The road to trust

> *How do Australian banks build a more customer outcome focused business model?*

Australia's banks can focus on customer trust and gain a sustainable competitive advantage by delivering the "right" customer outcomes using behavioural economics, better aligned reward structures and insights into risk culture as roadmaps.

- Australia's banks have a window of opportunity to focus on trust and create a sustainable, customer outcomes focused business model which is consistent with the bank's strategic objectives
- Emerging insights from behavioural economics are offering new ways to deliver superior customer outcomes and build trust
- Broadening customer centricity initiatives to consider product and services from a past, present and future perspective as a means of managing conduct risk
- Aligning reward and incentives to delivering the "right" customer outcome
- Banks should also work to close the gap between 'actual' and 'desired' states of their risk culture to mitigate against scandals and losses

Australia's banking and financial services sector has been hit by a number of scandals in recent times, which has damaged customer trust. It's a common story around the world, where scandals and collapses have seen regulators forcing banks to place customers' interests ahead of their own.

Evidence shows a customer outcome focused approach delivers value, not just for the customer, but also for the firms themselves. Locally, regulators are increasingly scrutinising banks' behaviour, but Australian banks still have a window of opportunity to rebuild trust themselves by creating more customer outcome focused- business models.

PwC has identified three key areas: behavioural economics, rewards and incentives and risk culture, which are key levers to pull in ensuring customer focused outcomes.

The value of a customer outcome focused approach

The primary competitive differentiator in the new competitive landscape will be a more agile, innovative, risk-conscious and customer outcome focused culture.

The importance of putting the customer (past, present and future) at the heart of a firm's business model has been rapidly growing in the last few years.

Whilst customer centricity seems to be a key pillar of most organisational strategies, often it is narrow in focus and centered on initiatives to understand the voice of the customer. Conduct, on the other hand, whilst aligned in the desire to understand customer needs, is about changing behaviours and the lens through which business decisions are made.

To PwC, a good customer outcome and effective conduct risk management contemplates products and services that are designed to meet customer needs, processes and infrastructure that enable consistent fulfilment, a culture of wanting to 'do the right thing' and a performance and incentive framework that supports it.

This requires looking beyond the customer experience to consider product suitability at both origination and throughout its life across the whole business model to achieve the right outcome for the customer. As well as implementing the risk and compliance routines, there is a need to pro-actively scan for potential vulnerabilities.

But how do Australian banks actually build a more customer outcome focused business model? How do they engineer their business so they deliver better outcomes for customers?

Behavioural economics: insights to deliver better customer outcomes

In the past we have instinctively designed customer interactions around the idea that – given sufficient information (ie disclosure) – customers will make rational decisions aligned to their long term self interest.

The reality, of course, is that despite ample information and incentive, customers make persistent and predictable errors.

50 years of evidence from the behavioural sciences (often collectively referred to as behavioural economics) helps us to understand why.

It shows us that because of emotions, clumsy decision shortcuts and self-control challenges they may be drawn to short term discounts, get stuck in bad products and overweight headline information when deciding.

This then opens up the possibility that some banks may engineer products, distribution models and sales promotions to profit from such predictable biases – either inadvertently over time, or intentionally. But as we have seen, while such practices will lead to short term profit, they also produce widespread customer regret, poor or patchy customer advocacy and even crises or scandals, significantly eroding trust and reputations in the process.

Regulators, including the Financial Conduct Authority (UK), Consumer Financial Protection Bureau (US) and Australian Securities and Investments Commission (Australia) are now using behavioural economics to more readily identify and crack down on such practices.

> “ ***Behavioural economics provides a richer understanding of customer decision making***

Some banks will respond by implementing minimum controls to manage this increased scrutiny. But those that are truly investing in customer centricity and rebuilding trust will go further faster, demonstrating their proactive intentions to regulators and customers alike.

They will fully embrace these emerging insights, designing products and interactions that make it easier for customers to choose wisely and engage with their bank. Longer term relationships and profits will result through deeper customer trust, engagement and confidence.

Getting risk culture right can reduce trust-destroying scandals

Organisational risk culture is another area where Australian banks can start acting to rebuild customer trust. Right now company culture is headline news. Recent high-profile corporate scandals and an increasingly prescriptive regulatory environment have shone a light on the importance of promoting a strong, cohesive risk management culture at every level of an organisation.

As an outcome, there is a real opportunity for leaders of Australian banks to shape a healthy risk culture, to proactively identify and mitigate risk, protect their brands and unlock new growth options.

Regulators such as APRA have highlighted the gap between the ‘aspirations’ and ‘reality’ when it comes to risk culture.

Risk culture execution, for example, can lag behind C-suite expectations. Senior leaders might set the right “tone at the top”, but management action – such as setting appropriate risk standards and promoting desired behaviours – may not live up to those expectations.

Based on PwC’s experience and informed by our Risk Culture Model, we have identified a number of themes for banks to focus their efforts on. This includes establishing a culture where leaders at all levels role-model taking accountability for their actions; establishing an environment where employees feel safe to speak up; and creating a true seat at the table for the risk function.

Remuneration and Incentives

One of the key levers for banks to consider in driving towards a more customer focused outcome is how their workforce, leaders and third parties are incentivised and remunerated.

A disconnect between desired outcomes and performance goals can, and has, led to sub-optimal outcomes. The importance of this alignment extends to commissions and trails which are heavily under scrutiny. We observe that even a minor misalignment of incentives can result in undesirable outcomes and behaviours.

Current developments are to focus on the quality inputs such as customer engagement and interactions rather than outputs such as product sales or increased share of wallet.

A key to sustainable and profitable growth

As banks face the threat of constant innovation and technology disruption, delivering appropriate customer outcomes will be a key to sustainable and profitable growth for banks. New insights and research in behavioural economics, the way in which banks approach product related decisions, reward structures and bank risk culture help provide a road map for banks to improve customer outcomes, rebuild trust and create a strong growth platform.

If customers can truly see that their financial institution is focused on this, and takes a proactive approach in prioritising this outcome, then focused trust and the financial rewards that flow over the sustainable future will outweigh the short term costs of change. Is this a brave decision to be the first mover? Or is it an even braver decision not to be?

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