

Asia's digital banking race: Giving customers what they want

Global Banking April 2018

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Introduction

Smartphones in hand, customers across Asia are changing how they bank, growing more open to exploring and using digital channels for their financial needs. This openness to digital channels will reward those banks that can meet customers' expectations; but it also represents a challenge to incumbent banks—because customers are also expressing a willingness to bank with non-traditional players such as fintechs and nonbanking payments players. Incumbent banks need a response to this changing landscape if they are to remain relevant and sustain growth.

The insights in this report are based on McKinsey's proprietary Personal Financial Services Survey, which has been conducted every three years since 1998. The survey now covers about 17,000 urban banked respondents in 15 Asian markets. It provides rich insights into consumer behavior and trends in customer acquisition, loyalty, and retention, answering questions such

as “How do consumers make their banking decisions today?”, “What do they feel about their banks and the services offered?”, and “What are consumers open to exploring in the way they manage their finances?”

Each new survey is refreshed to address changes in customer behavior, reflecting themes like digital banking and the use of financial technology (fintech) or nonbanking payments solutions. The 2017 edition covers Australia, China, Hong Kong, India, Indonesia, Japan, Malaysia, Myanmar, New Zealand, Philippines, Singapore, South Korea, Taiwan, Thailand, and Vietnam.

The PFS Survey is independent, reflects our own views, and has not been commissioned by any business, government, or other institution. Unless otherwise specified, all conclusions and insights in this report draw on the findings of the PFS Survey.

The continuing rise of digital banking in Asia-Pacific

Consumers across Asia have embraced digital technologies, making steady and growing use of the internet, social media, and e-commerce platforms. Smartphones—the device of choice—alone generate around 65 percent of all internet traffic. Most governments and regulators across Developed and Emerging Asia¹ are open to new digital propositions that do not jeopardize consumer protection. This new digital reality holds true for banking, with most consumers embracing digital banking either on their computers or smartphones/mobiles.

Customer insights from McKinsey's Asia Personal Financial Services (PFS) survey reveal that digital banking penetration has grown 1.5 times to 3 times in Emerging Asia since the last survey in 2014. The median for Developed Asia is around 97 percent, and 52 percent for Emerging Asia. Smartphone banking penetration has grown at a faster pace than overall digital banking, jumping two- to four-fold in many Emerging Asian markets. With 30 to 50 percent of those not using digital banking expressing the likelihood that they will eventually make the switch, growth in digital banking penetration is expected to accelerate in Emerging Asia.

The percentage of digitally active customers (those who use digital banking at least every fortnight and have made e-commerce purchases in the last six months) has grown significantly since 2014, doubling in Emerging Asia (to 25 percent of the population) and growing 1.2 times in Developed Asia (to 85 percent of the population). This trend shows the increased relevance of digital channels for day-to-day customer operations.

This significant growth of digital banking has led to disruptive trends such as the declining

relevance of physical bank branches and the increasing threat of new-age “pure” digital players gaining share. Three questions loom large for banks and nonbank disruptors in this dynamic landscape.

1. Are branches still relevant?

Physical branches have been the traditional customer engagement channel, but there is a clear shift in Asia towards digital channels for daily transactions. Bank branches now account for only 12 to 21 percent of monthly transactions (Exhibit 1). Customers prefer digital platforms for simple, routine transactions such as checking their balance, peer-to-peer transfers, or bill payments. Overall customer engagement has grown from an average of 12.7 to 14.9 monthly transactions in Developed Asia, and from 6.0 to 8.1 in Emerging Asia, with increased smartphone usage driving growth in each case.

However, a significant percentage of customers in Asia still use the physical branch for transactions they consider complex. For Asia's banks, this means that as they evaluate their branch networks they need to think about more than simply footprint. They also need to shift branches from purely transactional points to interaction hubs that meet customer needs for financial advice and sales of more complex products (e.g., investments).

Banks are also rethinking the role of the branch. A more user-friendly design could help banks to migrate more customers to their own digital channels, allowing them to reorient their physical branches to offer more complex products and services.

¹ Emerging Asia: China, India, Indonesia, Malaysia, Myanmar, Philippines, Thailand, Vietnam. Developed Asia: Australia, Hong Kong, Japan, New Zealand, Singapore, South Korea, Taiwan.

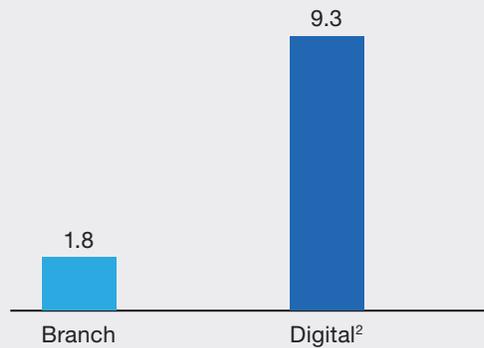
Exhibit 1

Across Asia, digital transactions are 1.6 to 5 times as frequent as branch transactions.

Channel usage frequency¹

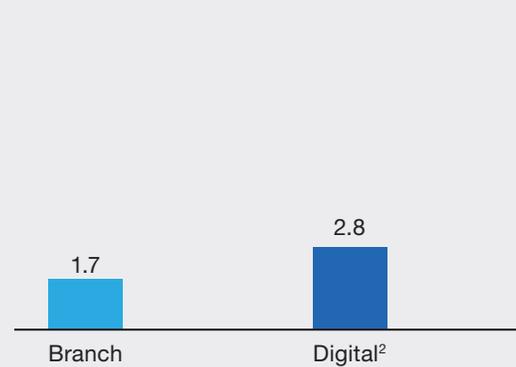
Developed Asia

Average transactions per customer per month



Emerging Asia

Average transactions per customer per month



Branch transactions account for only 12% and 21% of total monthly transactions in Developed Asia and Emerging Asia respectively

Note: N = Developed Asia (4,562, 2014; 4,540, 2017); Emerging Asia (10,467, 2014; 12,532, 2017).

¹ Refers to monthly usage of ATMs, branch/call centers, internet banking, and smartphone banking

² Includes internet and smartphone transactions

Source: McKinsey Asia Personal Financial Services Survey 2017

2. How disruptive are the new-age digital players?

Customers' changing behavior and increasing comfort with digital propositions in other sectors (e.g., e-commerce or travel) has paved the way for new firms aiming to capture banking revenues through purely digital propositions.

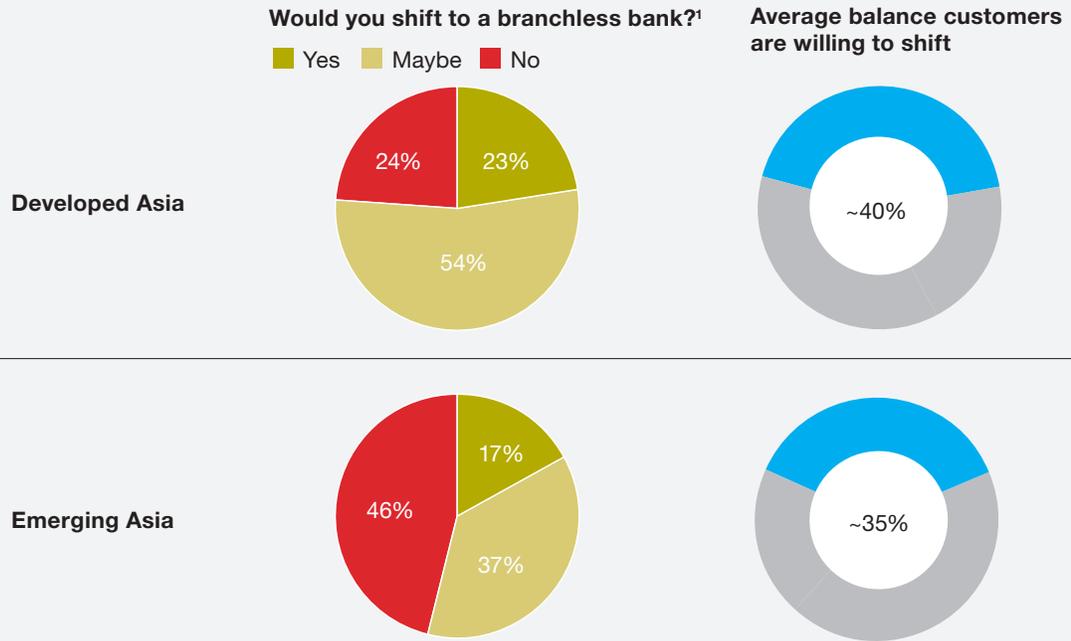
The attraction of digital-only banks

With many consumers willing to go "fully digital" with regard to banking, a set of digital propositions is emerging to cater to these digitally savvy customers without the limitations of a physical distribution network.

Over the last three years, several new banking propositions have been launched across the Asia-Pacific region (APAC). In Korea, Kakao launched Kakaobank, building on its nearly 40-million strong chat user base in South Korea to acquire one million customers within the first five days. The new bank also raised up to \$3.6 billion in deposits and issued over \$3 billion of loans in the first 100 days. It is now the fastest-growing mobile bank in the world with over 5.5 million users, \$6 billion in deposits, and over \$5 billion in loans issued as of February 2018. Kakaobank is now expanding its portfolio

Exhibit 2

A significant proportion of customers would be willing to shift 35% to 40% of their wallet to a digital-only proposition.



Note: N = Developed Asia (3,690), Emerging Asia (9,798).

¹ Asked of respondents who have an internet connection and currently do not use branchless banks.

Source: McKinsey Asia Personal Financial Services Survey 2017

into mortgage, credit cards, and new payments offerings. Emerging Asia is not far behind in the move towards establishing pure digital banking. In 2016, BTPN in Indonesia launched Jenius—a standalone and first-to-market digital bank, while Singapore’s DBS launched its mobile-only digital bank—digibank—in India in 2016 and expanded to Indonesia in 2017.

McKinsey’s PFS survey results highlight a significant opportunity for these entities—approximately 55 to 80 percent of customers in Asia would consider opening an account with a branchless digital-only bank; and those willing to bank

digitally would be willing to shift between 35 to 40 percent of their total wallets to the digital account (Exhibit 2).

The rise of nonbanking fintech players

The penetration of nonbanking payments solutions varies significantly in Asia. While 40 to 50 percent of the population in Developed Asia uses nonbanking payments solutions, in most of Emerging Asia penetration ranges from 5 to 15 percent.

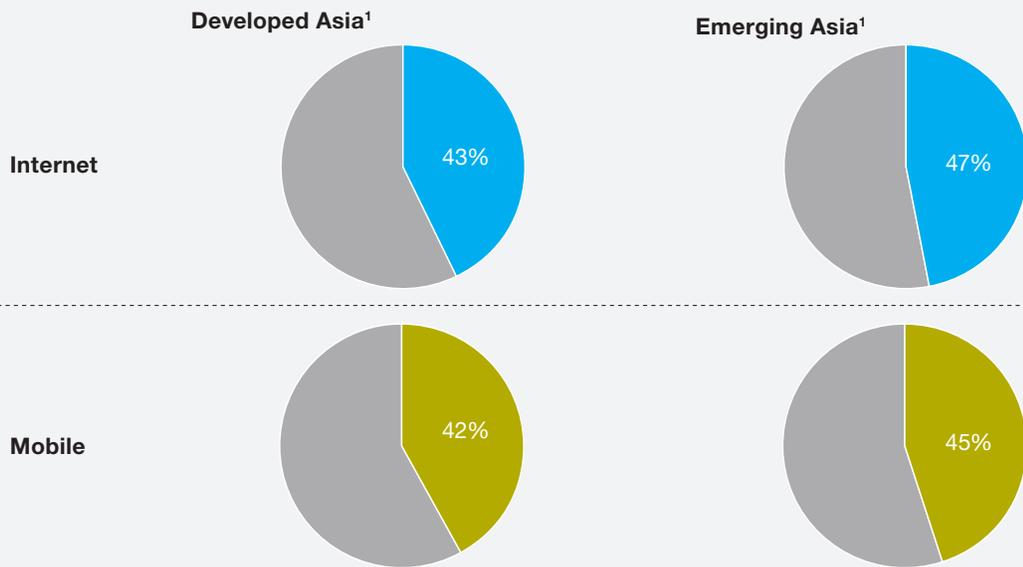
In Emerging Asia, two markets are ahead of the pack in terms of nonbanking payments

Exhibit 3

Digital channel satisfaction has significant potential to grow.

Question: How satisfied are you with the following channels of your primary bank?

% respondents marking 6 or 7 on 7-point satisfaction scale, 2017



Note: N (2017) = Developed Asia (4,540); Emerging Asia (12,532).

¹ Numbers denote median values.

Source: McKinsey Asia Personal Financial Services Survey 2017

solutions—China and India, with 67 percent and 39 percent penetration respectively. These leading positions are due in large part to the widespread success of payments solutions from firms such as Alibaba, Tencent, and PayTM.

Combined, Alibaba's Alipay and Tencent's WeChat Pay have an approximately 94 percent share of China's \$6 trillion mobile payments market. Both boast an active customer base of over 500 million and have made their mark in the Chinese payments market through strong integration with their existing sister entities—Taobao and Tmall (Alibaba) and WeChat (WeChat Pay).

India's PayTM launched in 2010 as a mobile recharge player but now operates a variety of payments-related solutions, including a mobile wallet, a payments gateway, an online mall for bookings and bill payments, and a financial marketplace for investment and loan products. PayTM has more than 200 million customers and 5 million merchants. The company plans to venture into wealth management and insurance distribution soon.

New-age digital players are venturing beyond payments and transactions, with offerings in areas like lending or investments—traditionally

part of banking revenue streams. The rise of such disruptive companies could directly affect the volumes and margins of incumbent firms that offer these products.

3. Can banks still bank on loyalty?

The PFS Survey measures loyalty and customer satisfaction by asking how likely customers are to recommend their bank. The research shows that loyalty towards primary banks in Asia is comparable to 2014 levels, and varies significantly between Developed and Emerging Asia. While about 70 percent of Emerging Asia consumers

would recommend their bank to a friend or colleague, only around 40 percent of consumers would do so in Developed Asia.

Branch satisfaction is particularly low in Developed Asia, while the survey reveals moderate satisfaction with digital channels across Developed and Emerging Asia, again with considerable scope to grow (Exhibit 3).

In a banking landscape with numerous options, incumbent banks must find ways to remain relevant or risk losing customers.

Winning in a world of digital banking

In a fast-changing digital landscape, incumbent banks will need to scale up their capabilities in four important areas: digital marketing for customer acquisition and engagement; value-generation through digitally active consumers; the judicious use of customer data to provide a differentiated proposition; and embedding banking in customers' daily lives for seamless transactions.

Improving digital marketing

With digital platforms enjoying increasing customer trust and reliance, banks need to respond by improving their digital marketing capabilities—nurturing a digital brand image that places them top of mind for customers.

Customer adoption of digital banking has gone beyond online transactions to an increased number of digital purchases of banking products. In Asia, customers rely quite heavily on the internet to evaluate banking products such as credit cards and auto loans, and to compare products, benefits, and prices before purchase. Customers also trust these digital resources—about 35 to 50 percent of consumers in Asia changed their mind after considering or evaluating a product online (Exhibit 4, page 10).

But these increased numbers still lag those in other sectors. Digital sales penetration is around 65 percent in Developed Asia and between 10 and 15 percent in Emerging Asia; by comparison, e-commerce penetration in the two regions is around 95 percent and 45 percent respectively.

For banks, a focused digital marketing effort will involve building up their online brand and presence and investing in customer acquisition campaigns and engagement through social media, internet advertising, and other media. Done well, digital marketing can help banks acquire customers at a lower cost than traditional marketing. A range of initiatives—campaigns; tailored, dynamic messaging; audience-specific marketing—can be monitored using advanced analytics to understand audience responses, why some campaigns work, and why others do not. These efforts will require a very different set of capabilities than the ones banks have traditionally used for customer engagement.

US-based bank Capital One has rapidly scaled up its digital marketing capabilities, running multiple digital campaigns in A/B testing mode to improve reach and conversion.² For example, the bank conducts tens of thousands of data experiments each year, offering credit cards with different interest rates, incentives, and marketing techniques.³ It also uses Facebook and Instagram to connect with consumers online. In 2015, it launched its first Instagram campaign, in which three photographers shared photos of objects they carried in their wallet, and encouraged users to respond with their own posts. The campaign boosted Capital One's ad recall by 16 percent, and gave it access to user-generated content for use in multichannel campaigns across digital, print, and out-of-home entertainment media advertisements.⁴

² A/B testing, or split testing, compares the performance of two versions of a campaign. Similar visitors see two variants of the same page (Variant A and Variant B) at the same time, or same campaign is showed to two different profiles. The version that yields a better conversion rate is considered superior.

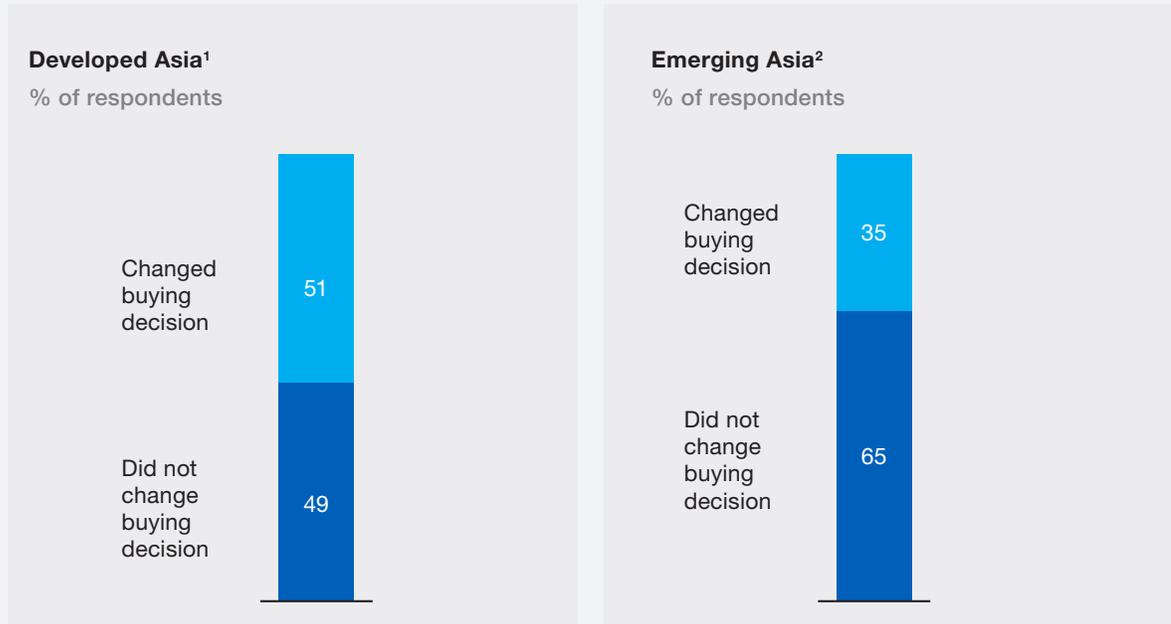
³ "How Does Capital One Differentiate Itself In The Card Industry?" Forbes, September 11, 2015.

⁴ "How Capital One Used Instagram to Boost Ad Recall by 16 Percent," Adweek, August 11, 2015; "Capital One Bets Big on Facebook in New Campaign," AdAge, December 8, 2016; "Capital One tells 'story in every wallet' on Instagram, Digital Training Academy, 2015.

Exhibit 4

Digital research on a banking product influences between 35% and 50% of purchase decisions.

Use of digital channels for product evaluation, and influence on final buying decision



Note: N = Developed Asia (3,425); Emerging Asia (6,462).

¹ 77% of total respondents in Developed Asia used digital channels for consideration/evaluation of banking products.

² 26% of total respondents in Emerging Asia used digital channels for consideration/evaluation of banking products.

Source: McKinsey Asia Personal Financial Services Survey 2017

Digitally engaging customers for value generation

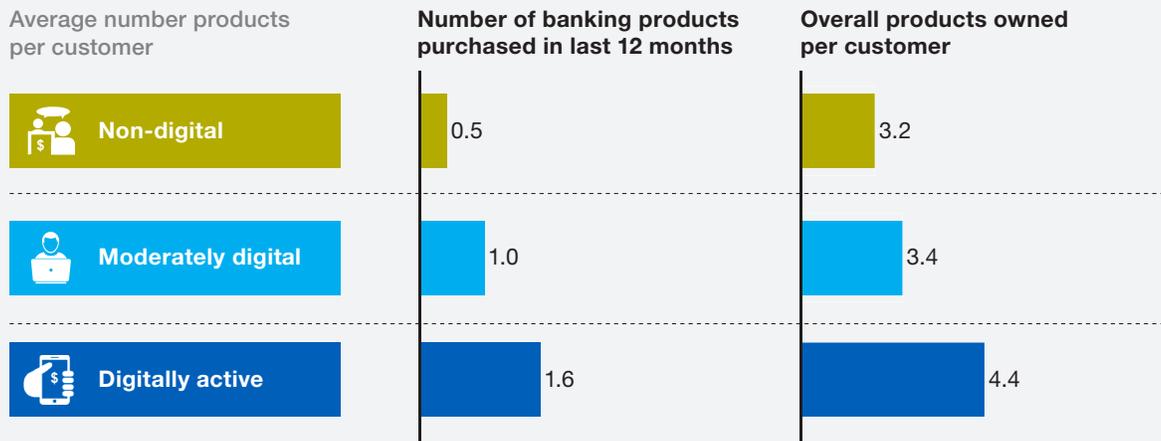
Deeper digital engagement with customers generates value for banks in two ways. First, digitally active customers buy more products. Our research shows that digitally active customers bought 1.6 products on average over a 12-month period, compared to 0.5 on average for customers that were not digitally active at all. The active digital customers also owned 1.5 times the banking products compared to their nondigital peers (Exhibit 5). Second, since most simple digital transactions are conducted through self-serve channels, digitally active customers have a lower cost-to-serve than nondigital customers.

In terms of their digital preferences, we categorize banking customers into three segments:

- *Digitally active consumers* use digital banking at least every two weeks and have made e-commerce purchases in the last six months
- *Moderately digital consumers* use digital banking less than fortnightly, but have made e-commerce purchases in the last six months
- *Non-digital consumers* use no digital banking products or services

Exhibit 5

Digitally active customers buy and own significantly more products per customer than others customers.



Note: N = non-digital (developed, 254; emerging 5,149); moderately digital (developed, 643; emerging, 2,895); digitally active (developed, 3,644; emerging, 4,489).

Source: McKinsey Asia Personal Financial Services Survey 2017

The 2017 PFS survey found that the percentage of digitally active consumers has doubled in Emerging Asia since 2014, and grown by 20 percent in Developed Asia over the same period.

Globally, there are examples of banks that have had success in developing digital offerings that attract new customers and migrate their existing ones to digital channels.

Itaú Unibanco of Brazil created a digital app—Itaú Light—in 2017. By the second quarter of 2017, the bank’s customers’ internet and mobile transactions grew by 400 basis points (compared to end of 2016). In 2017, Itaú Unibanco also saw 6 percent growth in digital clients, a 15 percent rise in mobile users, and over 140,000 accounts opened using mobile phones.

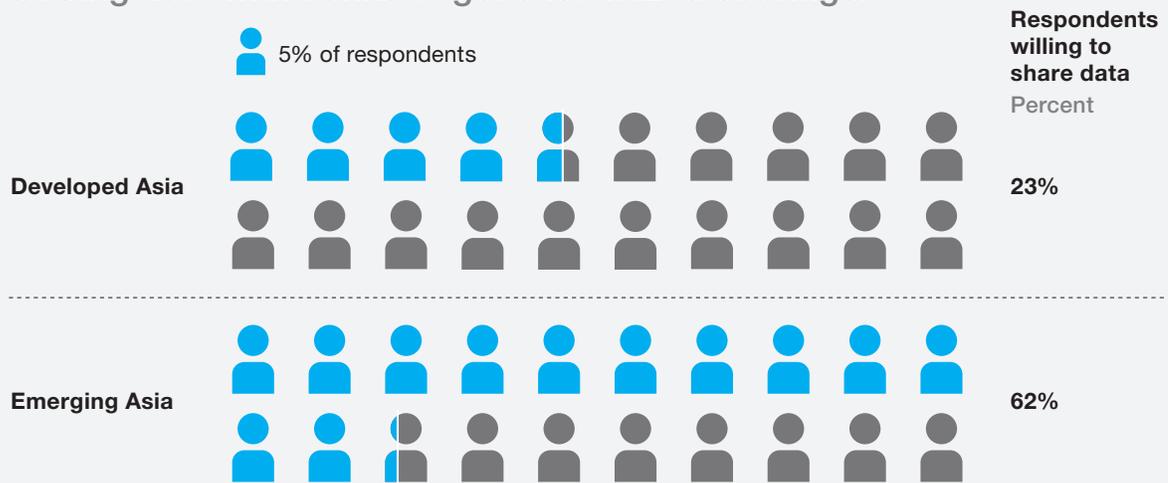
After a few years of investments in creating a seamless, multichannel experience, Spain’s Banco Bilbao Vizcaya Argentaria (BBVA) was

named the best mobile banking service in the world in 2017. Their banking app is intuitive and easy to use, and the bank focuses on three pillars—convenience, transparency, and advice—to promote customer satisfaction and digital sales. Digital sales share across the banking group grew from 10 percent of total sales in 2015 to 33 percent in 2017. The bank has 22.6 million digital customers—25 percent higher than last year—17.7 million of which are mobile customers (representing a 44 percent increase over 2016 figures). In Turkey, Spain, the United States, Argentina, Chile, and Venezuela, digital customers comprise half of BBVA’s overall customer base.

In Asia, DBS was the first bank to develop a methodology to measure digital value creation, reflecting the changing attitude of banks towards the topic. It defined “digital customers” as those who either purchased a product digitally over

Exhibit 6

More than 60% of banking customers in Emerging Asia are open to sharing data with banks to get customized offerings.



Note: N = Developed Asia (4,540); Emerging Asia (12,532).
Source: McKinsey Asia Personal Financial Services Survey 2017

the last year, or conducted over 50 percent of their financial or nonfinancial transactions over digital channels. Tracking digital value creation helped DBS enhance value from digital channels. Today, DBS digital retail segments report twice the income, 20 percentage points lower cost-to-income ratio, and 9 percentage points higher return on equity (ROE) than nondigital segments. Digital customers, who form 39 percent of the customer base, contribute to around 68 percent of profit for the bank, before allowances.

Extracting value from customer data

A wealth of customer information (from internal and third-party sources) could help banks strengthen customer relationships. Banks could gain insights on customers' personal financial management (where they spend their money), offer tailored solutions (e.g., the next-best product to buy), and create new products and services (such as end-to-end digital lending

using the additional information for more reliable credit scoring).

Incumbent banks have always had access to vast amounts of customer data such as transaction behavior and payments records. The digital world offers many additional external sources of data that could allow banks to deepen their understanding of existing and prospective customers. With increased access to more digital platforms, consumers in Emerging Asia appear more willing to share data with banks in return for customized offers (Exhibit 6).

Globally, banks are relying on national databases (e.g., Aadhaar in India), nonbanking partners (e.g., telecommunication or e-commerce companies), and the correlation of publicly available information (e.g., social media and employment records), to develop customer insights.

In the first quarter of 2017, India's Aditya Birla Financial Services launched a digital lending platform with a re-imagined approach for unsecured personal lending. The solution allows for loan approval within three minutes, with 70 percent of the decisions made by machines. Such a differentiated customer journey is made possible by an underlying design that leverages instant access to verified data, either from publicly available sources or data shared by customers digitally.

Another leading nonbanking financial company in India used analytics to increase cross-sell in its small and medium enterprise-lending business. The analytics-based credit engine and prioritization engine, coupled with an end-to-end sales and loan process, led to over 40 percent growth in cross-sell loans and around 10 percent growth in the overall book.

In China, Alibaba used its various sources of data to develop a proprietary credit assessment engine called "Sesame Credit," which supports the consumer and SME lending business of Ant Financial (formerly Alipay). Sesame Credit combines traditional sources of information for assessing creditworthiness with data on 300 million "real name" registered users and 37 million small businesses on Alibaba Group sites. This extra data includes shopping habits, timeliness of payments, residential status, loyalty to one mobile company, among others.

Although fintechs often rely purely on nontraditional information for credit assessment, global banks usually incorporate these additional variables into their existing credit assessment process to enhance their predictive power.

Applying analytics effectively along the customer lifecycle will require banks to not only build distinctive analytics capabilities in a central team, but to embed them across the organization and

into employees' daily work lives. Experience in implementing analytics engines suggests that the hardest part is not the modelling or insight gathering; instead, embedding analytics in daily operations is often a matter of overcoming legacy working styles and a very human reluctance to change.

Embedding digital banking in customers' daily lives

A new breed of "ecosystem players" are focusing on the best way to digitally serve the daily needs of customers across a range of services, including meals, grocery shopping, travel, entertainment, and even medical services. Service providers who embed themselves in customers' daily routine through an ecosystem stand to significantly increase usage of their services while offering customer convenience: a win-win proposition.

One such ecosystem player is Ping An. In 2015, the Chinese insurance company launched "Good Doctor," a platform that connects customers with doctors not only for online appointments, but also to receive diagnoses and suggested treatments, often by exchanging pictures and videos. It now has 170 million registered users, covering more than 3,000 partner hospitals and clinics and processing over 460,000 daily consultations at peak periods, all channelled through an app that can provide within minutes what used to take many weeks and multiple providers.

Banks could follow a similar approach, embedding themselves in the daily lives of customers to attract higher usage and offer an enhanced customer experience. Banking institutions enjoy three key advantages over firms from other industries—consumer trust, extensive consumer data, and regulatory experience—which could help to facilitate ecosystem shifts. They could

play three roles in the ecosystem depending on their relative competitive situation:

- **Participant:** In this role, a bank joins a partner's existing ecosystem in order to grow core business revenue
- **Orchestrator:** An orchestrator builds a platform to connect third-party services across sectors to create new revenue streams
- **Creator:** In this role, the bank creates the ecosystem, building digital services or acquiring service providers across sectors to establish a platform that meets customer needs beyond the core banking business

Banks have already started to move in this direction. India's largest bank, State Bank of India (SBI), launched the YONO (You Only Need One) app in November 2017 with the aim of becoming the "digital bank" to over 600 million customers. The app offers a seamless omnichannel experience, with over 30 banking products, paperless account opening, a complete suite of investment products, and pre-approved loans. It also offers lifestyle goods across travel, gifting, and fashion

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The authors would like to acknowledge the contributions of Pearl Singhal, Nitin Sethi, and Narasimhan Seshadri to this report.

from more than 70 e-commerce merchants, all on a single platform. The app went from concept to commission in just 14 months and achieved over 500,000 downloads in the first 15 days after launch. As of March 2017, the app has been downloaded more than 3.7 million times, with daily logins reaching 180,000, and 20,000 clicks daily into its online marketplace.



Consumer behavior and the competitive landscape for Asia's retail banking sector have shifted significantly in the three years since the last PFS survey. While consumers are growing more engaged and digital, they also have many more digital options, including offers from nonbanking companies and fintechs ready to fulfil their banking needs.

Customers will continue to adopt digital channels for banking. To ensure customer stickiness, banks should make a concerted effort to improve customer satisfaction, especially through digital offerings. If banks can build capabilities to harness the power of digitization, they can remain relevant in a fast-changing, fast-paced environment.

