digitalization to improve operational costs and meet client expectations, but few can claim success. In this viewpoint we argue that a vast majority of companies seem to have started digitalizing themselves aimlessly, with no clear objectives of how they want to move forward. It's time to re-examine the facts and adjust the course.

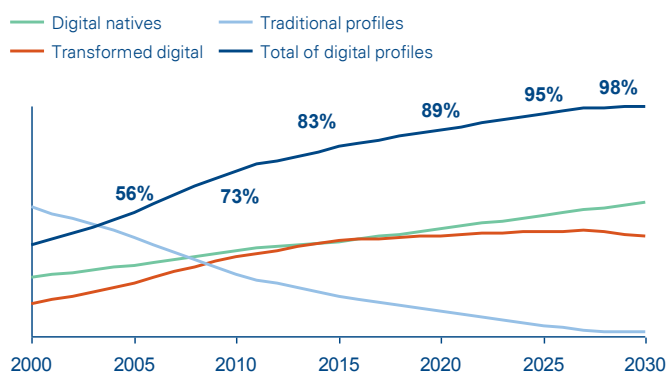
The background to digitalization involves new social trends, which in turn impact the financial sector.

Increasing mobility – the growing overall number of people traveling abroad, or working far from home – hyper-connectivity and hyper-information through digital devices (e.g. the average UK user owned 3.3 devices in 2015) are important factors modifying consumers' behavior.

Additionally, changes in social trends, such as more youthful consumer behavior, more diverse families (e.g. lone parents, singles), and propensity toward individuality, lead to a rising demand for customized products and services according to new needs. Examples include pension plans for different risk profiles, insurance for sportsmen and cyclists, "pay-as-you-drive" car insurance and insurance with home-monitoring services.

Digitalization is already latent

Digital population evolution (EU-28)



Source: Cepalstat, Statista, ITU, eMarketer, Recargapay, Eurostat, Arthur D. Little analysis

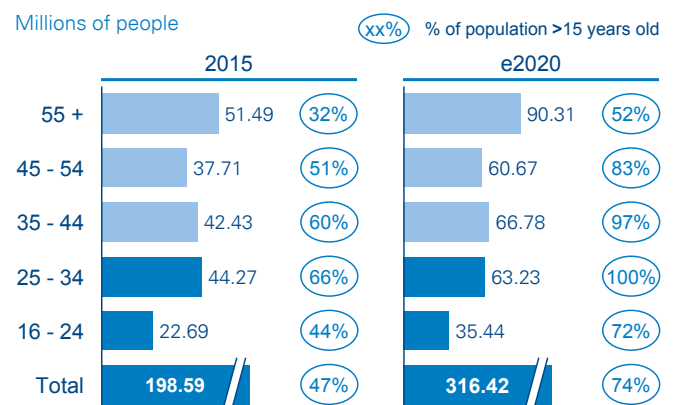
Looking at digitalization in the different generation gaps, digital natives include generation Z, generation Y is unsurprisingly shaped by technology, and traditional profiles – generation X and older – have been to a great extent transformed to digital profiles.

As a result of this, digital profiles amount to around 83% of the total population in Europe today, and are not expected to stop growing in the next years.

Those figures show that the digital opportunity already exists – people are already digitalized.

Even though the financial sector is well known for being one of the most traditional industries, the impact of digitalization is revealed by the fact that almost half of customers in the EU today operate to some extent through digital channels – a number expected to rise to 74% as soon as by 2020.

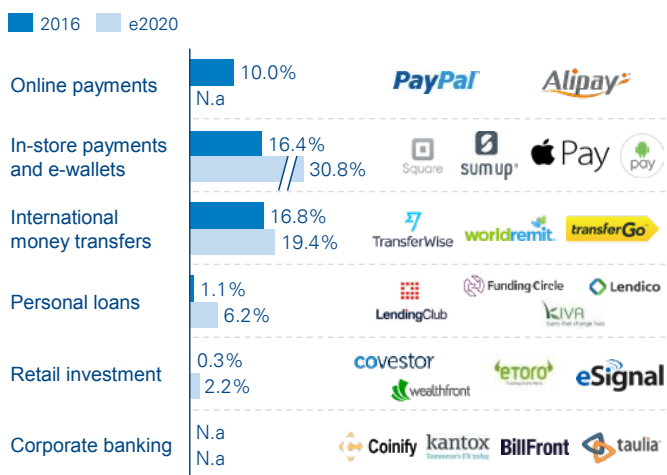
People who operate online¹ (EU-28)



Note (1): Individuals using the internet for internet banking: includes electronic transactions with a bank for payment or for looking up account information. Source: Eurostat, Arthur D. Little analysis

Furthermore, digitalization in banking and insurance is picking up speed, driven by innovative start-ups in financial services (“fintechs”), which are developing new IT-based business models. With over 100 annual fintech operations with value greater than \$1M, these disruptive players are threatening all bank business lines – starting with payments and ending with working capital finance.

Fintech penetration and example providers



Source: Statista, Arthur D. Little

What can financial companies get from digitalization?

Digitalization comes with both operational and commercial advantages. Which one of the two is more important for a bank or insurer depends on where the company lays its focus, the market maturity (how other financial institutions are positioned in digitalization, e.g. pressure from fintech companies) and the level of development of the affected market (less-developed countries have younger populations, which indicates a bigger opportunity for digitalization).

Operational advantages

Effectiveness in processes is one of the main concerns of financial companies, and one of the main budget consumption. Digitalization can help with automating and optimizing end-to-end processes – which can be empowered by making use of new technologies such as digital signatures and OCRs. This can reduce the need for resources, especially in back offices, and improve effectiveness and efficiency, overall operational metrics, and service quality.

But operational advantages don't only come from process efficiencies. One of the more relevant margin contributions is due to transforming relationships with customers from physical to digital – i.e. from personal attention to auto-service.

Additionally, if banks and insurers can interact with their clients through digital channels, they will be able to interact with them anywhere, anytime. By doing this they will achieve an

important improvement in the quality of service and increase the touchpoints for commercial opportunities.

This is especially relevant in banks, as they have intense relationships with clients, performing one or two daily interactions with digital clients. Insurance companies, on the other hand, are limited to an average of one interaction every three years, and thus digitalizing customer operations is less relevant.

Commercial advantages

Digitalization also brings important commercial advantages for companies with a large amount of clients, such as retail banking and insurance companies.

Digitalization is the main driver to augment the knowledge of the client. This allows companies to better understand their needs and expectations (what products and services fit better with their requirements) and their engagement (which customers are likely to leave, on which customers they need to focus their loyalty efforts). Digitalization can be seized to understand potential client needs.

Nowadays, customer intelligence is an important tool to leverage to lead the bank's commercial efforts and design suitable product offerings – i.e. products tailored to real client needs.

Moreover, the financial offering is now evolving thanks to digitalization: grouping products with discounts, personalizing products for specific segments and even “technification” – the use of technology for measuring risks and optimizing prices – as a part of the value proposition. The efforts are increasing the fit of the commercial offering with the evolving needs of customers.

Efforts to evolve financial companies must take place with continuous improvements in product lifecycle, in which companies test products with clients and adapt them under the obtained result in shorter periods.

In the end, financial companies must adapt their offerings to client needs and reduce their release times to be able to answer to changing customer demands.

Thus, by applying customer intelligence to guide commercial efforts, and by developing proper product offerings, financial institutions can raise sales and profitability ratios.

What are the goals of digitalization?

A vast majority of companies lack clear-enough objectives and need to decide on how they want to move forward.

Arthur D. Little, after developing digitalization cases for banks and insurance companies in several geographies, has developed a framework that collects the objectives a company must pursue with digitalization in reference to operational and

commercial advantages. The framework is called “The DIGITAL framework”.

Key indicators to measure digitalization goals

Goals	KPIs examples	Expected improvement ¹
D evelopment of new products	■ Sales of new products	5% 10%
I ncentivize sales to current clients	■ Number of products per customer	25% 50%
G enerate new clients	■ Acquisition of new clients	15% 25%
I mage: positioning as digital company	■ Engagement in social media and visits to corporate websites	50% 100%
T ransfer operations to digital channels	■ Operations in digital channels	50% 100%
A utomation of operations	■ Savings in operational cost	10% 30%
L oyalty and churn of clients	■ Clients' satisfaction – NPS and churn ratio	15% 35%

Note: (1) As percentage of current value in 3-4 years
 Source: Arthur D. Little analysis

The framework comes with the necessary KPIs to measure the progress in achieving specific goals.

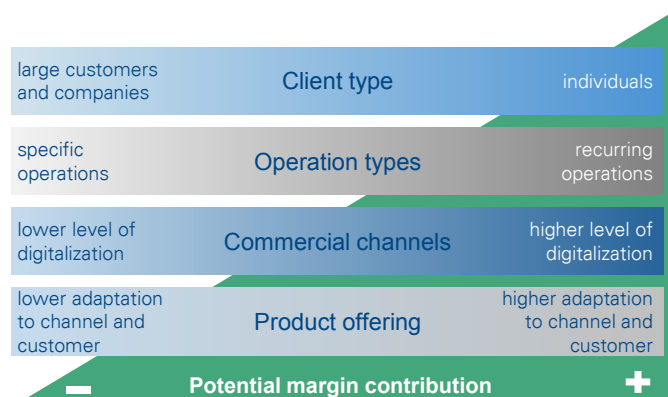
It is important, however, not to take this framework as a universal answer that is relevant to all financial institutions. These objectives will have more or less relevance depending on where companies concentrate efforts and how many other companies are pursuing the same piece of the pie.

Companies trying to digitally transform themselves must start by defining their specific objectives, how they want to move forward and the KPIs they need to measure the progress of digitalization.

Additionally, tracking those KPIs regularly during program development is critical to ensuring the success of the transformation. They are the true measure of success, as they represent the progress in gaining operational and commercial advantages – not the progress of software implementation.

Banks and insurance companies will obtain relevant increases in results

Main internal factors impacting digital benefits

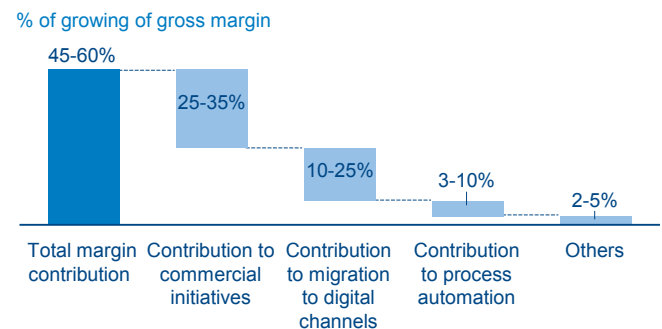


As we move forward through the digitalization journey, the progress in operational efficiency and commercial effectiveness will impact margin contribution.

Arthur D. Little has worked with several financial services companies, estimating the impact of digitalization. Assuming our estimates are indicative of potential and depend on diverse internal factors, the impact of making the change is worth circa 40–50% of increased annual gross margin.

Based on our experience, the main resources of margin growth are: (i) developing customer intelligence together with improving the commercial tools in order to increase effectiveness in commercial actions, i.e. commercial initiatives; (ii) migrating client operations from physical branches and call centers to digital channels; and (iii) optimizing processes.

Contribution to digital initiatives



Source Arthur D. Little analysis

Improvements in the effectiveness of commercial efforts impact directly on the number of products per client, the acquisition of new clients and the churn ratio. Based on Arthur D. Little experience, improvement in those ratios involves an upgrade of between 25 and 35% in a company's gross margin.

In relation to savings from the migration of operations to digital channels, as an example, migration of 20% of transactions to digital channels can bring out operational savings of around 10–25% of gross margin, depending on the intensity of the customer's operations.

Finally, savings due to process automation and optimization represent a significantly smaller contribution than from other initiatives, especially in digitally mature organizations.

Digitalization is a three- to four-year journey with the involvement of the entire organization

So what do financial services companies need to do? Digitalization is a three- to four-year journey that usually requires adapting the overall organization, to a greater or lesser extent.

Digital transformation cannot be undertaken if different departments are moving in different directions. Thus, a common direction, responsible for achieving overall business goals, is needed, which implies important changes in organization structure.

From a business perspective, a large part of company processes, from front end to back office, are impacted by transformation in order to be digitalized or optimized. The processes that are commonly more impacted are those processes that are related to customer management and product development, considering that those processes were out of digitalization scope previously. Moreover, changes in customer management and product development must be managed by multiple teams, which complicates the definition and coordination of tasks.

In the IT landscape, companies usually need to adapt back-end systems to ensure that front-end systems have enough flexibility to implement the digital requirements. Therefore, changes affect most systems, from core to front end, involving all the IT departments. One option is to consider acquiring new digital capabilities by integrating third-party white-label solutions instead of developing everything on their own, which must speed up the process.

Another basis of digitalization involves activities related to data quality and data governance. These are essential to improving customer intelligence – that is another aspect in which most financial organizations are lagging behind.

Finally, the proper adoption of new tools by employees and new digital channels by customers involves the development of incentives and promotion strategies and a complete change management program.

Conclusions

Faced with this approach, financial companies, especially those with intense relationships with their clients, should join the bandwagon of digitalization because society is already digital. When seizing the opportunity of digitalization, the transformation should not only involve leveraging operational improvements, but also the development of more effective commercial capabilities.

Building those commercial capabilities requires the development of customer intelligence and an appropriate offering that fits client needs.

In our view, the only way to ensure digitalization success is to define specific business goals and measure the progress with business KPIs that really deal with the strategic objectives of the company and deliver monetary benefits for the company.

But the journey towards digitalization is not an easy one. The transformation normally requires important changes in processes, organization structure, and company systems, and must involve all business and IT areas.

We hope that this viewpoint provides food for thought, and we look forward to supporting you on your digitalization journey.

Glossary:

OCR: Optical Character Recognition

KPI: Key Performance Indicator

NPS: Net Promoter Score

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