The state of smarter banking

Smarter Industries Symposium, Barcelona, November 2010

The possibility of smarter industries

Two years ago, IBM first introduced the concept of a Smarter Planet, a world in which collaboration, systems thinking and data analytics improve the efficiency and effectiveness of the many systems that facilitate life on earth. It was a bold idea, but one that resonated within the business and government communities because it is rooted in a deep understanding of what's possible with today's technologies and capabilities. For this reason, our clients and business partners immediately embraced and echoed the concept.

Two years later, IBM has collaborated with more than 600 different organizations worldwide that are each doing their part in making this vision a reality. In November 2010, we brought many of these world leaders in government and business to Barcelona to share their stories of a Smarter Planet. We called the event Smarter Industries Symposium because while the notion of a Smarter Planet may be global in scope, the work of building it happens industry by industry, company by company, government by government, and process by process.

Representatives from ten different industries attended the event, including banking, communications, energy and utilities, healthcare, government, insurance, oil and gas, retail, transportation and electronics. And though each of these industries faces unique circumstances in today's economic environment, the most advanced organizations in each field share a common outlook. They are the organizations that have stopped seeing change as a threat and started seeing it as an opportunity. They have changed the conversation from one about problems to one about possibilities.

IBM Smarter Industries Symposium

Smarter Industries. Smarter Business.

"We are climbing out of a global downturn in an environment of accelerating complexity and uncertainty, with an explosion of data all around us," said Frank Kern, Senior Vice President and Managing Partner at IBM Global Business Services. "Yet the question on the mind of global business leaders is shifting from 'What's my biggest problem?' to 'What's my greatest opportunity? What are my prospects? What's available to my enterprise now that wasn't before?'"

Analytics, ROI and the customer

During the course of the Symposium, attendees saw many examples of how organizations are answering those questions with action. In particular, they saw the power of data and analytics in making smarter industries a reality. "Analytics: The New Path to Value," a study jointly conducted by IBM and the *MIT Sloan Management Review*, found organizations that utilize analytics outperform those that are just beginning to adopt analytics by a factor of three.[1] They use them to understand historical trends, to model current conditions and to predict the return on investment of different courses of action.

And though the approaches to analytics vary, every organization shared a remarkably consistent design point: the customer. From Fundacio TicSalut, an institution of the regional healthcare administrator in Spain that has built a shared electronic medical records system to improve health services for its citizens, to Best Buy, the electronics retailer that is listening to its customers across multiple channels and engaging them over social networks, smarter industries are being built around serving the needs of the customer.

"Our customers are asking us to know them, empower them, offer them and support them," said John Thompson, Senior Vice President and General Manager at BestBuy.com. "We're inclined to listen to them."

A path to possibilities

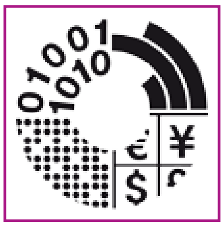
Having the design point of the customer is important because without it, all the innovation in the world has no purpose. John Kao, Chairman of the World Economic Forum's Global Advisory Council on Innovation, explained it to symposium attendees like this: "Creativity and innovation are not the same thing. Creativity is the ability to generate new ideas. But innovation requires a goal to move forward."

Kao advocates having a plan, or a system, when pursuing any innovation. And smarter industries are no different – which is why IBM has produced more than 30 industry-specific progression paths that identify key transformation milestones, outline the return and benefits of each step, and simplify the journey to getting smarter. The progression paths address specific aspects of various industries, from building a collaborative care model in healthcare to meeting regulatory requirements for municipal water systems.

Not surprisingly, some consistent patterns emerge at each stage of transformation, which Ginni Rometty, Senior Vice President and Group Executive for Sales, Marketing and Strategy at IBM, noted to attendees of the symposium:

1. **Instrument to manage** – The collection of data to measure, monitor and understand a system
2. **Integrate to innovate** – The analysis of that data to see patterns and identify opportunity
3. **Optimize to transform** – The action of reaching system-specific goals and redefining what's possible.

Throughout this report, you will read about what was shared at the Smarter Industries Symposium and the stories of how many organizations in your industry are applying this progression path. It's a path that is helping improve the efficiency and operations of hundreds of IBM clients and business partners around the world. It is a path to possibility. And it's a path to a Smarter Planet, one industry at a time.



The state of smarter banking: From challenges to opportunities

As banks and capital market firms emerge from the shellshock of the financial crisis, they face a host of challenges. Among these are meeting stricter regulatory requirements, increasing capital reserves, growing revenue in recession-wrecked economies of mature markets, competing and partnering with non-traditional players, rebuilding trust across the global financial system, and competing to attract and retain increasingly demanding customers.

And yet a host of factors indicate that the financial services industry is on the cusp of significant growth: global assets are set to quadruple by 2025, global GDP is expected to grow at 5.8 percent and 2.5 billion unbanked or underbanked people worldwide constitute a large untapped customer pool.[1] As such, attendees of the Smarter Banking track at the Smarter Industries Symposium were not shy in discussing the best ways to both meet the challenges and capitalize on the opportunities. In particular, there was wide agreement that three critical actions were keys to success:

1. Balancing risk management with innovation
2. Refocusing strategy around customers and
3. Simplifying the business to achieve efficiency and agility.

Balancing risk management with innovation

Symposium attendees recognized that the financial crisis demonstrated the need for both integrating risk management and further regulatory overhauls. Discussions covered the unstable environment banks face as governments tighten regulations and oversight. Clearly banks need to continue their focus on the innovation required to compete and grow while coping with the instability engendered by reform: “There is no way to regulate without creating some instability in the market; it is inevitable. But the instability also creates opportunities to change and to grow,” said Joe Cassidy, Managing Director, Global Head of Rates Prime Brokerage and Clearing of Deutsche Bank.

There is a model for further enhancements to regulation: “The pharmaceutical industry spends a long time perfecting a new drug before it is allowed to be used by humans,” one of the panelists observed. “But banking products are unleashed untested, and yet they are so important to the stability of the general economy. Financial regulators will need to perform more like the FDA in this regard.”

Innovations addressing risk are being incubated across the financial ecosystem. Two examples were discussed during the symposium, both involving data sharing among institutions – one market driven and the other driven by regulatory action. Operational Risk Data Exchange (ORX) is a voluntary consortium that lets firms anonymously share loss data to gain deeper insight into operational risks in the industry.[2] Members provide data in a standard format for improved risk modeling, as well as for collaborating on specific risk scenarios. The motivation for sharing is improved risk management, benchmarking against industry norms and meeting regulatory mandates. "New data is very helpful. No one firm has enough data to develop the rich insights we now have. We cannot get it from any other source, and it helped us understand our operational risks and the risks of the industry much better," asserted a bank executive.

The other example is data sharing through government mandate. The Office of Financial Research (OFR) within the U.S. Treasury is being established to measure systemic risk. The agency will collect data from market participants with a focus on "systemically important" institutions.[3] The objective is to identify and measure systemic risk, especially during times of market stress, and ultimately to control it. Modeling systemic risk is complex and has been compared to predicting hurricanes. However, "Hurricanes do not respond to forecasts about them," said Professor John Liechty of Pennsylvania State University, an informal advisor to the Treasury Department. "Banks will react to the forecast. Therefore, what the OFR communicates and how it communicates are important in avoiding or reducing, not increasing, the impact of hurricanes of the financial kind."

The industry is still trying to make up its mind whether OFR is friend or foe. Demanding data clearly presents a regulatory burden. But it could also be a friend if providing data to OFR helps the industry by encouraging adoption of standard data formats that would facilitate a better view of risk internally, increase the agility and speed of sharing and collaborating with partners, as well as offering the industry an opportunity for significant cost savings through greater efficiency.

Refocusing strategy around customers

The easy money banks made by trading their own capital is less attractive, or simply no longer available or allowed under new regulations such as the Volker Rule. Banks are taking a back-to-basics approach that requires a keen focus on winning and retaining clients to increase revenue. Until recently, banks did not pay sufficient attention to developing existing customers. However, the recognition is dawning that they have lagged other industries – especially retail – in use of customer data to improve customer service and increase revenue through cross-selling. "We need to use scarce financial resources better – and now we have to use our intellectual capital and infrastructure to win and sustain client relationships," said Joe Cassidy of Deutsche Bank.

To complicate the task, customers are increasingly more knowledgeable: "It is a dialog with an equal. We need to train our staff to deal with them in the right way with the right tone of voice," said Philippe Wallez, General Manager Marketing of ING Bank, Belgium. "Customers are impatient – we need to be right the first time as we may not get a second chance. Technology and tooling can help, but the industry really needs to shift the paradigm and align ourselves to understand customers from their perspective."

There was an almost universal agreement that banks need to do a better job of aggressively reaching out to the younger generation, as this constitutes the base for future customers and employees. “We need to reach out to young people, research their needs and then co-create products with these new customers,” said Gerard van der Heiden of Rabobank. Participants also noted that this will require banks becoming adept at leveraging social media as a means to stay in touch with how this new generation of customers thinks.

Symposium attendees agreed that the more banks know about their customers, the better they are able to serve them and create meaningful customer experiences. Innovations in analyzing customer data will be key. Alberto Guidotti, Director of Research and Development ICT at Intesa Sao Paolo, asserted, “To be effective in cross selling and for improved customer service, we need to use realtime data and analytics.”

However, participants in this discussion also noted a major challenge: incomplete customer data. And they fretted that managing customer relationships with incomplete data can negatively impact the customer’s perceptions and widen the trust gap between the customer and the bank. Thus, banks will focus to ensure they have a single corporate view of customer data that can be accessed in real time at every access point by bank employees or even self-consumed by customers. Together with analytics, this view of customer data will be the base to excel in offering a positive customer experience and regaining customer trust

Simplifying the business to achieve efficiency and agility

Symposium attendees understand that the playing field is changing, and they need to change too. “It is important to invest in new business models, in innovation,” said Alberto Balestreri, a consultant to Italian banks. “The banking industry is in a different competitive world today, requiring new ways, new innovations, compliance and customer centricity. Banking will never be the same.”

Still, understanding the need for change and actually acting on it are two different things. But banks big and small are adapting and finding success. For example, small rural banks with fewer customers and branches are succeeding by tightening their personal relationships with customers. Conversely, ING’s business model is built around mass customization and online banking with far fewer branches than traditional banks models.[4] In general, big firms are expected to get bigger and others will specialize.

“We seem to be moving toward an era of specialization – where we will have fewer major institutions and many specialists,” said Christophe Roupie, Global Head of Trading and Securities Financing, AXA Investment Managers. “However, it is hard for giants to be agile, but it can be done by bringing more flexibility and operational efficiencies into the model.”

Two innovative changes were also discussed at the symposium:

Gaining efficiency through collaboration

Changing the business model may include some innovative approaches such as sharing resources and monetizing unused assets. Several bankers made the point that compliance is an increasing cost burden without an associated revenue opportunity. Banks could explore combining resources for regulatory compliance. Gary Greenwald, Chief Innovations Officer, Global Transactions Services of Citigroup mused, "Can we do KYC/AML compliance once across all institutions?"

Back office transaction processing is another area that can be examined for resource sharing. "The four major banks in Australia are contemplating or undertaking major systems replacement programs, probably costing in excess of $4B AUD. Given much of this spend will fund the creation of identical banking product and delivery systems, we should consider cooperating via a utility model. Historically, this model operated in New Zealand, and it can be argued that the efficiency of the NZ Banking System has not been enhanced by the incumbent banks attempting to compete on the basis of technology spending," observed Peter Yarrington, Chief Information Officer, Bank of New Zealand. It's not a model without precedent: cooperative processing centers already exist in some regions, including Rural Servicios Informaticos (RSI) which is the outsourced core processing provider for more than 70 rural savings banks in Spain.[oh]

Another cooperative opportunity is sharing data. The industry needs to share both "positive" and "negative" data; but in both cases, participants get a reciprocal benefit by participating in the creation of industry benchmarks and also gain in-house benefits from these improvements, amounting to significant savings. The earlier example of ORX is sharing "negative" data, although there are possibilities to monetize it through development of an insurance market against operational risk. An example of sharing "positive data" is FIS: by pooling account opening data across most of its 14,000 clients, it is able to predict bust-out fraud.

"Sharing good data is harder for large banks, but the smaller banks can get value from shared models and are more likely to look for anonymized shared services," according to Michel Jacobs, Executive Vice President for new solutions Development at FIS.

Expanding into related services

As banks gain the trust of customers and social institutions, there will be opportunities to offer non-banking services. For example, in Lithuania, banks offer tax payer identification services for the government and are looking into expanding other eGovernment services, according to Valdas Monkus, CIO of AB Bank Snoras, Lithuania.

Mobile Payments is an emerging area that banks are eyeing. “Mobile is not ‘just another channel’ but rather has the potential to reinvent banking,” according to Gary Greenwald, Chief Innovations Officer, Global Transactions Services of Citigroup. Many participants were excited about the possibility of using mobile devices beyond the digital wallet paradigm and more as a channel for saving (such as Kenya’s mPesa program), location-based services and reaching the unbanked population through microfinance and microinsurance.[6] Solutions will require the cooperation of telecom companies and banks and, given the size of the opportunity, they will find a way to make it work.

“In most countries, more than 60 percent of all retail payments are cash and checks, which do not generate any revenue and, in fact, cost money to banks. Converting these into digital payments presents a tremendous revenue opportunity – mobile is clearly making new markets; it’s not a zero sum game,” said Mung Ki Woo, Vice President, Electronic Payments and Transactions of France Telecom - Orange Group.

In summary, the banking industry has a good measure of the opportunities and challenges facing it. Despite apprehension regarding regulatory instability, it is innovating on several fronts: managing risk holistically, reducing business complexity, sharing data assets across banks and achieving customer centricity via advanced analytics. Many industries were found to face similar issues and participants had begun to see the advantages of working on common solutions to similar issues.

As Frank Stockx, Managing Director, Head of Operations & Information of ING Belgium observed, “The challenges we have in banking are exactly the same as those in retail. We both have logistics, supply chains and physical as well as digital stores. Many problems are cross-industry in nature, and it is possible to get leverage by working on common solutions.”

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