



# Banking redefined

*Disruption, transformation and the next-generation bank*

## Executive Report

Banking

### How IBM can help

To succeed in today's environment, businesses need to lead through increased complexity and volatility, drive operational excellence and enable collaboration across enterprise functions, develop higher quality leadership and talent, manage amidst constant change and unlock new possibilities grounded in data.

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## *Banking at the brink*

*Disruptive forces that have swept across other industries are now squarely centered on banking. Born-in-the-cloud startups and retailers with lower marginal costs and greater agility are competing in payments and core banking. And a new generation of financial technology companies are aiming to decompose the financial services value chain—selecting high-volume activities like small business and consumer lending, threatening to reduce the incumbents to settlement agents of last resort. Traditional banks, often burdened with inflexible and costly legacy systems, struggle to redefine new operating and business models to meet what may become existential challenges ahead. With insights from 1,060 banking executives and 1,600 retail banking and wealth management customers, this executive report identifies key business imperatives and tangible actions that can position traditional banks at the center of a rapidly evolving financial services ecosystem, accelerate transformation and help bankers map a path to sustainable success and profitability.*

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## **Executive summary**

For generations, banking was nearly impenetrable to outside agencies. Value was generated by providing customers with core banking services. As critical intermediaries, bankers were able to sustain healthy margins.

But a triple set of challenges have emerged, requiring bankers to rethink how they do business: many banks are struggling with sluggish profits; new classes of customers are easily dissatisfied and disillusioned; possessing ever-growing expectations of engagement and experience; and a new breed of competitor is emerging for banking customers.

Traditional banking functions are being contested and becoming commoditized. As a consequence, value is shifting from functional capabilities to relationships. While emerging competitors may be able to replicate banking functions better and at lower cost, they will find it much more difficult to build and manage the breadth and depth of customer relationships traditional banks have carefully built over decades.

Because of these relationships, traditional bankers, far from being disintermediated, have the ability to shift their focus from service fulfillment to service facilitation and orchestration. Banks can position themselves as the principal gatekeeper to their customers, creating an ever-evolving ecosystem of services and experiences.

To achieve this, traditional banks will need to rapidly transform. They will need to connect with an ever-expanding portfolio of business partners. And they will need to engage customers in new, powerful and enduring ways. The rewards will be significant for those banks that can rise to these new challenges. For those that fail to do so, the future may be less bright.

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Only

30%

of customers believe their banks provide personalization, compared with 45 percent of bankers

Only

16%

of customers believe wealth managers provide an excellent customer experience, compared with 57 percent of wealth managers

Only

21%

of global banking executives believe their organizations possess above-average agility compared to their peers

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## Industry in flux

Banks have struggled financially since the global economic crisis. For many banks, profits have been stagnating.<sup>1</sup>

At the same time, bankers surveyed seem overly confident they are meeting customers' expectations. While 62 percent of retail banking executives indicate their organizations are able to deliver an excellent customer experience, only 35 percent of retail customers share their view, a 27-percentage-point difference. For wealth management, the gap was even greater, at 41 percentage points. Fifty-seven percent of wealth-management executives believe they provide an excellent experience, while only 16 percent of wealth-management customers concur (see Figure 1).<sup>2</sup>

Banks are not challenged across every dimension. In terms of timeliness and consistency, customers are actually more satisfied than banking executives expect. But in the key areas of creating a personalized customer experience across interactions, and encouraging customer loyalty, bankers significantly overstate their effectiveness (45 percent for bankers, 30 percent for customers) and loyalty, (48 percent for bankers and 35 percent for customers).<sup>3</sup>

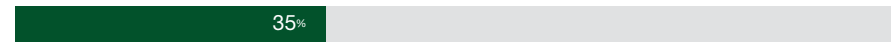
Customer trust is also overestimated by banking executives surveyed. As many as 96 percent of bankers believe their customers trust them more than other non-bank competitors. Only 70 percent of customers agree. And fewer still—67 percent of customers—trust their primary bank compared to other bank competitors.<sup>4</sup>

**Figure 1***Bankers overestimate customer satisfaction<sup>5</sup>***Retail banking**

Delivering excellent customer experience



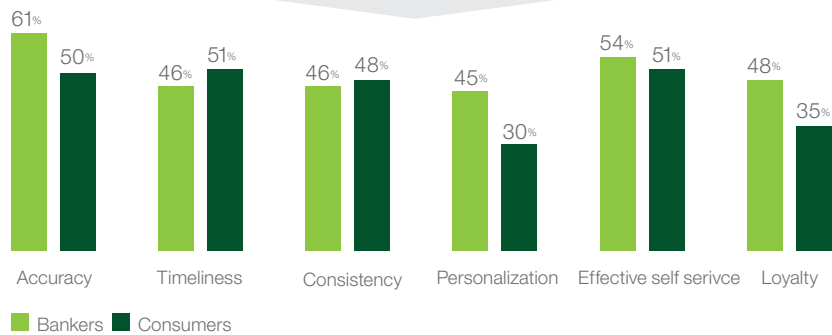
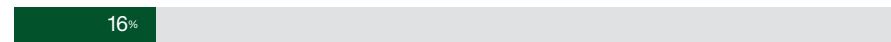
Perceive customer experience as excellent

**Wealth management**

Delivering excellent customer experience



Perceive customer experience as excellent



Source: IBM Institute for Business Value analysis based on Economist Intelligence Unit survey of 1,060 global banking executives and Ketchum survey of 1,600 retail banking customers.

At the same time, non-traditional competitors continue to enter banking, offering an ever-expanding range of products and services. Successful entrants in the payments space, such as M-Pesa and Paypal, are being joined by a cast of virtual banking providers and financial technology (fintech) businesses.<sup>6</sup> New, virtual banks, such as Simple, Fidor and Smarty Pig, offer retail customers engaging, fun, socially-enabled experiences.<sup>7</sup> Other fintechs, such as Lending Club and Currency Cloud, offer less expensive, easy-to-use lending and currency-trading capabilities.<sup>8</sup>

Benefiting from strong investment, fintechs are unbundling traditional banking value chains.<sup>9</sup> By redressing historical inefficiencies (Kabbage can approve a small business loan in minutes), or improving and expanding service quality (Wealthfront offers significantly lower investment advisory fees, and Square has extended low-interest loans to its merchant network), fintechs are progressively shutting down traditional sources of banking fees and other income.<sup>10</sup>

By so doing, fintechs and other digital-only or non-bank competitors undermine traditional banking business models, especially for those banks that are relying on infrastructure-intensive legacy systems. For example, born-in-the-cloud digital competitors are able to achieve significant benefits over incumbents – more than 40 percent increase in net profits by the successful use of digital technologies in process automation, creation of new products, improved regulatory compliance, transformed customer experiences and disruption of key components of the value chain.<sup>11</sup>

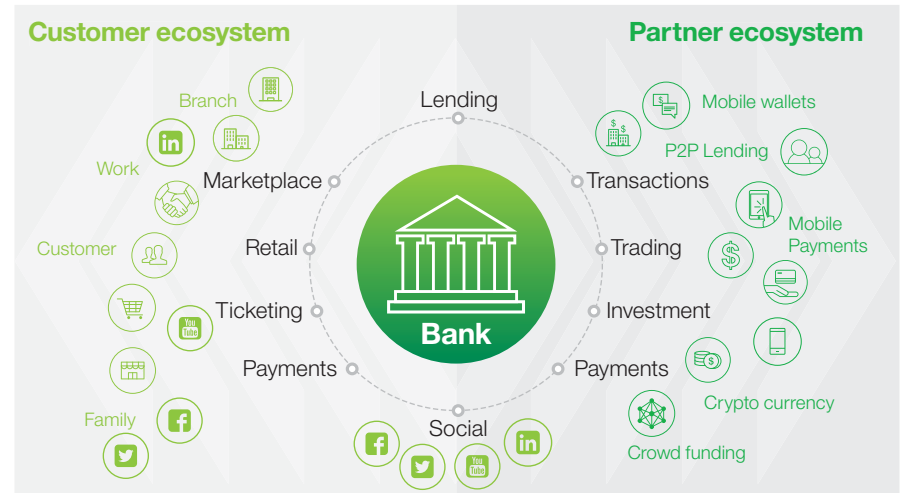
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## Antagonist or ally

Traditional bankers face a stark and, for many, existential decision. They can work to defend and protect themselves from an emerging onslaught from fintechs and others – or they can embrace them.

Banks that pursue a defensive strategy will face a perilous journey. They will need to improve their service capabilities constantly to redress fintech innovation across broad and rapidly changing dimensions. And they will need to do it at ever-lower cost and greater speed. They will need to dissuade customers from embracing new services from new entrants. For those unable to maintain customer loyalty, the implications will be dramatic. Income sources will diminish incrementally as customers shift more and more of their business to innovators. Profitability will decline, along with market share, as previously strong incumbents shrink into marginal participants or acquisition targets.

Alternatively, bankers can work to position their organizations at the center of rapidly evolving banking ecosystems. While fintechs are able to leverage new technologies to compete against banks in specific functional activities, they do not yet have the benefit of banks' customer relationships. Bankers have historically created value through the specific banking functions or services they provide. But in a future where these are readily replicable, banks' value will be centered on the quality of the customer relationships they maintain (see Figure 2).

**Figure 2***Customer and partner ecosystems are emerging*

The ecosystem around customers will be built to cater to a range of customer-needs beyond traditional banking services

The ecosystem of partners, such as fintechs, will extend bank capabilities and support operational scalability

Source: IBM Institute for Business Value analysis.



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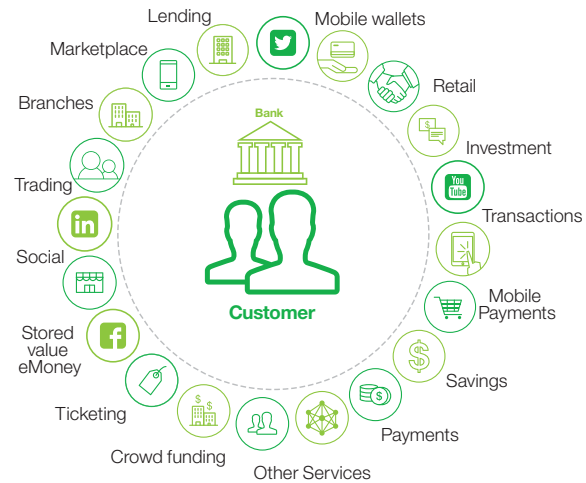
Banks have an opportunity to position themselves at the epicenter of evolving ecosystems, overseeing and orchestrating a broad range of best-in-class services for the benefit of their customers. Although technically able to engage individually with a range of service providers, customers of banks able to build powerful ecosystems are more likely to remain loyal, entrusting their banks to manage processes and relationships on their behalf. These banks will be better positioned to offer customers lower costs and a wider range of compelling services and experiences from the innovation occurring within the ecosystem, fintechs and others.<sup>12</sup>

Banking culture will also evolve and transform. As the incumbent institutions are relieved of the burden of many traditional banking functions, time and resources will be available to focus more intensively on the needs of the customer. Capitalizing on the ecosystem will demand a radically different bank culture, mandating customer centricity as the predominate force within ecosystem-centered banks (see Figure 3).

As progressively fewer services are offered directly by banks, infrastructure costs will fall. Bank business models will evolve with greater focus on pass-through commissions or mark-ups. Banking will be redefined, much as the global hotel industry has reinvented itself from property ownership to specialist services provider.<sup>13</sup> Margins are likely to increase, reversing recent trends and repositioning banking once more as a profitable, valuable, yet substantially less capital-intensive industry.

**Figure 3**

*Banks will become an integral part of customers' everyday lives*



Banks are uniquely placed to be the orchestrator of fintechs and other partners

Banks are also best positioned to continue to manage the relationship with customers

Banks can add value by orchestrating solution providers around the customer

Banks can integrate core capabilities with partner solutions and "own" customer experience

*Source: IBM Institute for Business Value analysis.*

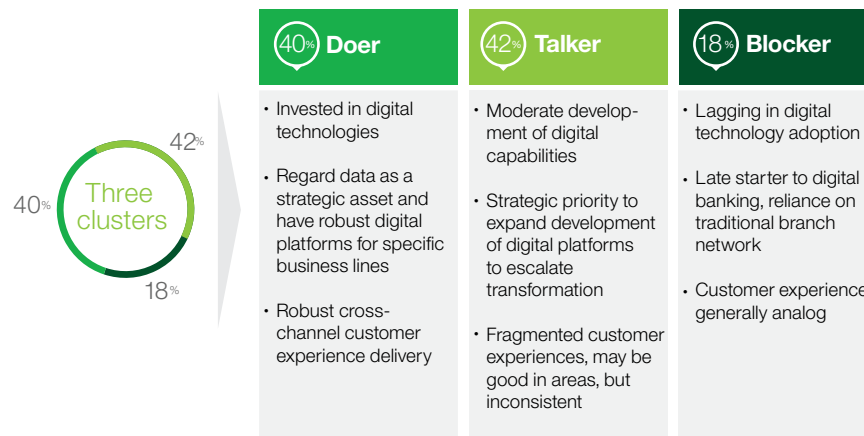
## Cluster buster

Some banks have further to travel down the transformation path to prepare for banking ecosystems. To gain insight into banks' readiness for transformation, we conducted a cluster analysis based on data from the more than 1,000 banking executives surveyed. Based on their digital capabilities, three clusters were identified (see Figure 4).<sup>14</sup>

Doer banks outperform peers in both revenue growth and operating efficiency. And they face fewer barriers to providing compelling and consistent customer experience across the board. Doers are 39 percent more likely to have customers who believe their assets and information are safe, 17 percent better in managing risk compared to non-traditional competitors and 12 percent better at managing risk effectively across all businesses and functions.

**Figure 4**

*Three groups emerge among global banking organizations – doers, talkers and blockers*



Source: IBM Institute for Business Value analysis based on 2015 IBV/EIU global banking survey.

### TD Bank embraces partnering and collaboration

TD Bank Group, one of the largest banks in North America, wanted to compete effectively by becoming a more innovative and social bank. TD Bank pursued a social transformation, making the business more open and promoting collaboration across the enterprise, and by extension to a wider partner and fintech community. TD Bank has achieved substantial success in its collaboration initiatives, with thousands of communities created, comprising well in excess of a million network connections.<sup>15</sup>

## Preparing for orchestration

By embracing five principal capabilities, traditional banks can accelerate the transformation necessary to prepare for ecosystem leadership (see Figure 5).

### Partnering and collaboration

Partnering is foundational to the evolution of banking ecosystems. Indeed, ecosystems are characterized by a set of partnering relationships. And forty-five percent of global banking executives believe that partnerships and alliances improve their banks' competitiveness. By making partnering and collaboration a core business capability across the organization, banks will prepare for a new environment that has partnering and collaboration at the center of every business activity and function.

**Figure 5**

*Five principal banking capabilities*



Source: IBM Institute for Business Value analysis based on 2015 IBV/EIU Global Banking Survey data.

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## Agility

Agility reflects a bank's ability to adapt rapidly and cost effectively to change. A defining feature of fintechs and other non-bank competition is their ability to be agile. And traditional banks will need to match this agility to collaborate effectively in emerging banking ecosystems. Survey data reveals that only 21 percent of global banking executives believe their organizations possess above-average agility compared to their peers, reflecting a gap between bank capabilities today and those required.

## Innovation

Innovation can be thought of as anything new that adds some type of value to the bank or its customers. Rather than a "nice to have," innovation has become a core business capability. And 48 percent of global banking executives say they believe that social will help accelerate innovation of products and services. Successful organizations tend to be more open and embrace more open forms of innovation, encouraging participation and co-creation from customers and partners alike. Social technologies provide a key means to promote this type of participation and engagement.<sup>17</sup>

## Analytics

Robust predictive analytics based on big data are necessary for banks to deliver such experiences, and 48 percent of global banking executives indicate investment in predictive analytics is a key priority. Cognitive computing, in particular, will enable banks to deepen and scale workforce capabilities, as well as support the creation of compelling experiences for mass markets that were once only the purview of the very rich. Through its ability to instantly process and contextualize massive amounts of data and information, cognitive will enable a profound transformation of banking processes and relationships.<sup>19</sup>

### ICICI Bank constantly innovates to improve customer experience

ICICI Bank leads innovation in product offerings by embracing new technology faster than its competition. It leveraged social media to launch bank account offerings through Facebook and created a real-time dashboard to integrate customer complaints from Twitter and Facebook directly into its customer relationship management processes. ICICI pioneered "Cardless Cash Withdrawal" service in 2014. And it continued to achieve double-digit growth despite global financial instability.<sup>16</sup>

### Tangerine Bank creates innovative customer experiences on mobile

Canadian bank Tangerine specializes in technology-enabled customer experience. With customers becoming used to almost instant gratification on mobile, Tangerine developed its own compressed DevOps approach to expedite development cycles and launch mobile innovations faster and responsively to consumer preferences. Tangerine was able to shorten development cycles from six weeks to two and reorient development provisioning from days to minutes.<sup>18</sup>

### **BBVA uses analytics to better understand customer needs**

When BBVA, a global financial group, deployed a solution in Spain to analyze social-media data, it knew the information could be useful across the company for a variety of purposes. Insights obtained are now distributed among the various business departments, enabling a holistic view across all areas of the company's business. They are used not only to better understand customer needs, but also to devise appropriate solutions and support campaigns.<sup>20</sup>

### **Nationwide continues to invest in digital banking**

Nationwide, among the largest building societies in the world, began a major IT transformation project in 2008, developing digital services to meet customer expectations and equipping itself to survive in a rapidly evolving digital society. Nationwide now has over 2 million active users of its digital services, with over half of daily logins executed via the Nationwide mobile banking app.<sup>21</sup>

## **Digitization**

Digitization is an essential precondition for the next-generation bank. And 52 percent of global banking executives say that investment in mobile technologies is a key priority. Manual processes will be a thing of the past. Successful banks will not only become digitally integrated, but also open to flexibly connect and interact with partner organizations across ecosystems.

Redefining traditional banking organizations will be essential to bring about enterprise-wide digitization. End-to-end re-engineering of the key business processes, as well as of systems of insight and record in order to support implementation of a holistic digital strategy, will be required to enable successful banks to compete with born-in-the cloud digital companies. Regular, consistent and proactive assessment, monitoring and reporting of digital implementation progress across the banking organization will distinguish leaders from the pack.

In addition, banks will need to enhance risk management, compliance and security capabilities. Enterprise risk management is already a key concern of banking executives, and it will only grow more important in the future.<sup>22</sup> New ways of monitoring, evaluating and remediating security threats and risk should be pursued with the assistance of best-in-class partners who will inevitably become key participants in evolving banking ecosystems.

## Implications and recommendations

Banking executives and employees alike will need to recognize that transformation will be a permanent condition. There is no end state. The bar will always be rising, goal posts shifting, innovation deepening and partnerships evolving. Change will be the only constant, and those that cannot adapt quickly enough will face marginalization and decline. To embrace change, bankers focus on four key areas of their organization.

### Strategy – Catching the wave

Strategy will need to recognize the permanence of change. Traditional banks will refocus on their customer relationships. These relationships will become banks' single-most-important asset, and they will need to be more intimate, nurtured and protected. Banks will need to prepare to cede many traditional core functions to partner organizations, while maintaining clear values and brand, and promoting organizational stability and security.

### People – Reskilling for success

Banks will need to act decisively to future-proof their employees. In an age of ecosystems, banks will be less about transactions processing and more about relationship management and engagement – with customers, partners and stakeholders alike. Different capabilities will be required – collaboration, innovation and entrepreneurialism, among others. Reskilling will be necessary, as will selective recruitment of a new, different breed of banker.

### Process, organization and culture – Open for business

Banks will need to change their internal culture so that they can embrace far-reaching implications of becoming central to emerging ecosystems. As an ecosystem orchestrator, banks will collaborate seamlessly with partner organizations, customers and others. Security, compliance and control will need to be balanced against an imperative of experimentation and collaboration with an ever-changing array of prospective collaborators. Organizational structures will become porous, and banks will build cultures of common understanding to encourage desirable behavior on the part of both bank employees and partner organizations.

**Figure 6**

*Four key areas of change*



*Source: IBM Institute for Business Value analysis.*

**Technology – Best-in-class**

Application programming interfaces (APIs), connectivity and coordination characterize banking ecosystems. Bank technology will become the model for extreme agility of an otherwise highly regulated industry. Initial investments to transform and re-architect proprietary systems will morph into a substantially lower capital environment in which the bank IT function will interact deeply with partners as it manages extended, diverse networks.

**Conclusion**

Banking is, indeed, at a critical moment. Traditional conceptions of what a bank does and how it does it will change fundamentally and permanently. The most successful banks of tomorrow will orchestrate broad portfolios of partners to deliver compelling banking experiences and services to their customers. Innovations from one organization will be shared across ecosystems quickly and efficiently in a virtuous cycle in which everyone is better off: bankers, partners, customers and other stakeholders. Leaders of the future are already transforming today, equipping their organizations and people with new skills, cultures, technology and processes. These leaders, rather than being oblivious or afraid of disruption, are positioning themselves at the epicenter of what promises to be the most dramatic evolution in banking the world has ever seen.



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## Key questions

- In what ways will your bank disrupt or be disrupted?
- How will you deliver adaptive personalized experiences for your customers and stakeholders?
- How will you pursue agility to accelerate your transformation?
- How does your bank plan to optimize decisions with insights from across the bank and ecosystem?
- What steps are you taking to reinvent processes to engage and participate in emerging banking ecosystems?

**Methodology**

Our banking executive and banking customer surveys were conducted in 2015. Our banking executive survey of 1,060 retail banking, commercial banking, wholesale banking, investment banking, private banking and wealth management executives was conducted in 38 countries by the Economist Intelligence Unit. Our survey of 1,600 banking customers was conducted in the United States, Germany, United Kingdom, Singapore and China by Ketchum.

**About the authors**

Jim Brill is Director, Global Industry Marketing and Communications for IBM. He is currently responsible for marketing and field enablement, targeting the financial services sector. Jim joined IBM in 1999 to startup the New York Center for e-business Innovation, which has evolved into IBMiX, the largest digital agency in the world. He has more than 20 years' experience in collaborating with some of the world's most recognizable brands in technology, media, retail and financial services. He can be reached via Twitter [@jimbrill](#) and [jim.brill@us.ibm.com](mailto:jim.brill@us.ibm.com).

Nicholas Drury is the Global Banking and Financial Markets Leader for the IBM Institute for Business Value. Nick has over 20 years' practitioner experience with blue-chip names in international banking and financial markets over three continents. His recent consulting portfolio of clients include leading global banking groups and major financial services players in Asia-Pacific undergoing deep transformation journeys. Nick can be reached at [nickd@sg.ibm.com](mailto:nickd@sg.ibm.com).

Anthony Lipp is the Global Strategy Leader for Banking & Financial Markets at IBM, where he leads the development and execution of IBM's strategy for its business serving banking and financial markets clients worldwide. He has had global responsibility for IBM's business strategy consulting practice. He has more than 20 years of diverse industry and consulting experience serving top management on major strategy, organization and enterprise transformation initiatives in the banking, capital markets and insurance industries. Before IBM, he served as Consultant, Engagement Manager, Partner and Practice Leader roles with McKinsey & Co. and PwC in New York and London. Anthony can be reached at [anthony.lipp@us.ibm.com](mailto:anthony.lipp@us.ibm.com).

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Anthony Marshall is Research Director and Strategy Leader in the IBM Institute for Business Value. Previously, Anthony led numerous projects in IBM's Strategy and Innovation Financial Services Practice, focusing on business strategy and innovation. Anthony has consulted extensively with U.S. and global banks, working with numerous top-tier organizations in innovation management, digital strategy, transformation and organizational culture. He has also worked in regulation economics, privatization and M&A. Anthony has more than 20 years of consulting, research and analytical experience. He can be reached at [anthony2@us.ibm.com](mailto:anthony2@us.ibm.com).

Likhit Wagle is Partner and Global Industry Leader for Banking and Financial Markets within IBM's Global Business Services. Previously, Likhit led IBM's Banking and Financial Markets team in North East Europe and the M&A practice at PwC, having extensive corporate finance experience. Under Likhit's leadership, IBM have developed a market-leading position in solutions that support the transformation of core banking and multi-channel processes and systems. He can be reached at [Likhit.Wagle@uk.ibm.com](mailto:Likhit.Wagle@uk.ibm.com).

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### **For more information**

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### **IBM Institute for Business Value**

The IBM Institute for Business Value, part of IBM Global Business Services, develops fact-based strategic insights for senior business executives around critical public and private sector issues.

**Notes and sources**

- 1 IBM Institute for Business Value based on S&P Capital IQ, McGraw Hill Financial data of top 500 global banks ranked by total assets, 2006-2014.
- 2 IBM Institute for Business Value survey, in collaboration with Ketchum, of 1,600 banking customers.
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- 22 IBM Institute for Business Value / EIU survey of 1060 global banking executives (n= 1060). Of the 1060 senior banking executives surveyed, 52 percent of them mentioned that it is important to link risk management with sustainable and profitable revenue growth.

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Somers, NY 10589

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