

PERSPECTIVE

The Direct Approach to Growth



Consider stopping over at your favorite fast-food joint for a burger – the service is quick and efficient, while the take-away is satisfying, affordable and hits the spot. Translate this experience to the direct banking scenario where self-service brings in never-before convenience and efficacy, and the higher returns on deposits are immensely gratifying. It is no wonder that in these cost-conscious times, customers, tripped by actual or expected pink slips, want an inexpensive, always-available banking proposition which offers safe yet higher returns.

Direct banking is attracting many players, both in new markets and existing ones. It is a fast, low-cost route to break into new markets and capture new customer segments. Building a branch network to make inroads into new markets is expensive. Not only must a bank get a branch license, but it must also build numerous plush brick-and-mortar offices filled to the brim with full-time employees.

With direct banking, a bank has a quick and ready entry strategy for a new market. It need not spend time and money in setting up extensive branch networks. With a one-time technology investment, the bank can ensure that customers enjoy convenient and efficient banking, customized to meet their disparate needs.

With the bank able to set up shop quickly, it has a critical time advantage in a new market. Lessons learnt in one market may be applied to another, helping the bank shorten its learning curve and hit the road running. Banks seeking to start a new line of business at a lower cost often opt for this route. The cost savings can be passed along to customers in the form of better rates, a great incentive to attract customers looking to make the most of the saved money.

Thus, direct banking is a service delivery mechanism that confers symbiotic advantages – to the bank in terms of earnings and to the customers in terms of expectations met.

Before Setting Up a Direct Bank

With the industry's ability to grow deposits constrained in a tough economy, direct banking can help the bank grow its network and win customers in response to market changes and business requirements. Direct banking offers financial institutions economies of scale and access, so critical in any retail business. It can help bring about innovation and flexibility, allowing banks to change in accordance with customer demands and competitive challenges.

When setting up a direct bank that enjoys a favorable cost structure and enables customers to benefit from the best prices, banks need to be guided by impact on two sets of imperatives:

- External factors that improve customer experience and address customer needs
- Internal factors that deal with the bank's processes, products, organization, and structure

External Factors

Direct banking is rather like a low-cost airline – passengers may not get free food served on bone china crockery but they get to reach their destination quickly for a significantly lower price. Passengers do not board the plane with heightened expectations for they have done a cost benefit analysis of the no-frills experience. They know that the cheaper fare more than makes up for not getting hot towels from the hostess.

Similarly, direct banking customers do not expect marble-tiled branches and personal bankers. They are looking for simple products and inexpensive service and basic products because they expect the bank will pass on the savings to them in terms of higher deposit rates.

That does not mean, however, that customer experience must be neglected. As direct banks are looking to expand, they are doing more for customers. After all, satisfied customers translate into better growth and higher profits.

Simple is the way to go

'Keeping it simple' has been the strategy that most direct banks have followed. Products offered cover the basics: a checking account, a savings account, and perhaps some simple asset offerings, like a personal loan. These are products that allow customers to start a relationship with minimal documentation and procedural requirements. The bank does not need to spend too much time and money on formalities and logistics.

Such simple products are critical to retaining relationships with existing customers and acquiring new customers. This is because the time and money saved in offering basic products allows banks to deliver on the value proposition of the direct route – low costs. Banks can offer benefits – such as zero minimum balances, fee free accounts, and high-yields for savings and checking – that are not economically viable in branch-delivered products, and these benefits help attract customers.

For example, ICICI Bank launched its direct bank in Canada targeting non-resident Indians but the high deposit rates drew in locals too. The bank could apply this learning and replicate this experience in Germany and the UK, helping it expand into new geographies quickly and at a lower cost.

Looking to enhance the customer experience and grow customer share, banks are now expanding their direct banking product portfolio beyond savings products. While offerings continue to be simple, banks are venturing into asset products that require limited processing such as personal loans. They are also adopting different lines of business such as insurance investments.

Innovation is key

Innovation is crucial as banks seek to offer their direct banking customers products hitherto available only to branch customers. Limitations exist in the products offered but direct banks are making extensive value additions to their line-up. These include bundled products such as bill

payment and loans for bill payment, and insurance products and loans to pay the premium.

Channels for growth

With the branch becoming an expensive channel to operate and maintain, the direct banking requirement of efficient service at low cost has spurred banks to look for alternative channels. Ranging from the Internet, call center, mobile and ATM, these channels extend the bank's network beyond the branch and help both the bank and its customers.

Being self-service channels and requiring lower investment, costs come down dramatically. At the same time, they allow the bank to meet customer service expectations 24 hours a day, 7 days a week. With these channels, banks are able to do almost everything they do with the branch – including acquiring customers, promoting deposit growth, and launching innovative products. As more customers move to these cost-effective channels, banks can leverage economies of scale and collect higher revenues. Banks can reach a greater number of customers easily, thus reducing time to market and increasing agility even as transaction costs come down.

One of the primary requirements of today's on-the-go customer is convenience and greater control over finances. She expects to be able to conduct banking transactions when she wants, how she wants and where she want – quickly, easily, securely and in real time. For customers, these self-service channels rank high in convenience and allow them to manage their finances on their own terms.

Most banks have kept channel offerings simple by operating one or two channels. This helps keep costs low as investment, processes and employees are kept to a minimum. Today, banks are providing more low-cost channels beyond the Internet. As they expand channels, banks are addressing their customers' need to speak to a banker by setting up call centers. While such a facility may come with a charge to customers, they can at least get help from a banker through direct banking channels.

Today's consumer is loyal to banks that offer choice and convenience, exemplary service and tailored products. Focused as they are on balancing their busy lives, customers reward with continuing patronage banks that help them make life easy and profitable. Direct banking channels offer this and more, enabling financial institutions to offer a quality and breadth of service.

Customer empowerment

Banks can offer more than just products and services by leveraging online financial simulators to attract customers. These self-service simulations are low in cost since the customer can learn about her finances without a banker's assistance. By offering customers a peep into their future earnings, these sales enablers are also an effective way to entice them into increasing their deposits at the bank.

Internal Factors

Given the increasing competition in the banking industry and the race to grow deposits, how are banks to grow customers and profits? There's one cost-effective route to achieve this — direct banking. This ensures that products developed for the customers reach them in accordance with their needs, and reach them fast. Operating with fewer employees, its cost-efficiency is greatly enhanced. There are other internal imperatives positively impacted by direct banking, that can enhance efficiency and help banks operate with a competitive cost structure.

Streamlined processes

The simplicity of direct banking itself clearly lends itself to easy process streamlining. Tightly defined processes are critical in direct banking as products are basic and efficiencies and low costs are crucial. Increase in the number of processes lead to errors, lengthen turnaround time and time to market, while hurting service delivery, thus making customers unhappy and enhancing costs. Convenient and cost-efficient banking are the hallmarks of the direct platform and a bank must simplify processes to enable these.

Thus, when setting up a direct bank, a financial institution needs to leverage proven process practices. Banks can reuse these processes across borders, thus ensuring that time and money is not spent to develop and test processes in the new environment. This flexibility allows a direct bank to respond more quickly to customer needs and changes in the marketplace at a lower cost.

Outsourcing and offshoring

Primarily self-service entities, direct banks have limited customer-facing activities. Hence to increase efficiency and reduce costs, a direct bank can look at an external partner to help run the bank. Outsourcing and offshoring can be winning alternatives for direct banks.

A partner able to provide enriched services can offer a cost-efficient end-to-end solution for a bank's business needs – from setting up the infrastructure and processes to running and maintaining operations. A partner conversant with the platform can help the bank save valuable resources in terms of training costs. A bank can seamlessly out source its process management to such a partner at a lower cost for greater efficiency and speed. This will allow the direct bank to enter a new market quickly and deliver customer right from day one of operations.

Moving from capex to opex

Although a direct bank needs nowhere near the capital investment required for a brick-and-mortar operation, it still needs some investment on the IT platform and back office operators. As margins get squeezed, lower investment amounts can make an enormous difference to the bottom-line.

A back office premised on the transaction-based pricing model can give direct banks the best of technology at the lowest possible price. A direct bank need not buy the IT infrastructure or the framework software. Instead, it can merely use the software and hardware hosted by another entity as a service, paying a license fee for the privilege. In such a scenario, the bank need not deploy and maintain an on-site IT infrastructure,

but can still enjoy all the advantages of a cost-effective, efficient and agile implementation framework. This can bring huge dividends when a direct bank is testing waters in a new market. Instead of making a one-time upfront payment before the new geography delivers on its promise, it can use a shared service.

Involving application delivery by a vendor, such as an IT setup, capitalizing on the transaction-based pricing model, can transform the way a direct bank builds and consumes its hardware and software. This method is fast emerging as a vital and compelling option for banks to cost-effectively reduce the complexity of its IT landscape while reaping the benefits of commercially licensed software.

However, the benefits of transaction-based pricing for IT may not be fully utilized if the vendor is unable to meet the bank's requirements. Such a setup requires collaborative effort on the part of the vendor and the bank, with both needing to understand their roles and responsibilities and contribute proactively. A trusted vendor with a proven track record has a distinct advantage.

Technology

Business agility is a fundamental imperative. If direct banks are to take on competition and keep costs low, they must invest in an appropriate IT landscape. Technology can be a pivotal enabler, empowering a direct bank to transform possibilities into reality – helping it enter new markets quickly, attract new customers, and maintain efficient operations at a low cost. What are the prerequisites of a direct bank's IT setup?

Scalable platform

Direct banks need to keep fixed costs low if they are to increase profitability. Only then can any deposit growth help sustain the bank's margin. This can be ensured by going in for a scalable platform, allowing a bank to serve the evolving needs of the marketplace and welcome new customers.

This scalability is two-pronged. One, it must take care of rising customer volumes and allow the platform to deal with the growing requirements of a widening customer base. Two, it must fulfill an expanding breadth of offering. This is critical since the bank is an evolving organization and may require certain features and specifications in the future. The platform must thus have the ability to handle value additions to existing offerings and ensure readiness for multi-channel transactions. For instance, a direct bank taking the Internet route today may want to include the mobile channel tomorrow. The platform must be open, configurable and allow interoperability with new channels. So, when the bank wants to go to market with the new channel or offering, all it has to do is activate an already existing configuration and launch the product.

Process orchestration and outsourcing

The platform must also allow process orchestration to gain greater operational efficiencies from the lean processes that help run a direct bank. Moreover, the platform needs to allow outsourcing of processes and sharing of services.

A direct bank must choose an outsourcing partner who is able to run the platform in accordance with defined processes. A single partner with proven know-how across all products and functions – hosting, consulting, BPO – can help a bank increase efficiencies and lower costs.

Conclusion

Running a bank in these trying times is likely to be one of the most challenging jobs one can have. With the stalling economy, south-bound markets, tight credit, and massive cross-sector job losses, there just does not seem to be enough money, demand and hope to go around.

But direct banking can help a financial institution grow its customer base in these difficult times. By keeping customers happy - providing them with the best possible experience and high deposit rates, and meeting internal banking imperatives, a direct bank can break into new markets effectively.

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