Disruptive Innovation
and Digital Transformation:

A Win-Win for Banks

Written by Rick Jaros

Spinnaker
CONSULTING GROUP

Digital Transformation and Banking: What Better Time?

Long before the concept of “disruptive innovation” was introduced in the *Harvard Business Review* in 1995, Plato provided this often-quoted insight in his *Republic:* “The true creator is necessity, who is the mother of our invention.”

We’ve seen this concept play out countless times through the ages with science and technology, business and medicine. Invention is a response to need. A crisis threatens business survival, and that forces change. And that change, when executed strategically, sparks real growth.

This dynamic is playing out right now, with the COVID-19 pandemic serving as the change agent. And a strong digital foundation, along with the ability to pivot nimbly, is helping many stores and businesses adapt quickly.

SUDDEN CONVERSION TO ONLINE PLATFORMS

Consumers typically hesitant to use technology are converting their customary hands-on shopping experiences to digital formats in droves. Older shoppers, often a segment not inclined to test the waters of online platforms, are embracing the opportunity to shop for groceries online, realizing that stepping into a supermarket could jeopardize their health. Those customers contributed to a 450% spike in demand for the grocery delivery service Instacart from December 2019 through mid-April 2020, resulting in the platform's first profitability.

There's also the rush to Zoom. Videoconferencing – whether for work or digital happy hours – is up 40%. While binge-watching Netflix, Disney+, Hulu or other streaming services is not a new phenomenon, viewership is up dramatically, creating a habit that might be hard to break.

While the digital mandate is not new, the current crisis has imposed an unrelenting demand on businesses of all sizes to accelerate their efforts. Based on a January 2018 article in *McKinsey Quarterly,* "only 8% of companies said their current business model would remain economically viable if their industry keeps digitizing at its current course and speed."

The shift toward digitizing the economy has been underway for years. What was lacking? A sense of urgency – the realization that you either go digital or go dark.

- *CURRENT EVENTS DEMAND DIGITAL TRANSFORMATION*

Businesses can no longer postpone pursuing a meaningful digital transformation because consumers, thanks largely to the disruption of COVID-19, are now living more than ever before in the digital age. Like businesses from other sectors, banks can and should capitalize on this moment. Doing so will not only enable them to provide their customers with the exact services they need in a manner that is both easy and convenient, but they can also reduce their operating expenses. The end goal for your bank is to meet the needs of your customers in the most expeditious, cost-effective way possible.

But each bank needs to follow the right transformation path for its organization and customers. According to "What Is Disruptive Innovation" in the *Harvard Business Review,* "The problem with conflating a disruptive innovation with any breakthrough that changes an industry's competitive patterns is that different types of innovation require different strategic approaches. To put it another way, the lessons we've learned about succeeding as a disruptive innovator (or defending against a disruptive challenger) will not apply to every company in a shifting market. If we get sloppy with our labels or fail to integrate insights from subsequent research and experience into the original theory, then managers may end up using the wrong tools for their context, reducing their chances of success. Over time, the theory's usefulness will be undermined."

In other words, there is an art and a science to how we leverage a crisis to effect positive change, and that applies to digital transformation in the banking industry. So the process of building out digital product offerings must be based on what we know about our customers – who they are and what they need both now and as their relationship with their bank matures.

Leveraging Digital Transformation to Meet the Needs of Banking Customers

Today's banking customers only walk into a branch or call for one of three reasons:

- ***They tried a digital service and it failed.***
- ***They chose not to use the digital option.***
- ***The action they needed to perform wasn't offered online.***

Based on these three options, it's no surprise that more than half of all banking customers were still attached to their local bank branch before the pandemic started.

- *WORK FROM UNDERSTANDING THE CUSTOMER EXPERIENCE*

Banks should think strategically about the scenarios that drive their customers to branches or the phone as they approach a digital-first customer experience. The nuance here isn't just putting your customers at the center of your banking strategy, but rather put them in front of your strategy by starting with an understanding of what they want and need – and then working backward.

Many banks get sidetracked by building products for unproven customer segments they hope to gain. Instead, they need to invest time in understanding their existing audience and developing digital products and services designed specifically to deepen engagement and loyalty with them. As mentioned earlier, your customers need to know you're committed to supporting the digital relationship they establish with your bank. They should also feel confident that you will sustain their banking relationship with services that will meet any emerging needs.

Digital transformation allows companies to radically rethink how they can use technology to change, and hopefully enhance, business performance.

All financial institutions have a rich base of customer data, including hard transaction data and softer call center logs and branch satisfaction surveys. Combing through data from each channel – digital, branch and phone – can help you determine which services are most utilized by your customers and which are underutilized. Data can also help you understand which high-volume activities might be better suited for a digital platform and which could be eliminated due to lack of interest or application.

- *USE EXISTING DATA TO PLAN STRATEGICALLY*

No bank can compete in the marketplace unless it continues to drive cost out of the customer experience. In addition to improving customer experience and loyalty, digital transformation can reduce your bank's operating expenses while reducing compliance risk. However, simply increasing your rate of digital interactions is not enough to improve your operating margins, you must also ensure that the number of transactions in the assisted channels actually decreases. Digital channels are nearly infinitely scalable.

Approaching digital transformation purely as a means for cutting operating expenses bypasses the opportunity to disrupt and improve your customers' banking experiences — and that's your ultimate goal when you move customers to a digital platform. Putting cost savings first risks compromising customer service.

- *DISRUPT AND IMPROVE WITH BALANCE*

If you view digital transformation as solely an expense-cutting strategy rather than a customer service opportunity, that's when customers will flood your branches or phone lines with questions and problems. That's when their confidence in your commitment to provide exceptional online service will begin to erode.

Understanding Banking Customers: Who They Are and What They Need

Banks need to be clear about their strategy for investing in digital transformation. That strategy will be successful only if they know who their customers are and use the data they've garnered to identify how those customers use financial services and what they want in the way of new products.

Too often, banks develop products independent of the services that are relevant to their customers. Marketing departments create personas – Sally Saver, Bill Buyer, Robin Retiree – and then discuss what they think their product offerings should be and how they should be promoted. They overlook the core functionalities that one customer or another might want, and they forget to discuss the root causes that drive customer need.

- *UNDERSTAND THE DIFFERENCES IN CUSTOMER NEEDS*

In addition, financial solutions are often designed by people who are fairly well off. They are likely to be well compensated, and they are financially savvy. Most of them save money, and they're not as concerned as some of the people they serve with how often they get paid. They're more concerned about whether their net worth is increasing or decreasing. In short, their concerns are not the same as those of their core customers.

Who are the audiences that drive the decisions you make about digital services? Three segments of people represent the entire universe of customers, and they can be defined by the financial statement that controls how they live:

- ***Cash Flow Statement Customers – live paycheck to paycheck***
- ***Income Statement Customers – concentrate on net income***
- ***Balance Statement Customers – focus on wealth***

Any effort to shape a bank's digital transformation strategy should begin by mapping your customers against the framework above, understanding the distinct needs of each group, and engaging them with digital services that fulfill actual needs.

Most banks focus their sales and service efforts on Balance Statement customers because that is the segment who is developing those services and because they hold so many assets that require a wide variety of services. These services include general banking, of course, but also investment advice, trust and estate management, mortgage loans, and equity lines. But ironically, the majority of your customers may be people who don't really need the kinds of services banks trip over themselves to provide.

- *FOCUS ON THE SEGMENTS THAT ARE MOST RELEVANT TO YOUR CUSTOMERS*

The other two segments provide just as much of an opportunity to embrace digital platforms for the services they use. Once you understand the segment in which your customers primarily fall, their needs become simple and well defined, and you can begin to truly leverage your strategy for digital transformation.

What's critical to note about these three distinct customer groups is that the individuals who comprise them are not being segmented by traditional demographics. These categories are not being driven by social demographics, age or race. Granted, customers typically progress through these segments – from cash flow to balance statement – as they age; some can even go backward from a higher tier to a lower one. But people will still find themselves in one segment or another based on how they use their money and how that activity relates to their needs for different services.

- *GROUP CUSTOMERS BY NEEDS RATHER THAN DEMOGRAPHICS*

Your job is to figure out the needs of your customers and then work with your product and marketing teams to create the products and messages that will best suit them.

In the new environment of digital transformation, that means providing each segment of your banking universe with a digital option for services when possible and then providing the support necessary to make sure that option works as it should.

Segment 1: Cash Flow Statement Customers

Most of us begin our financial lives living off cash flow. Customers in the Cash Flow Statement category are people who often live paycheck to paycheck. They need instant access to cash and short-term liquidity. It's important that they have the ability to move money and protect certain funds.

These customers may have two or three accounts for specific needs: One may be a mortgage checking account, or they may have a rent checking account and put money in it only to cover the rent. Customers in this category often treat accounts like the envelopes people once used to compartmentalize their expenses: money in one for rent and money in another for food, a third for car expenses. People now open accounts to do that. They create two or three bank accounts to force themselves to manage cash.

You may need to help customers in this segment manage their cash on a daily timetable, at the micro level. According to the Federal Reserve's *Report on the Economic Well-Being of U.S. Households in 2017,* "about 40% of adults said that if faced with a $400 unexpected expense, they would either not be able to pay it or would do so by selling something or borrowing money." The same report comments on saving habits and retirement planning: "Additionally, less than 40% of nonretired adults think they are on track in saving for their golden years and 25% have no retirement savings or pension at all."

Segment 2: Income Statement Customers

As people improve their financial situation, their needs extend beyond the services associated with the Cash Flow Statement group. That's when they migrate into the Income Statement segment. Who are these customers? They're typically young professionals who are starting to accumulate a nest egg but still don't have much in the way of savings. They're thinking about whether they'll earn enough money in the next year to buy a new, nicer car or go on a vacation. Based on their earnings, they're imagining what their bonus is going to be and whether that performance reward or some other windfall will provide a nice cushion for their savings strategy or spending needs.

Unlike Cash Flow Statement customers who live paycheck to paycheck, income statement customers are not really worried about whether they're getting paid on Friday or Saturday or next week. That said, they do not feel completely indifferent toward their pay cycle. They look at the amount of income they net to make sure that amount covers their expenses.

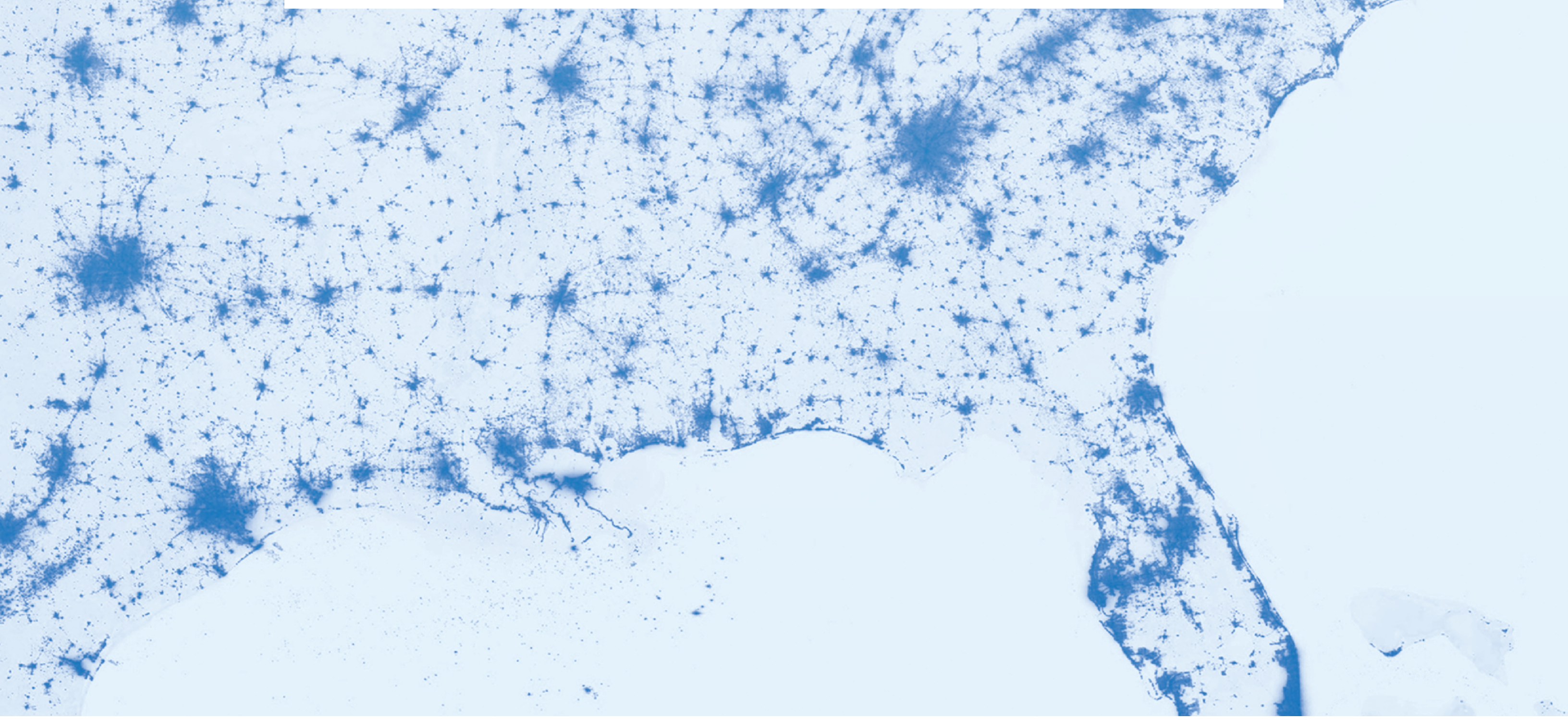
As you serve customers in this segment, who are in a fairly stable financial position, you'll recognize that they need to move into new vehicles for saving money. Having started to accumulate their nest egg, they need access to services and resources that allow them to smooth out their financial highs and lows and help them migrate into the next customer segment. This need translates into services that help them track expenses and facilitate effective budgeting.

Your goal is to help them manage expenses versus income so that they can increase retained earnings. By doing so, you enable them to become Balance Statement customers. The products and services they may need include checking accounts, debit and credit cards, mortgages, and accounts for accruing a nest egg.

Segment 3: Balance Statement Customers

As their financial foundation strengthens, customers eventually migrate into the Balance Statement segment. These individuals are customers whose depth and breadth of liquid assets allow them to make financial decisions without looking at their income statement. Instead, they consult their balance statement. They want to make sure they're continuing to make money, so they track the totals on their balance statement. As long as their balance sheet continues to grow year after year, they're less concerned about the individual cycles of when they get paid or whether they earn a bonus.

This focus on bottom line differentiates them from customers in the Cash Flow and Income Statement segments. Once in the Balance Sheet segment, they are still focused on managing the daily activities that involve money, but their more pressing concern is growing their net worth. Banking products and services they typically use include private banking, investments and IRAs, credit cards, and travel rewards. Ease of use and ease of payment are paramount.



Moving Customers to Your Bank's Digital Storefront

So given the three segments of customers, each with its own needs, how do you put your digital transformation strategy in place?
You start at the beginning.

According to a study by McKinsey & Company, the rate of migration from the traditional delivery of banking services to digital platforms varies internationally. While that might be the case, customers across the board are ready for a change: "Eighty to 90% of banking customers in the Nordics, for example, are open to digital product purchases for most financial products, compared to 50% to 60% in North America and Southern Europe. While customer willingness to purchase products via digital channels varies, however, the common thread is that in all markets, this readiness is far ahead of actual digital sales and will require banks to catch up to consumer needs and expectations."

The best entry points for digital transformation are routine, repeatable, simple transactions. Getting people to sign up for remote check deposits or to opt for electronic statements rather than paper generates short-term wins and establishes momentum with each customer. As customers experience the advantages of making transactions on your bank's digital storefront – ease of access, speed of service, immediate results, incredible convenience – you can sustain their interest and grow their relationship by greeting them with targeted messages about additional products and services.

- *ROUTINE TRANSACTIONS ARE KEY POINTS FOR DIGITAL INTERACTIONS*

Remember, one of the major barriers to digital migration continues to be customer trust in the process. Focus on gaining that trust and reassuring your customers that you're still there if they need you. There's a reason why digital-first companies like TD Ameritrade are building physical locations.

When you address the needs of your customers at the precise moment they arise, you can then capitalize on their satisfaction with those services to promote additional opportunities, including more sophisticated digital experiences. Once you're comfortable that you can fulfill on the promise of digital servicing, you can start pushing customers to the online or mobile experience – which becomes, in essence, your one-stop primary branch.

- *MEET CUSTOMER NEEDS AT THE RIGHT TIME TO BUILD CONFIDENCE*

To build customers' confidence and trust, tackle the quick fixes of existing digital pain points and, if necessary, provide clearer instructions on how to use your services. Digital processes should be closely managed and continuously optimized. It's been said many times, but it bears repeating: Your digital offering is being compared not only to other banks', but also to digital leaders like Amazon.

Do customers generally have the capacity to shop the digital storefront from a mobile platform? Yes, they do.

According to a June 2019 Pew Research study, 96% of all Americans own cellphones, and 81% own smartphones, which is up from 35% in 2011. In addition, nearly 75% own a desktop or laptop computer, while half own tablet computers.

▪ *MORE PEOPLE ARE ABLE TO ACCESS DIGITAL SERVICES THAN EVER BEFORE*

With bank customers segmented by their need for services and financial liquidity, it's helpful to look at how technology ownership breaks down along financial lines. Again, cellphone ownership is at 96%. Smartphone ownership is as follows: 71% for individuals earning less than $30,000, 78% for those earning less than $50,000, 90% for those earning less than $75,000, and 95% for people earning more than $75,000 a year.

SMARTPHONE OWNERSHIP

71%	**78%**	**90%**	**95%**
FOR THOSE EARNING LESS THAN	FOR THOSE EARNING LESS THAN	FOR THOSE EARNING LESS THAN	FOR THOSE EARNING MORE THAN
$30K/YEAR	**$50K/YEAR**	**$75K/YEAR**	**$75K/YEAR**

So the majority of people have the capacity to go digital with their banking – even mobile. The key to moving them to that platform is distinguishing yourself through the digital design, user experience and delivery of the products your customers need. That means focusing on promoting and servicing your core offerings better than anyone else. When building and managing your digital experience, strive to deliver an end-to-end digital solution. Offering an existing solution digitally makes it easier for customers to use the service, and that drives up volume.

Making Your Digital Transformation Journey a Success

Whether you're serving the needs of Cash Flow Statement, Income Statement or Balance Statement customers, your strategy should be to make their transition to and use of digital platforms easy and convenient. Any problems that arise must be resolved immediately and accurately. Satisfaction with your services is shaped by the experience customers have across all your channels.

Here are a few ways you can make sure your journey into and through the digital landscape is successful:

MAKE SURE EVERYONE AND EVERY SERVICE CHANNEL AT THE BANK IS ENGAGED. Your goal is to have your digital transformation serve your customers, regardless of which segment they fall into. In order to do this effectively you'll need to engage every channel at your bank. Your front-line employees – in the branches and on the phones, need to be committed to the transformation if it's going to be a success. It's not enough to simply offer a digital capability – you need to make your customers want to use it. By far the greatest reason why a customer doesn't perform a transaction digitally is that they could have but chose not to. Your front-line employees are your best way to address this driver. They need to become your digital ambassadors and they will need to sustain that effort. Remember: When you launch a piece of technology, your employees will have to deal with it as it ages. The customer reps on the phone may have to answer questions about problems related to outdated technology or pieced-together systems as time goes on.

SOMEONE HAS TO OWN THE PRODUCT. For every new capability you launch, you have to have a product owner. Why? Because you need to continually grow and manage the capabilities you introduce. Just look at how often apps are updated in app stores. You cannot treat your digital capabilities and one and done.

KEEP THE TECHNOLOGY AND SERVICE SCREENS FRESH. The greatest blessing with digital can also be its greatest curse. Signing up someone for a new account is simple. Migration from paper or phone interaction to online and digital is almost frictionless. But as soon as your site looks dated, your service isn't fresh and fluid, and your technology lacks the capabilities customers in all segments expect, they will leave. Too many people in banks are used to building something and then walking away from it. You can't do that with digital capabilities. In the digital domain, shelf life is months, not decades. It only makes sense that when you're promoting innovation with your services, your website and mobile platforms should stay fresh.

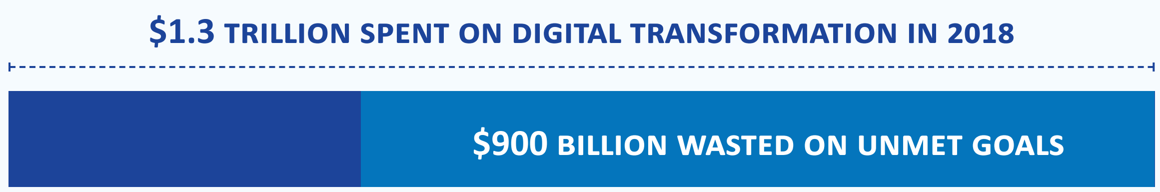
FOCUS ON CUSTOMER SATISFACTION AND OPERATING EFFICIENCY WHILE REDUCING THE HUMAN COST OF DOING BUSINESS. Outside of the cost of funds and losses, the number-one expense for banks is people. They represent the human cost of serving customers. To reduce that expense, digital transformation takes the services provided by people at call centers and bank branches and digitizes them. With select services automated, you can streamline staff. Not only does this kind of human resource management reduce costs, improve efficiency and increase speed of service, but it also benefits the bank from the standpoint of regulatory compliance. When services are provided digitally, all customers and processes are handled the same way with each interaction.

The Future of Digital Technology Is Now

"Almost overnight, the COVID-19 crisis widened a performance gap – between those organizations that invested in technology innovation at scale before the pandemic and those that did not – into a chasm."

The truth of that comment from Julie Sweet, CEO of Accenture, has played out in nearly every sector since February 2020. The challenge now is how to accelerate the kind of digital change businesses have experienced, and that most certainly includes banks.

There's a great deal at stake – not the least of which is the financial investment companies are making in digital transformation. According to a pre-COVID-19 *Harvard Business Review* article on change management, a recent survey of directors, CEOs and senior executives found that digital transformation risk was their number-one concern in 2019. According to the survey, "70% of all DT initiatives do not reach their goals. Of the $1.3 trillion that was spent on DT [in 2018], it was estimated that $900 billion went to waste."



In spite of the risk, digital technology provides the opportunity to transform your business. Efficiency gains and earned "customer intimacy" in the form of better, more secure relationships and high-quality service are not only beneficial outcomes of your digital transformation campaign – they are also key to your bank's survival in the current environment.

About the Author

Rick Jaros

Principal, Critical Initiative Delivery

Rick is a Principal with Spinnaker Consulting Group. With rich experience in digital integration, business strategy, operational and process improvement, and change management, Rick's focus area includes digital transformation across financial institutions.

In his 20 years as an executive with some of the largest banks in the U.S., Rick gained deep experience in the credit card business leading efforts to develop, launch and optimize new card products for multiple leading monoline companies. During this time, he led a variety of teams driving fundamental change and significantly expanded digital sales and servicing performance.

Prior to entering financial services, Rick was a Nuclear Qualified Officer in the U.S. Navy, assigned to the USS Bergall. He held several key roles while on board, including Damage Control Assistant, in which position he was responsible for implementing a new process for maintaining quality control procedures for all nuclear and hull integrity systems.

Rick has a Bachelor of Engineering degree from The State University of New York Maritime College and a Master of Business Administration from the University of Texas at Austin. He lives in Richmond, Virginia with his wife. Their daughter is a recent graduate of The University of Pittsburgh, where their son is a junior. For relaxation, Rick makes detailed wooden models of 1800s sailing ships.

Notes

Clayton M. Christensen, Michael E. Raynor and Rory McDonald. "What Is Disruptive Innovation?" *Harvard Business Review.* December 2015. https://hbr.org/2015/12/what-is-disruptive-innovation

Jacques Bughin, Tanguy Catlin, Martin Hirt and Paul Willmott. "Why Digital Strategies Fail." *McKinsey Quarterly.* January 25, 2018. https://www.mckinsey.com/business-functions/mckinsey-digital/our-insights/why-digital-strategies-fail

"Retail Banks Face Major Customer Satisfaction Challenge as World Shifts to Digital-Only Engagement." J.D. Power Press Release. April 30, 2020. https://www.jdpower.com/business/press-releases/2020-us-retail-banking-satisfaction-study

Kris Holt. "Coronavirus Grocery Delivery Demand Has Made Instacart Profitable for the First Time." *Forbes.* April 27, 2020. https://www.forbes.com/sites/krisholt/2020/04/27/coronavirus-grocery-delivery-instacart-profitable/#7ea43a7c71e2

"Consumer Sentiment and Behavior Continue to Reflect the Uncertainty of the COVID-19 Crisis. *McKinsey & Company/Marketing & Sales.* July 8, 2020. https://www.mckinsey.com/business-functions/marketing-and-sales/our-insights/a-global-view-of-how-consumer-behavior-is-changing-amid-covid-19

Sarah O'Brien. "Fed Survey Shows 40 Percent of Adults Can't Cover a $400 Emergency Expense." CNBC. May 22, 2018. https://www.cnbc.com/2018/05/22/fed-survey-40-percent-of-adults-cant-cover-400-emergency-expense.html

Vaibhav Gujral, Nick Malik and Zubin Taraporevala. "Rewriting the Rules in Retail Banking." *McKinsey & Company/Financial Services.* February 18, 2019. https://www.mckinsey.com/industries/financial-services/our-insights/rewriting-the-rules-in-retail-banking

Mobile Fact Sheet. Pew Research Center/Internet & Technology. June 12, 2019. https://www.pewresearch.org/internet/fact-sheet/mobile/

Julie Sweet. "5 Rules for Rethinking Digital Transformation During COVID-19. *Fortune.* June 26, 2020. https://fortune.com/2020/06/26/coronavirus-accenture-ceo-digital-transformation/

Behnam Tabrizi, Ed Lam, Kirk Girard and Vernon Irvin. "Digital Transformation Is Not About Technology." *Harvard Business Review.* March 13, 2019. https://hbr.org/2019/03/digital-transformation-is-not-about-technology