

# In the World of Digital Banking, Customer Retention is Key

---



**TEMENOS**

in collaboration with



**IBS** intelligence

---

## TABLE OF CONTENTS

Foreword .....	3
Methodology .....	3
Customer retention and its importance in today's digital world.....	4
Customer retention practices within the banking sector in Europe .....	5
Current customer retention challenges and strategic imperatives for banks.....	8
Conversational banking – the missing ingredient .....	10
Outlook   How customer retention could drive the future role of banking .....	12



---

## FOREWORD

Customer acquisition has always been one of the top agendas for banks and financial institutions. A higher number of customer accounts was directly proportional to a higher market share, and banks have always focused on this as their primary strategic goal. However, the emergence of new age technology-enabled market entrants and ever-evolving customer expectations has resulted in heightened competition within the banking industry and consequently led to high customer churn for both incumbents and the new entrants. The preferred strategy to stem this churn and retain customer relationships is to leverage digital technology to improve the customer experience and strengthen their relationship with the bank. This whitepaper, developed by IBS Intelligence and Temenos, analyses the dynamics and drivers of customer retention and looks at the various strategies currently in play within the European banking industry. The objective of this whitepaper is to give the reader a fresh perspective on the criticality of customer retention and how digital technology can help in developing an effective strategy.

## METHODOLOGY

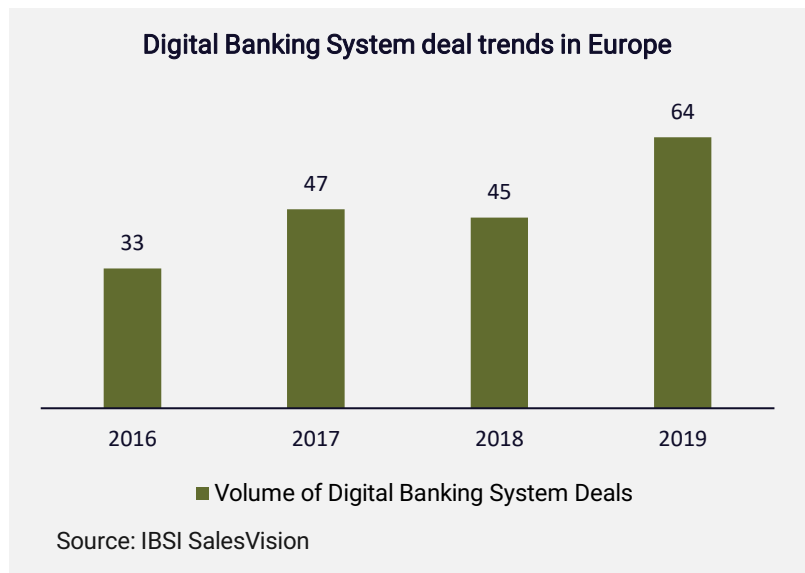
The whitepaper was written by the IBS research team based on their research and discussions with Temenos and various banks in Europe. The discussions revolved around the challenges that banks face in retaining their customers, the role of technology in managing customer relationships and the current and future strategies being employed to retain customers.



# CUSTOMER RETENTION AND ITS IMPORTANCE IN TODAY'S DIGITAL WORLD

Maintaining and retaining profitable customer relationships has become more critical than ever for banks to survive in today's competitive market. It is especially true in the European context, where PSD2 and Open Banking regulations, along with the growing ecosystem of neo banks and fintech companies, have levelled the playing field for the banking industry. These developments against the backdrop of weak profitability amongst banks, stringent regulatory requirements, low interest rates and uncertainties surrounding Brexit, make the task of customer retention even more challenging.

Moreover, banks have to not only keep up with the rapidly evolving e-commerce influenced customer experience and expectations, but also meet the technological requirements to cater to this growing need. It is no surprise then to see more than 100 digital banking software deals reported in Europe since 2018, an increase of 30% on the number recorded between 2016-17.

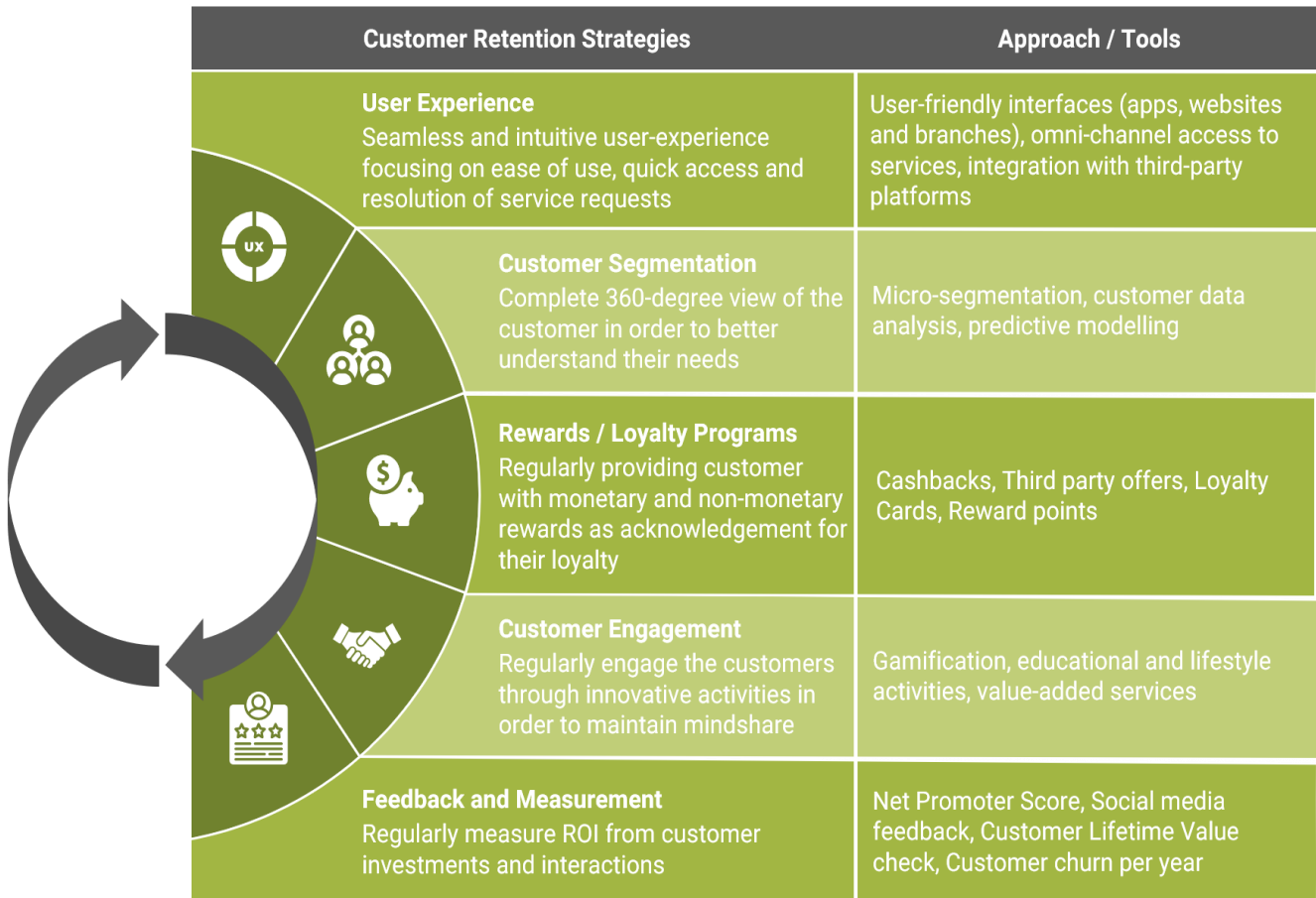


Multiple statistical studies in the past have shown that the cost of acquiring a customer is higher, often pegged at 5x, compared to the cost of retaining a customer. Additionally, the unit economics of maintaining a customer account and customer lifetime value play a critical role in the long-term profitability of a bank. While banks aggressively pursue their objective to acquire new customers in today's highly competitive European market, this whitepaper aims to highlight the growing importance of customer retention which is critical in today's market, maybe even more so than acquiring new customers.



# CUSTOMER RETENTION PRACTICES WITHIN THE BANKING SECTOR IN EUROPE

The current banking sector in Europe is a diverse mix of large traditional banks, mid-sized and small local banks as well as the new age digital-only banks. The broad customer retention strategies observed across all bank segments focus on five key aspects as depicted below.



While each of the five areas is being looked at in some measure by all three banking segments, there is a stronger emphasis on one over the other observed in each respective segment. It is therefore essential to understand the trends relative to the three banking segments.

*We see the development of both technology as well as customer experience and customer expectations changing at a much faster pace than what we've seen before and as a bank we haven't traditionally been able to follow that speed. What we are looking at now is bringing that speed up through collaboration with fintechs and we do that in our open banking initiative.*

**- Sr. Vice President, Nordea Bank**

---

## Large Banks

The customer retention strategy for this segment has primarily focused on improving customer stickiness by enhancing the user experience. Large banks have been investing heavily in improving their front-end internet and mobile banking applications to enhance the customer experience and bring it on par with the user experience offered by competitors, including challenger banks. Many have been struggling with the transition. In the UK, bank customers faced misery as the Royal Bank of Scotland, Barclays and the Co-op Bank mobilised their banking services but then left millions without online access to their accounts. Barclays and Co-op Bank fixed their own computer outages while RBS admitted to issues with its online services and had to tell the 5.5 million users of its mobile app to use its telephone banking or cash machines instead. However, for those banks that have managed to tide over such transition challenges, their mobile and digital banking applications are noted to be on par with their challenger bank counterparts in terms of functionality. Banks are also looking to optimise the omnichannel experience by digitalising their branches. Some of the large banks such as Lloyds, Barclays and Caixa Bank have setup coffee shops and co-working spaces in their high street branches to foster face to face connections with customers, especially the millennial population.

*“People feel less connected to digital-only brands, and there’s lots of research showing that’s the case when there’s no face-to-face side of things”*

*- Chief Commercial Officer, Metro Bank*

While banks continue to maintain loyalty reward programs, they have been struggling due to the cost pressure on them at a time when bank profit margins are low. Customer feedback is being regularly measured now with NPS as the preferred choice of measurement. Many are looking instead to partner with fintechs and third-party providers through APIs to provide a better user experience. But the critical success factor for this endeavour will be to get their technology infrastructure in place and API ready.

## Challenger Banks

This segment of banks has an inherent advantage of technological agility, superior user interface (UI) and user experience (UX). They also have a pricing advantage where they cross-sell services and products via affiliations and pass on some of the commission earned in the form of rebates to consumers. Challenger banks have used this advantage over traditional banks and have been able to rapidly acquire new customers and also to keep them engaged with innovative approaches. An example of this is the UK-based challenger bank, Monzo, which uses a unique approach focusing on transparent customer engagement to build customer loyalty and grow its market. Monzo involves its customers in almost every part of its operations, including asking customers for feedback on product launches and fees, allowing them to invest in the company through equity crowdfunding rounds, and even sends every customer a copy of its earnings report. It also holds community events across the UK. The challenger bank has onboarded more than 2 million users since it was established in 2015.

---

NPS is, again, the preferred measurement for customer retention. The other measure that challenger banks track regularly is the customer lifetime value and cross buying rates which gives them a customer-centric view of the rate of involvement with the bank.

That being said, even the in-vogue challenger banks and digital banks are facing their own set of challenges of retaining customers that they have rapidly on-boarded using aggressive viral marketing and referral marketing strategies. The Lifetime Value (LTV) of a challenger bank's customer is lower relative to that of a traditional bank because customers who typically sign up with challenger banks do not use the account as their primary salaried account. In addition, customers of challenger banks which are largely millennials, with their low earnings profile, limit the potential for up-selling or cross-selling of asset-based services that the larger banking counterparts are successful in achieving. It means that challenger banks have to take additional effort to ensure that customers transact through their platform. This could become difficult for challenger banks as traditional bank start to catch-up on their technology upgrades and also due to competition from large non-banks who, by virtue of the Open Banking regulation, have taken on the role of TPPs. These TPPs, such as online aggregators, e-commerce platforms, etc. have an equally competent UI and UX with a much larger customer base, ergo, more massive customer data sets.

### Small and mid-sized banks

Small and mid-sized banks have traditionally focused on a community-based banking approach, often engaging with their retail customers by grouping them based on their post-code to understand them better. However, this segment of banks has struggled in keeping up with technology trends and they may be unable to meet the expectations of some of their digitally savvy customers. While banks, such as the UK-based Nationwide or Sparda Banks in Germany, have invested massively in a long-term digital transformation initiative, many of the smaller banks are unable to do so. The customer retention strategy then, that many are adopting or thinking of, is to focus on specialisation and technology outsourcing.

*“As banks have to maintain increasingly outdated IT systems and ever more costly branch networks, their product range will have to be refined, and they will have to focus on core competencies. This will mean traditional banks will become more specialised and it will be harder to find a traditional bank with an all-encompassing product offering.”*

- **Head of International Markets at N26**

User experience is the overarching focus for all segments. For the mid-sized and small banks, digitalisation and technology overhaul of their systems is an expensive affair; many are looking at platform-as-a-service providers and software-as-a-service solutions which are cost-effective ways to improve their service delivery and modernise their technology infrastructure.

**Customer Retention Strategies | Overview of focus areas by banking segments**

	User Experience	Customer Segmentation	Rewards/Loyalty Programs	Customer Engagement	Feedback/Measurement
Large Banks	Medium focus	Medium focus	Limited / No	Medium focus	Strong Focus
Challenger Bank	Strong Focus	Strong Focus	Strong Focus	Strong Focus	Strong Focus
Small & mid-sized banks	Medium focus	Limited / No	Limited / No	Strong Focus	Limited / No



## CURRENT CUSTOMER RETENTION CHALLENGES AND STRATEGIC IMPERATIVES FOR BANKS

While banks have been successful in some of their customer retention strategies, there are a few market-centric challenges that they need to consider and develop their strategy accordingly to have a sustainable and profitable customer relationship.

### Open Banking regulation

The biggest challenge faced by banks is the development related to the PSD2 regulation. With the regulation mandating banks to provide third-party providers (TPPs) access to their customer data, they (the banks) face the risk of losing direct customer contact and getting disintermediated. This risk is relevant for both traditional as well as challenger banks who are facing competition from large non-banking technology brands including data aggregator platforms, e-commerce platforms, insurance groups, etc. such as Check24, Amazon, Lufthansa Miles, Allianz X, etc. that take on the role of TPPs and own the customer interaction. These TPPs have the advantage of superior UI and UX as well as the advantage of starting with strong financial backing and large customer data sets of their own which when matched with bank customer data allows the TPPs to offer unique and valuable services to customers. **Strategic Imperative:** As the roles of production and distribution of financial services become decoupled with open banking, banks may choose the role they play and even become a TPP themselves. In either of



---

the roles, banks will need to prepare technology infrastructure that acts in real-time internally and be API ready to connect with fintech companies and other big companies, and effectively facilitate seamless integration with internal and external systems.

## Macro-economic challenges

In a digital banking ecosystem where banks are competing with fintech companies, a large part of a bank's customer acquisition and retention strategy is hinged on attractive pricing and cashbacks. With a persistently low interest rate environment, banks in Europe are struggling with margins and profitability, which limits the capacity to spend heavily on customer rewards and loyalty programs.

*"The good news about PSD2 from an end user perspective is that you don't need to change your bank account. Because you will have the TPP frontend or a UX front end which can initiate all the payments from all your different bank accounts if you want to. And that is why we are investing in front-end technologies enabling end-user dashboards where I have not only multiple bank accounts aggregated but also having some other valuable information on my dashboard which might be loyalty programs, air miles programs, mobile contacts, or even stuff like the weather, etc."*

*- Board Member, German Challenger Bank*

**Strategic Imperative:** Currently, digital banks have an advantage over traditional banks on two aspects – the user experience and an attractive pricing proposition for their products/services. However, with lower margin of interest income amidst difficult macro-economic conditions, challenger banks will inevitably have to start charging fees for some of their services in order to sustain their operating model. The eventual convergence in pricing will result in challenger banks and traditional banks competing only on superior user experience.

## Shorter Customer Lifetime Value

*"Today, banks across the world must look to set up a unified API ecosystem, supporting Open Banking business models, which will allow clients, partners and fintechs to interface seamlessly and securely."*

*- Head of Cash Management, Deutsche Bank*

Customers today increasingly expect digital experiences from their banks that match those of e-commerce and information service providers such as Amazon and Google. Additionally, in this age of

---

digital everything, customers are hit by an explosion of digital marketing campaigns every day. With innovative brand positioning and calls to action, maintaining the customer's mindshare is becoming more and more challenging.

**Strategic Imperative:** The end game for banks and other financial institutions will be to retain the customer by becoming a one-stop shop for all their banking and non-banking needs. Banks can explore these new business models such as marketplaces, banking-as-a-service, etc.

## CONVERSATIONAL BANKING – THE MISSING INGREDIENT

In our analysis of the customer retention strategies that have been most successful, a common factor is the user experience, be it by way of seamless access to a bank's various services or the way a bank is able to recognise and react to the needs of the consumer. Such customer experiences are made possible with the advances in AI and machine learning technology as well as the abundant digital data being generated every day. While banks in the last decade have been moving to a digital banking model, the next decade is likely to be focused on providing customers an interactive and intuitive experience which is embodied in the emerging concept called Conversational Banking. By definition, conversational banking is a bi-directional interface between a customer and a bank, where a conversation can be initiated by either participant through a voice, text or visual interface. While the responses given by the bank are machine-generated, responses can be delegated to bank staff where necessary to gently handle more difficult or sensitive conversations.

*"Whilst much of the focus for banks will be on self-service banking automation, already banks like DBS have made huge strides in automating more general queries. However non-bank data can add much greater dimensions to conversational banking to truly contextualise conversations not just down to the individual user, but the user, their emotion, their location, etc."*

- Chief Digital Officer, Temenos

Conversational interfaces offer a host of benefits over typical app capabilities and features. This is to be expected of a progressive, customer-centric innovation. The principal differentiator between conversational interfaces and apps is their usability, offering a more user-friendly and consistent experience across all interfaces. In contrast, apps vary enormously in look and feel, each featuring their own distinct style of menu and method of navigation. When interacting with a conversational interface, the customer benefits from no longer facing the limitations and restrictions of the app provider's terminology.

Instead, the customer can engage with the interface using their own vernacular. A successful example of this is Caixa Bank, which developed a conversational banking interface for its customers in partnership

---

with IBM to develop a cognitive system based on IBM's Watson that is able to understand Spanish voice. A well-developed conversational interface should have the ability to recognise and process the users' request no matter how it is phrased. The ease of use of a conversational interface becomes apparent before the user has even initiated a conversation as these interfaces do not require installation. Conversational interfaces are configured to work with a platform such as Facebook Messenger, enabling the customer to immediately connect with the service. No installation requirements also save the customer from any additional time spent on frequent app updates, as well as precious memory space on their mobile device.

As digital banking becomes the norm rather than the exception, a conversational AI-enabled banking experience will be the key differentiator for banks in winning and retaining their customers.



---

## OUTLOOK | HOW CUSTOMER RETENTION COULD DRIVE THE FUTURE ROLE OF BANKING

There is a popular saying that data is the new oil; and to remain competitive and profitable over the longer-term, banks will need to be the custodians of large amounts of customer data. In this race banks will be competing with fintech companies as well as non-bank technology companies. The catchword here is 'technology' which will be critical not just to capture customers' bank transaction data but all non-bank data and create a unique value proposition for customers to transact on the bank's platform. Customer retention, therefore, will not just be about owning customer accounts but also managing the customer's financial relationships and transactions.

*"The numbers of users are expanding but what is expanding exponentially are the numbers of channels the banks have to use to communicate with their partners, developers and customers. The numbers are so big that we couldn't do it all ourselves, so we have to partner and make alliances."*

*- Head of Digital Channels and CX, Rabobank*

It goes without saying, that a superior user experience anchored by conversational banking and hyper-personalised servicing will be the winning mantra. In an Open Banking ecosystem, this, of course, is possible only through alliances, collaborations and integration with the right technology partners.

The strategic importance of customer retention for banks is expected only to increase in the future with growing competition in a shared economy. As banks strive to position themselves as the right partner for their customers, the key to survival will lie in the strategic use of digital technology solutions to build a business model that provides its customer the best user experience at the right price point.