The Two Greatest Threats to the Banking Industry
Part I: The Business Case for the Digital Bank

Provided by:

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Ahead of the Market, Behind the Deal.

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Preface:

Fifteen years ago I had one bank account with one bank. I would visit an ATM machine once a month, and withdraw some pocket money from my account. If I was making a big purchase, maybe I would stop by my bank and talk to my banker to collect a cashier's check. If you're old like me, probably, you can relate?

Now, I have many different accounts at many different banks. I must perform hundreds of transactions per month, constantly setting up auto-pays, paying bills, checking balances, transferring money between accounts, wire transferring money to different banks, seeing if payments cleared, checking to ensure credit card charges are accurate, etc. I also have many mobile applications that are constantly accessing my accounts and notifying me of my financial digital footprint, whether they be my credit card applications, my investment applications, or my money management applications - all running online, all mobile, and all linked to my accounts.

Today, I almost exclusively bank online and nearly all that experience is via mobile platforms like my smart phone or tablet; and we could have predicted this. If you consider how much we as a modern society are self-directed and highly adapted to the digital online world – as so clearly evidenced by how we look for restaurant recommendations, search for and book flights, buy and listen to music, shop, ship and track things, and even order our groceries – it's only inevitable that once a credible digital banking alternative exists, customer adoption happens quickly and convincingly; leaving laggards in the dust.

What's more; digitalization is a critical financial imperative for banks today. When I was doing one transaction per month 15 years ago, the cost the bank incurred to process my transaction in their extremely expensive computing environment was what it was – but today, that same old infrastructure is being used at many times more cost for this huge influx of volume. The only way the legacy banks of yesterday thrive in the market of tomorrow, is to digitalize and transform their technology.

Our banking clients, who are pursuing a full digital transformation are seeing improvements in EBITDA of more than 40%, and about two-thirds of this value comes from the impact of the digital bank on cost basis and loss prevention rather than from revenue uplift. The message being: this isn't as much about gaining new clients, as it is reducing the costs to serve your existing ones. By doing so, the operational efficiencies gained, far outweigh the investments required and make the offerings more attractive to the market at large. Quite simply; it's a do or die decision.

The Banking industry has had its share of turmoil, which is not entirely unexpected given the central role banking has within our society and in the macro-economic sense on a global level. Safe to say, that when considering all these constituents, there is no area of greater area of sensitivity to people, business, consumers, and even governments than where their money is stored, saved, invested, and even lost in some cases. Planning for the next catastrophe may sound a bit morbid and perhaps somewhat negative, but planning for your own demise is sometimes the best way to avoid it. There are two ways that finance and banking organizations can and will fail in the coming years.

The Digital Bank. NET(net) will discuss these two issues in this short series entitled, 'The Two Greatest Threats to the Banking Industry'. The first is around the (lack of) digital transformation in the banking industry, often referred to as **'The Digital Bank'**.

There are several definitions of what a Digital Bank is, but we will simplify it here to say that a truly digital bank will:

- Own very few to no physical bank branches
- Have 'transformed' or migrated off legacy technologies that hugely expensive and often seen as barriers to innovation
- Offer advanced mobile applications that enable both consumers and business to execute new services from smartphones, tablets, or even soon – your car
- Provide availability to these same products and services is 24 hours a day, 7 days a week, 365 days a year
- Use disruptive technology as a normal part of doing business, not just an experiment

Even if we listed 15 more, we already know that to achieve any of these goals, significant change must take place for many in the banking industry, or else there are some as of this writing who will not be around to see what happens.

Challenge #1: People and Culture

There is almost no project or strategic initiative whose success or failure doesn't depend on the readiness of the people running it, and the foundation the company has laid to enable success. If either or both of those are even a little unstable, the odds of success plummet. Typically, what happens in these scenarios (we've probably all see or been a part of one) is that the programs launch with great fanfare and a flurry of activity, and then the excitement wanes over time as the players recede back to the status quo, doing business the same way they always have. Partial success is claimed somewhere along the way, but the intended ROI of the original strategy is either forgotten or conveniently modified to fit the actual results. Of course, by then the original project has been overshadowed by something completely different.

If any bank or financial institution hopes to transform to become a true Digital Bank, they must assess and address their corporate culture. Almost all banks today have managed to put a 'digital front end' on their products, but for most, the 'back end' is still working within a traditional banking infrastructure, with the same corporate culture. To move forward at the same rapid pace of their digital consumers, banks must change how they operate internally to mirror their customer behavior. They will need to become 'light on their feet' and move quickly. Staff and project teams will need to be 'open to new ideas' and experiment with new technology. They should have teams that are rapidly developing new solutions for all their channels, that are constantly challenging the status quo, and have the pulse on mobile consumer behavior.

Finally – they need to be people centric – not product centric. Start with the end in mind, and that is the customer not the product. When you start with how your customers behave and interact, you will do the same and develop strategies that mirror the behavior of those who utilize your services.

Challenge #2: Innovation

Banks should be more like Amazon.

If you live in North America the odds that you have used Amazon to get digital music, movies, all manner of retail goods, and even groceries at least once – are extremely high. If you are outside of North America, you will soon, as Amazon now realizes 10% of its revenue from Germany, with Japan and the UK not far behind. Amazon is making major investments in Europe, and no doubt has aims to dominate the online retail market – or should we say – the retail market, there as well.

To help explain Amazon's innovation and growth, we'll use a social media metaphor – banks should be looking to create the next app, website, or channel that consumers will want to use, not holding committee meetings deciding what existing social channels to 'maybe' try. By the time they've decided where to dip their toe in, the market (consumers) has already moved. Banks need to act more like cutting edge tech companies and less like a traditional brick and mortar. As stated earlier – putting a 'digital face' on a product, doesn't make you a digital bank.

Amazon didn't start by building 'brick and mortar' retail stores – they're buying them now to facilitate their digital business (Amazon Go, Whole Foods), and letting others build storefronts to sell anything Amazon sells. Amazon isn't just offering overnight shipping, they're testing drone deliveries. Amazon isn't waiting for mobility – they are adding Alexa (the name given to Amazon's voice control software) to Ford Cars. At home, I can place an order with Amazon Alexa standing in my kitchen – and never touch a keyboard, and the package arrives the next day. As of this writing, only Capital One has an Alexa 'skill' (skill is an app that allows voice recognition to execute a command) that is an actual transaction. All others are just to reference information (yawn).

"Our job," says Amazon CEO Jeff Bezos, "is to invent new options that nobody's ever thought of before and see if customers like them." - Fast Company

Understanding that it's not realistic for most financial institutions to turn into an 'Amazon like' development and innovation model, there are lessons to be learned. As with the social media metaphor above, banks are dipping their toe in and seeing what apps to 'maybe' develop with Amazon Alexa, when really, they should have already been fully integrated at launch with a suite of services available to consumers (transfer/wire money, check balances, pay bills, etc.). If banks can't develop it themselves, they should go all in with an innovator or fintech that can. How great would it be for a consumer to get in their brand-new Ford, say "Alexa, pay my phone bill" or take call from their son or daughter in college and say, "Alexa, transfer $500 to Paul's checking account from our primary" – all while heading home for the night.

To summarize – any of the largest Banks could have invented Alexa (Citigroup, Deutsche Bank, Bank of America, HSBC, Chase, Santander, Wells Fargo, Barclays etc.). They have the capital and resources, and certainly have a consumer base that is huge. Bank of America claims to have 47 million business and consumer relationships. They certainly know how to build machines to transact business with 16k ATMs. We could have had 'Erica', the Bank of America Virtual Assistant for the home to help you bank, that 'oh, by the way' does all these other great things like play music, hook up to your phone and you can order stuff from Amazon on it.

Most banks don't think this way – but they should. They are typically too busy reacting to disruption rather than creating it.

Challenge #3: Technology Investment

Outdated technology will kill banks before they even get started on the road to digital banking. Let's use the Mortgage Business in North America as an example, where almost all the largest banks play.

Traditional banks are quickly losing market share to non-traditional lenders such as Quicken Loans (a US based non-bank financial institution). Most of the traditional banks still can't process a loan application digitally, while the disruptive players in the market do everything online. The rationale is that banks are still heavily invested, and still investing in, traditional bank branches and their outdated infrastructure.

The investment mindset is evident in this example –Quicken Loans is innovating on ways to transact business faster and easier to fit the way consumers want to do business. For their next loan application, I'm betting millions more people will be at home sipping Starbucks in their pajamas, and using Rocket Mortgage by Quicken Loans on their tablet.

Technology investment will be enormous for some institutions that are in the infant stages of transformation to a digital bank model. You can already find many whitepapers and case studies from technology suppliers on all these related topics. Why? Because they know that the 'struggle is real', and want to be in a position to supplant the old infrastructure with the new – and get banks locked in for the long term.

Caution is advised as the technology investments are being made. Several critical questions need to be asked:

- Does this investment contribute to our digital bank, customer centric approach – or just putting a digital face on an old product?
- Are we getting locked into a solution that will limit our ability in the future to react to changing consumer behaviors and market conditions?
- Is the supplier we are reviewing disruptive and innovative, or simply selling us a newer version of a legacy system? Is the supplier(s) the right one for the long-term to enable our business?
- Are we getting the maximum flexibility at the lowest market rates for the services or products?
- Is the supplier at all invested in our success?

Banks have a perception to overcome as being stodgy and old fashioned. They are viewed as the Grandfather who just made a phone call on an iPhone and declares "I've gone digital!" Where and how banks manage and spend their technology investments over the next 5 years will determine who survives and who fails.

Challenge #4: Legislation and Regulation

Simply put, there are financial institutions that play by a completely different set of rules than others. Those rules are created by governments and oversight bodies that may or may not completely understand or be able to keep up with the pace of technological change. For example, in the United States there are over 10 regulatory bodies that have sway and influence over the banking industry, and on top of that, all 50 US states have their own laws and regulations. Can one reasonably expect that all those entities are keeping up with the technology banks need to realize full digitalization? Europe has the same issues, and in some ways, can be even more difficult. For example, in EU countries, banks must treat software as an 'expense' from an accounting standpoint, wherein the US its treated as 'investment'. This provides for billions more in available investment dollars for US banks over their EU peers and competitors. Individual non-EU European countries have all their own regulations in addition to those of the EU which can compound the obstacles. Another glaring example coming in May 2018 in Europe, will be the start of the General Data Protection Regulation (GDPR). This already has legal teams, and by extension, technology suppliers working overtime to ensure compliance.

Summary:

It's not too late for banks to digitalize. Once the leadership sets the tone, and implements the right teams and the appropriate policies that reward innovation and disruption – great things will happen. Innovation will flourish and the creativity from the inside and working with new partners will create new efficiencies, and new revenue streams that have not yet been thought of. This kind of innovation can lead a company beyond mere modernization efforts to complete digital transformation where thinking goes beyond banking, to how you are going to improve interaction with your customer. When you figure out those futuristic interactions – you invent ways to not only cater to them, but become them.

Lastly, banks must rethink their technology supply chain and invest with those that offer high value and low cost, with the proper amounts of organizational flexibility and protection. Banks have been historically monolithically focused on mitigation of risk, and to have a thriving technology supply chain, banks need to consider which partners are going to help them optimize:

- economic and strategic value of the bank's critical digital investments
- minimizing costs and risks while maximizing the opportunity to realize value and benefit

Legacy technology suppliers today are locked in a declining market with banks, and have turned fully to manipulative account control, tyrannical commercial policies, and rigid interpretations of the underlying contractual agreements to bilk their customers for every last drop of value before they wise up and leave. These behaviors should be recognized and dealt with appropriately before the damage gets too far out of control. Not only is digital transformation a financial and strategic imperative, it is also a great way to reset predatory relationships in the technology supply chain and regain control.

NET(net)'s Banking and Financial practice is unique in its ability to not just optimize the technology supply chain, but introduce dramatic and impactful results that transform the business. Talk to us and learn how **we've done this for one of the world's largest banks with 3,500% ROI**, as well as other companies around the globe.

About NET(net)

Celebrating 15 years, NET(net) is the world's leading IT Investment Optimization firm, helping clients find, get and keep more economic and strategic value. With over 2,500 clients around the world in nearly all industries and geographies, and with the experience of over 25,000 field engagements with over 250 technology suppliers in XaaS, Cloud, Hardware, Software, Services, Healthcare, Outsourcing, Infrastructure, Telecommunications, and other areas of IT spend, resulting in incremental client captured value in excess of $250 billion since 2002. NET(net) has the expertise you need, the experience you want, and the performance you demand. Contact us today at info@netnetweb.com, visit us online at www.netnetweb.com, or call us at +1-866-2-NET-net to see if we can help you capture more value in your IT investments, agreements, and relationships.