Lenders' Most Pressing Digital Priorities for 2021

Where credit unions and banks are placing their biggest digital bets to win big with borrowers

AdvantEdge Digital™
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THE FINANCIAL BRAND

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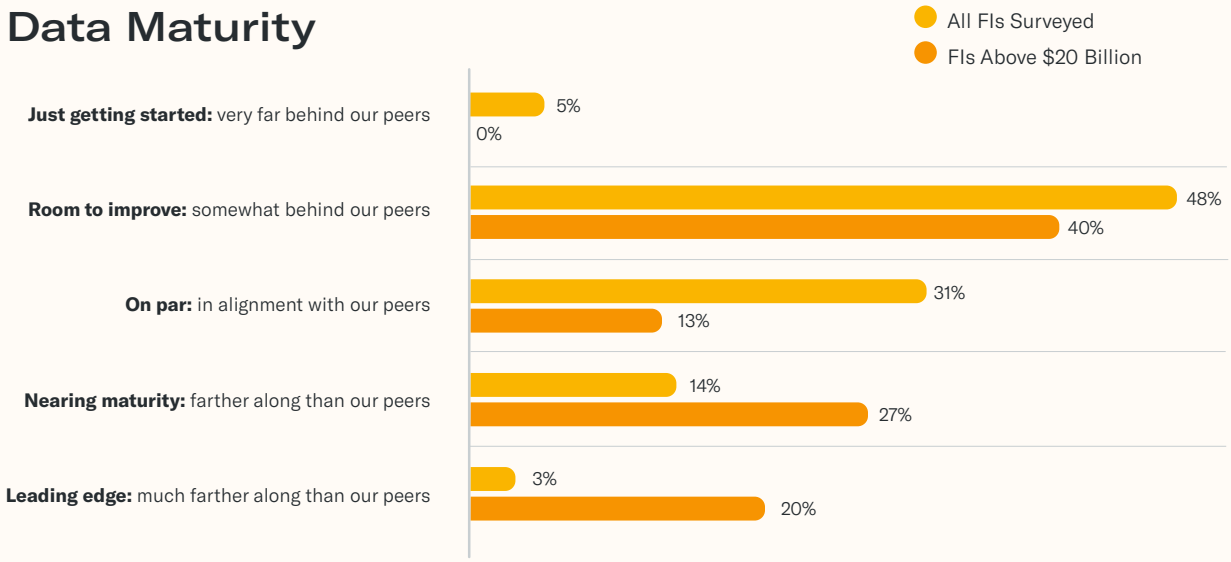
When it comes to digital transformation, a nearly universal truth seems to be emerging: Many organizations feel behind.

In fact, in a recent survey of 141 financial institution (FI) executives, 53 percent reported feeling at least somewhat behind, if not very far behind, their peers. That response includes the perspective of executives representing financial institutions with assets above $20 billion. Among those at the largest financial institutions responding to the survey, 40 percent said they felt behind.

Data Maturity



Who can blame them? The sheer pace of technology advancement is like nothing the world has seen before — computer processing speeds are increasing so quickly that some experts predict Moore's Law will become outdated in the near future. Exponential advances in everything from data analytics and artificial intelligence to 5G, cloud computing and soon quantum processing are democratizing once out-of-reach technologies, making it difficult to keep up.

Moore's Law: The principle that the speed and capability of computers can be expected to double every two years.

Almost every technology we care about, from smartphones to cheap laptops to GPS, is a direct reflection of Moore's prediction. It has also fueled today's breakthroughs in artificial intelligence and genetic medicine, by giving machine-learning techniques the ability to chew through massive amounts of data to find answers. Moore's Law... was always about the rate of progress, and we're no longer on that rate.

— MIT Technology Review

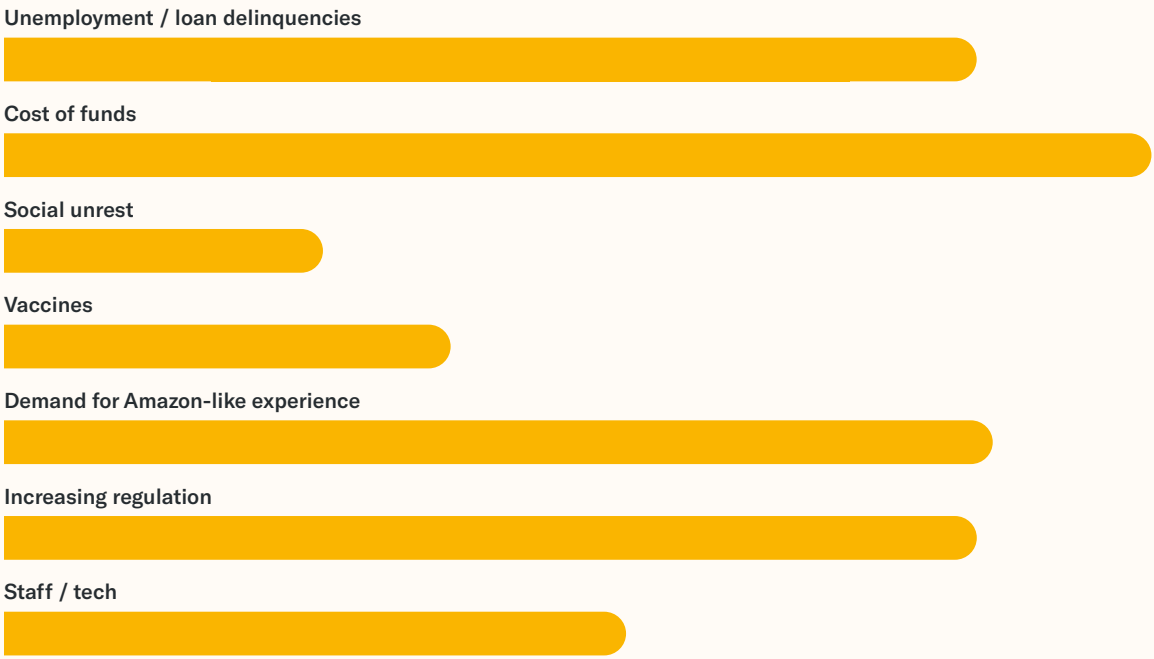
Big Tech Lending Experiences Ramping Up the Pressure

Lending departments, especially, are feeling the competitive pressure to keep up. Digital-native, lendtech providers are entering the auto, real estate and consumer lending marketplaces, ramping up borrower expectations for digital experiences on par with those delivered by Big Tech. "Meeting demand for Amazon-like experiences" was the second most popular answer given by our survey respondents when asked to name the greatest headwinds impeding their lending success in 2021.

> **One of our greatest headwinds to lending success is online challenger banks. They are gaining momentum and taking market share.**
>
> Financial Brand / AdvantEdge Digital survey respondent

Of course, meeting consumer demand for things like hyper-personalization, speed and transparency is just one of many challenges faced by today's traditional lending institutions. Revenue generation and profitability are two hulking elephants sitting in the corner of every room where digital transformation is being discussed. One of our survey participants put it best: "We need the funds to maintain exemplary, user-friendly tech." Indeed, "cost of funds" was the only circumstance to beat out "Amazon-like experiences" in the survey's question about headwinds to lending success.

What do you see as the greatest headwinds to your financial institution's lending success in 2021?



Loan Demand Is Strong. Digital Helps Win the Race to Funding.

The unprecedented events of 2020 flooded credit unions and banks with cash, turning all eyes toward the lending team. According to CUNA Mutual Group's February 2021 Credit Union Trends Report, credit union savings growth is the fastest it's been in 35 years and is expected to grow around 15 percent in 2021 due to stimulus payments, pandemic uncertainty, low gas spending and aging demographics. The pressure to secure loan business in a deposit-rich environment is intense and expected to remain if consumers continue to stockpile cash and pay down debt, both common responses in times of economic uncertainty.

In our survey, getting more loans on the books and earning increased revenue from both interest and non-interest (NII) sources topped the charts in terms of importance to the credit union or bank. Nearly 9 in 10 respondents said earning more business was significant to their financial institution, with 87 percent reporting "greater number of loans" as very or somewhat important. Greater outstanding balances was cited as either very or somewhat important by 76 percent of respondents; increased NII by 80 percent.

The credit union capital ratio is expected to fall to 9.2 percent in 2021, the lowest since 1994, as the expected pace of capital growth (5 percent) is expected to fall below the expected pace of asset growth (13.5 percent). This underscores the need for earning increased revenue from both interest and NII sources.

The good news is that loan demand is out there. With low interest rates and unprecedented federal support for community FI lending, the trick is not convincing consumers to borrow — it's winning the race to funding.

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Targeting Young Consumers? You Need a Strong Retention Strategy

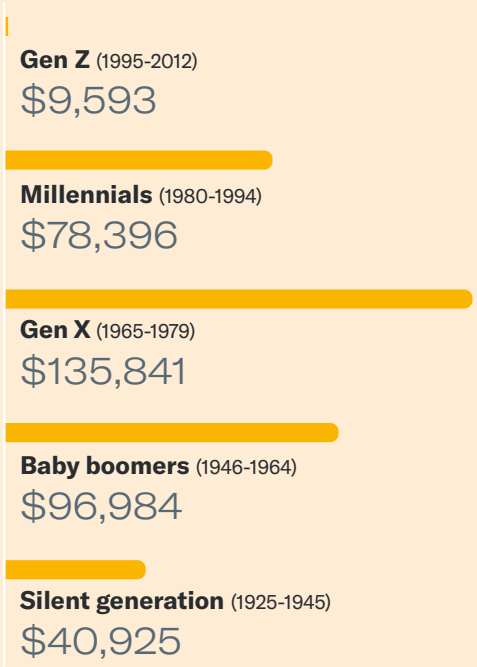
It wasn't terribly shocking to learn that the top three segments our survey participants are focused on growing over the next five years are Millennials (born 1980-1994), Xennials (born 1975-1985) and Gen Zers (born 1995-2012).

Just a few of the strategies our survey participants said they were designing to earn business from these hot segments were:

- Automation, digitization and streamlined, easy-to-use products
- Better online/mobile experience and tools
- Digital transformation and straight-through processing (STP)
- Building personalized digital marketing automation and interaction platforms for highly engaged member groups
- Develop mutually advantageous relationships by being proactive to customer needs, rather than reactive to requests

These are all great strategies and ones likely to be just as attractive to Gen X and Baby Boom consumers, too, in a post-pandemic environment. Why is that important for lenders to consider? Because the average debt balances of Baby Boom (born 1946-1964) and Gen X (born 1965-1979) borrowers far exceeds those of Millennials and Gen Z borrowers (see chart).

Average debt balances by age group:



The gap in profitability between the hot segments being targeted and those segments potentially being overlooked, or not as strongly supported, dramatically underscores the value of new customer retention for lenders. If FI marketers are successful at bringing Gen Zers through the door, it's important they stick around long enough for their life stage to allow them to fully engage with the FI's lending services. And, if fresh research is on point, we are going into a high period of relationship churn. A recent Foresight Research study conducted in the summer of 2020 found the number of people who intend to switch primary financial institutions in the next year or two went from an annually consistent 12 percent to 22 percent.

To retain customers — and attract new ones — digital capabilities and experiences are paramount. Of the more than 67 million credit union members in AdvantEdge Digital's aggregate data set, more than half have a preference for digital services.

These days, customer retention hinges on strong digital experiences.

30% of consumers say they **would leave their existing FI for better mobile capabilities** elsewhere

50% of consumers now **interact with their FI through mobile apps or websites at least once a week**

— compared to 32% two years ago

40% of respondents **expect to return to FI branches** post-coronavirus

Digital Demand Drives Investment Decisions

Another potential trouble spot for lenders is how decisions around innovation are being considered and ultimately made. When it comes to digital investing, existing levels of engagement appear to be steering the ship. Participants in the Financial Brand / AdvantEdge Digital survey said they plan to invest 2021's digital transformation dollars in online loan applications and account opening experiences, as well as overall improvements to mobile and online banking.

Which digital areas will get the most funding in 2021?

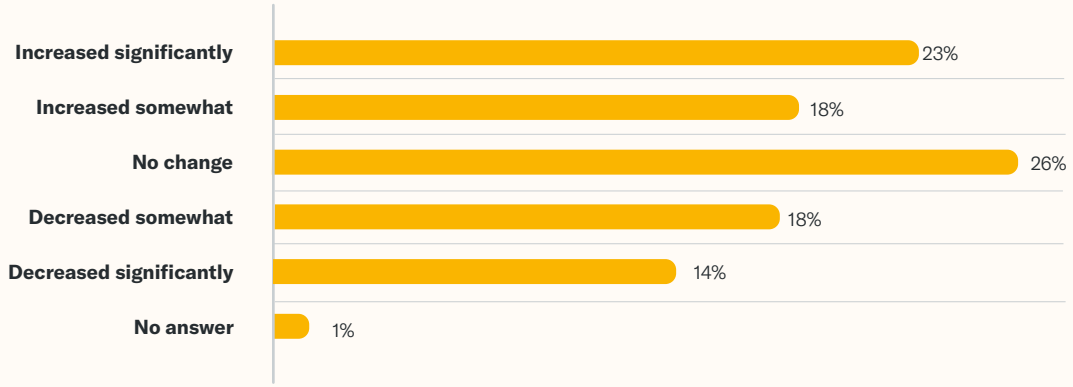
TOP THREE:

1. Mobile Online Banking
2. Online Account Opening
3. Online Loan Applications

As it turns out, those are also the top three digital performers within responding financial institutions. When asked where the FIs had seen the greatest increases in digital engagement, online loan applications, online account opening and online/mobile banking were selected most often. Among the largest lenders, things like data visualization, underwriting automation and contactless borrower experience stood out as key areas of 2021 digital-dollars investment, as well.

While there are merits to following consumers' lead when strategizing digital delivery, such a strategy should be balanced with a more aggressive exploration of future needs. That's because credit union members and bank customers may not take the time to ask for what they need or want. They may simply find it elsewhere.

How has digital engagement at your financial institution changed over the past 12 months?



Interestingly, 26 percent of the survey participants detected no change in digital engagement at their financial institution in 2020. Another 30 percent reported actual decreases in engagement last year. Is that because consumers were finding new providers to meet their increasing digital banking needs? Knowing that a digital consumer is a profitable consumer, this underscores the opportunity cost of failing to lead consumers down a digital path. For financial institutions with a double bottom line imperative, the loss of engagement can be even more costly, given they may be losing business to providers less concerned about consumers' long-term financial wellness.

A Digital Consumer is a Profitable Consumer

According to one recent bank study, consumers who had more than 50 percent of their dealings with the FI remotely...

2X generated income per consumer:
$1.3M vs $600K

Lower cost-income ratios
34% vs 55%

Higher ROE
27% vs 9%

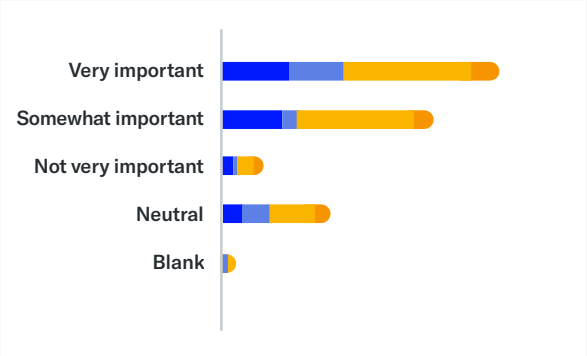
Lenders Migrating to the Cloud to Achieve Agility and Scale

When it comes to making investments in digital, many financial institutions are looking to the cloud. Cloud-based software as a service (SaaS) solutions, in particular, are expected to gain a great deal of that investment – some $118 billion in 2021 alone. According to Gartner, that's due in large part to the pandemic, which forced organizations to optimize IT costs while supporting a remote workforce. Now that SaaS cloud applications have proven their value, the tide of cloud demand is unlikely to recede.

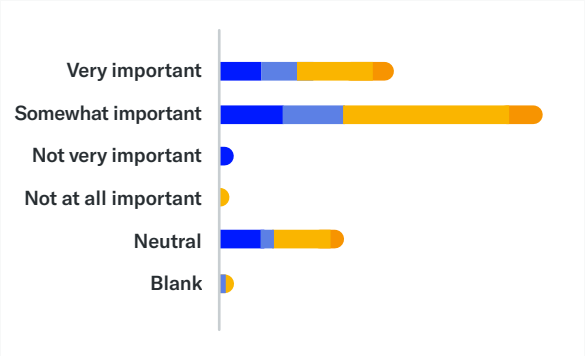
Notably, 93 percent of respondents categorized "operational improvements" as very or somewhat important to their lending success in 2021. This suggests lenders see a strong connection between process and outcome. Indeed, as we've seen at AdvantEdge Digital, streamlined processes and the integration of human-centered, intuitive technologies can have a strong impact on attaining new business and greater revenue. Cloud-based solutions have a lot to offer in the realm of operational improvements.

How important are each of the following to your lending team?

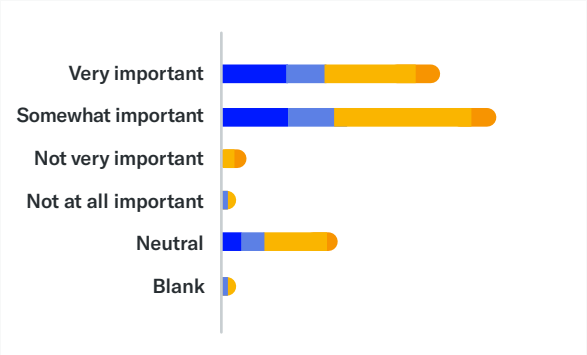
Greater outstanding balance



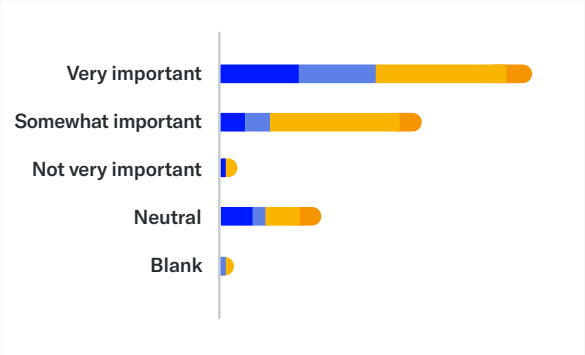
Loan portfolio diversification



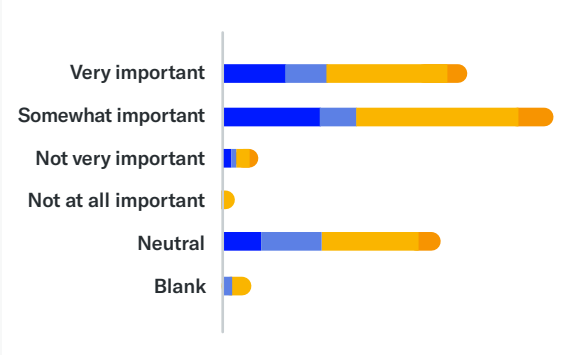
Flexible terms and pricing for borrowers



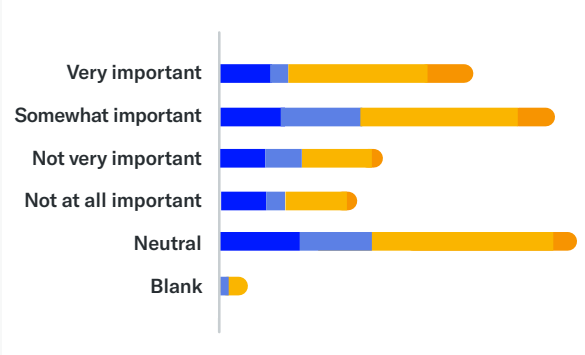
Increased non-interest income



Greater financial inclusion



Indirect borrower engagement



However, operational transformation may be slipping in priority. As pointed out by Shanker Ramamurthy, IBM Global Managing Partner, tomorrow's banking will upend the traditional technology pyramid: "You can think of today's bank technology... as a pyramid. 70% to 80% of all the bank tech spend is for middle and back-office operations. Maybe 20% is spent on the front end. Cloud and AI together will enable a dramatic reinvention of banking so that more and more of what happens is customer-facing."

SaaS tools designed to digitally transform both the back-end lender and front-end borrower experience run the gamut, from standard out-of-the-box solutions to fully configurable. Some are built on industry best practices; others via consumer-centric R&D. The beauty of nearly all SaaS solutions is agility and the ability to scale (both up and down as business and market realities dictate). SaaS models can adapt much more quickly than their on-premise counterparts – an essential capability today as rapidly changing market dynamics force faster evolution. Take Urban Sports Club, for instance. Before the pandemic, the app directed employees through fitness options at thousands of physical gyms. Within a few weeks of COVID-19 shut-downs, the SaaS company pivoted, launching 45,000 online fitness classes through 1,000 partners.

Financial Institution Lenders Are 'Extremely' Optimistic

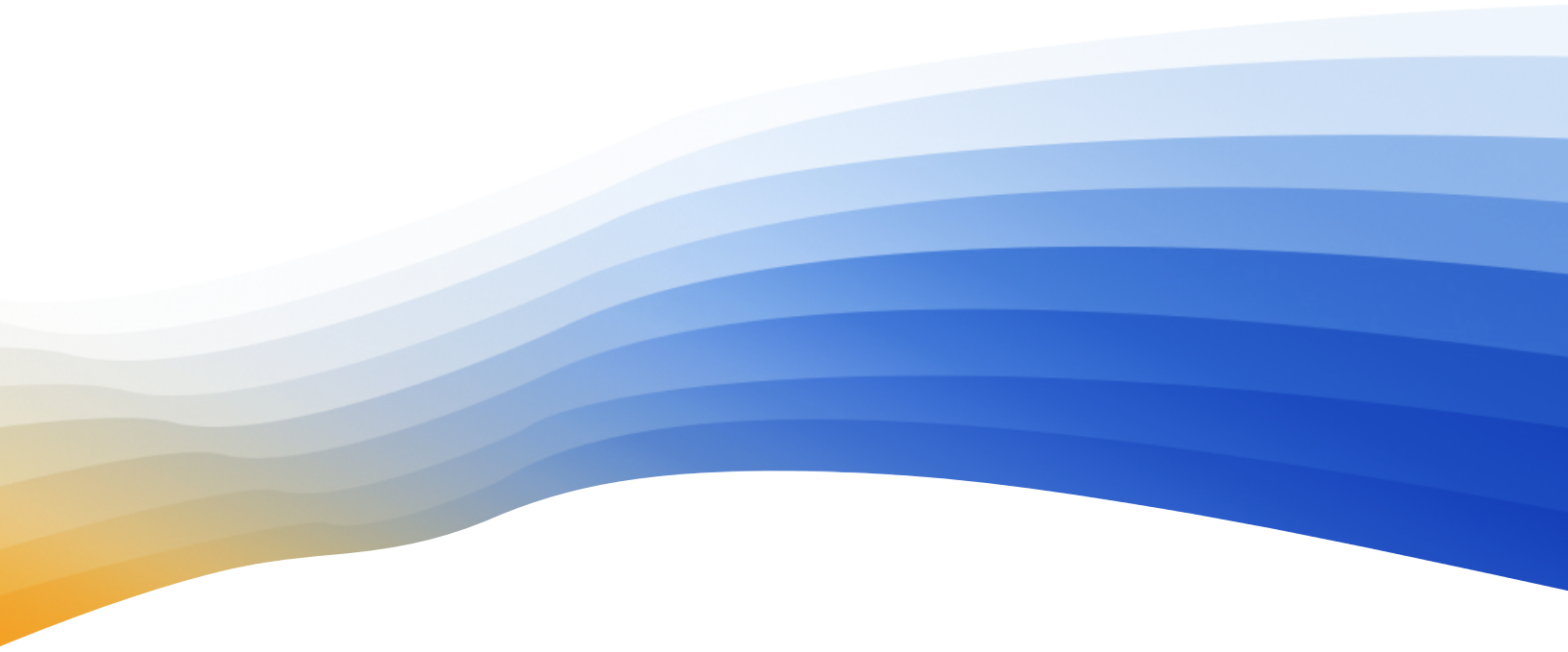
Even after all of the pandemic chaos, fierce social unrest and regionally devastating natural disasters, 2020 left the majority of financial institution leaders with an optimistic outlook. Eighty-nine percent of those who took our survey said that's exactly how they felt about the future growth of their credit union or bank. Remarkably, more than half of those who said they were optimistic called themselves extremely so.

Growth Optimism
89% of FI leaders surveyed are optimistic about future growth

Among those who reported feeling positive about the future was a participant who credited the optimism to working for an institution with a vision. Another said the FI's willingness to change direction was key to their growth predictions. Both are great examples of how influential top-down empowerment can be not only to a lending department, but also to an entire organization. The C-suite execs and board members who articulate where the organization is headed — while also letting team members know it's okay to pivot — can make all the difference to a credit union or bank's digital transformation.

Digital Transformation is a Continuous Journey. Just Keep Moving.

Lenders who are feeling behind the pack on the journey to digital transformation are in good company. The important thing is to continue taking steps forward. Leaders who design their roadmaps to achieve quick wins, leverage momentum and pivot when necessary have the greatest chance of unlocking their digital potential, winning the business of more modern borrowers along the way.



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