

Digital ambitions – from aspiration to reality

During Money 20/20 Europe in Copenhagen, The Banker hosted an evening roundtable, in association with VMware, with leading financial professionals to discuss how banks were responding to the digital disruption affecting their business.

New technologies and new players, customer experience and cultural change were three topics hotly debated during the Money 20/20 Europe event in Copenhagen, which brought together the fintech start-up community and incumbent financial services and IT companies. All three themes highlight the challenges banks face in reinventing themselves to adapt to an increasingly digital world.

Undoubtedly, banks must answer fundamental questions about their core infrastructures if they are to successfully transform into digital enterprises. Do they adopt a ‘platform approach’, externally sourcing best-of-breed solutions to offer a comprehensive service to customers, or do they hone in on those areas in which they can offer depth of experience and value-add to their customers, such as cyber security, cash management or treasury services?

These questions are being asked at a time of intensifying competition – in part promoted by financial regulators – when fintechs are perceived to be offering innovative, digital tools that provide better customer experiences.

However, while technology is one ingredient in a transformation journey, many roundtable participants highlighted the important role people and culture will play in the move to digital. There must be some understanding of what digital transformation involves and what it means at the board level. As one participant said, “The problem is not one of the availability of new technology, but of a bank’s culture and management strategy – we must identify the actual key performance indicators needed to become an agile, next generation bank because we won’t achieve that with the culture we currently have.”

New recruits will be important to create culture change, but it is increasingly difficult for banks to attract graduates with the expertise required. Banks need to empower the new workforce – millennials – with the

right tools, the right technology, and the right platform to be productive. If they can do that, their digital transformation will take a smoother path.

CODIFYING A DIGITAL STRATEGY

For some banks, a digital strategy is as much about prioritising innovation ideas, as it is about generally developing new products and services. A senior European bank payments executive said, “Our biggest challenge is that we’ve run up about 100 years of possible ideas to execute, which we won’t be able to. The initial incentive was to do a little bit of everything, which isn’t making much impact either. Strategy is actually all about what not to do, which is probably the phase we are in today.” Many incumbent banks are prioritising areas such as customer experience, cross-border payments and risk management, and looking to fintechs to help them execute change more quickly.

A digital officer at a large European bank made the point that there were few “genuinely new” business models. Most financial institutions’ responses to digital transformation have been to create faster, smarter, cheaper and “shinier” versions of what banks have today. “We are seeing big players now attending these conferences that aren’t banks or traditional financial service technology providers,” they argued. “These players are beginning to enter the fray and take away the margin business. They don’t talk about payments – they just plug the functionality into their platforms. It shows how far we’ve got to go in terms of thinking about what the customer is trying to do, and not about the product we as banks have carved out.”

Another participant agreed, pointing up that there is a difference between banks that have “an actual digital strategy” and those that are focused only on save money. They argue that most banks don’t have a digital strategy. “Many of the buzzwords just fade into the background to become a technology product – there’s rarely a business model attached,” they said.

A payments and regulation expert from a large US bank said technologies such as blockchain and mobile, as well as the move to real-time transactions, will change financial market infrastructure and risk distribution. “Velocity will be increased with real time, so how do we move with technology to that new world, where things get faster, but also more efficient?” Banks need to think about how they can use technology to architect and leverage an infrastructure that allows them to be agile, secure and increase speed to market, they added.

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WORKING WITH FINTECHS

Any discussion about innovation inevitably includes fintechs. One of the most significant trends in the past few years is a shift in how banks regard these companies. Initially viewed with suspicion as potential competitors and ‘lunch eaters’, fintechs are now courted by banks and have become important ecosystem components in the latter’s digital transformation. As one bank’s head of business innovation suggested: “There is often discussion about a battlefield between banks and fintechs, but I don’t recognise that. We are very aware of what fintechs are doing and we are creating new ways to collaborate with them more.”

The senior payments executive agreed, saying, “Fintechs help us in speeding up what we haven’t been able to do by being more agile.”

However, the conservative and stringent approach banks take towards supplier qualification and compliance can hamper collaboration with smaller companies. There is also much variation at the financial regulator level, from country to country. Some regulators applaud collaboration with small fintech start-ups, while others see it as a risk.

On the business side banks are not yet fearful about fintech disruption in the industry, said a VMware executive. “Most bankers don’t believe that there is yet the equivalent of a Netflix in the banking industry. They keep an eye on the fintechs, but to date their impact is small.”

To work more easily with fintechs could require a radical solution, the senior payments executive believes. “Because often problems arise from compliance, we should just split off the regulated part of the business from the distribution part – which is more lightly regulated – and innovate in white-label product factories that are fully compliant.”

Technology change doesn’t happen overnight, however. An innovation leader from a global bank said, “There’s a lot of buzz around artificial intelligence; maybe it’s the blockchain of 2017. It’s important, but it has been around for a while and it will be there in the future. It won’t be an overnight revolution.”

MOVING TO THE CLOUD

Cloud technology has become an accepted approach for most banks, although there is realisation that not all workloads can be placed

in the cloud, or that some must be placed in a heavily regulated, private cloud environment. Some of the regulatory barriers about what data could be put in the cloud have been removed; however, most roundtable participants acknowledged that the accountability for the data will always remain with the bank, rather than the cloud operator.

Issues with regulators remain, one participant pointed out. “Cloud is in a phase where we know what we want to do and what data we want to put in the cloud, but we are fighting with the regulators and our internal IT security teams to get a straight answer.”

A payments expert from a global bank also highlighted the challenges of working with regulators. “In Europe, we are used to asking whether we have permission to do certain things, which is a problem. We’re doing a big initiative that takes a long time to explain to regulators; it is about unlocking the growth in the EU and managing the cost. I’ve been preaching to everyone about the way organised crime is using the cloud to hurt you much faster than you can respond. Why don’t we use the cloud to create that business benefit?”

“In Europe, we are trying to work on the information society and digital development by using the cloud. There isn’t a high level of knowledge about this. We have to unlock it, because otherwise the market can’t move to the next level,” they added.

Another payments executive said: “The reality in financial services is that you must know where your data is. If it’s in someone else’s data centre, that’s fine, but you must know in which data centre, how many data centres there are in which countries, who can access it, etc.”

One way of solving the data issues with cloud technology could be blockchain, which can prove where data resides. While not showing the data itself, a blockchain solution could reveal aspects of the data that is being queried and banks can prove to regulators that the data hasn’t left a specific jurisdiction.

MORE THAN COST CUTTING

A move to the cloud does not necessarily mean cost reduction, said one participant. Moreover, moving data and processes to the cloud “is not a business imperative unless processes are unbelievably broken”. They believe the industry

does not yet have an essential question to which cloud is the answer. “Cloud is definitely a good answer to sustainability, but there are few organisations that have made a genuine business decision. Moving to the cloud is cheaper, yes, but it’s a business model decision.”

How banks move to digital platforms is a thorny issue. Replacing core banking systems can be a 20-year project. As one speaker pointed up, there are risks in retaining legacy core banking systems but also risks in replacing them. Another countered that replacement systems will themselves be outdated in 15 or 20 years. Given the rapid advances in technology, there’s a very real possibility that core banking will move into the ‘as-a-service’ realm.

In the past, IT executives viewed these big replacement projects as something that wouldn’t happen on their watch. However, billions of dollars are spent across the industry just maintaining core systems, which compromises their ability to devote budget to innovation. This cannot continue if banks want to stay relevant to their customers in the future.

It is clear to see that banks are rising to the challenge and truly grappling with their future strategy in the face of new technologies, such as cloud, artificial intelligence and blockchain, which are increasingly impacting the financial services industry and throwing up new business models that threaten the old way of working. But as The Banker roundtable illustrated, changing the internal culture of an organisation and building a new partner ecosystem with fintechs will be as important in their success as the technology itself.

ABOUT VMWARE

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