LET'S SIMPLIFY BANKING

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Building Tomorrow's Enterprise

The United Kingdom's Chancellor of the Exchequer pronounced 2013 the year that banking would be reset. Change is certainly in the air for banking. To cite just one example, 90 percent of the board members of U.K. banks have been replaced since the financial crisis broke, a record among all industries. Halfway across the world, in Asia Pacific, banking customers are contemplating a similar exodus. In a recent survey, only 35 percent of customers were sure they would not leave their primary bank in the next 6 months.

This theme is playing out in virtually every banking sector around the world. As the industry changes at an unprecedented rate, it is erecting multiple challenges and battlefronts for its leaders. In our role of business transformation partner to banks, we are constantly looking to refine our understanding of:

- The larger trends impacting the banking industry today
- The various ways in which banking leaders are trying to navigate challenges and create sustainable growth
- The best IT strategy to leverage banking trends
- What we should proactively offer to our clients to enable them to meet their business goals for today and tomorrow.

Towards this, we commissioned a number of research studies, and combined that with inputs from customers, prospects, and industry participants to identify the following key trends:

Demanding customer

Today, banks are dealing with the most informed, connected and sophisticated customer in history. One who demands convenience, speed and personalization – besides accessibility on a device and channel of his choosing. This customer expects a banking transaction to recognize the context in which it occurs, and progress in a way so as to maximize relevance. And the customer is highly articulate in social and other media.

Today's customer benchmarks every banking experience against those offered by industries like retailing, demanding value and real-time service from every interaction. This is no idle expectation; a study on global retail banking indicates that positive customer experience is strongly correlated to customer trust and retention. It is telling that despite registering a marginal improvement in the quality of customer experience in 2013, banks have not managed to impress – in the abovementioned survey, more than 50% of respondents indicated an inclination to switch banks within 6 months.

Regulatory demands

Although no stranger to regulation, the banking sector is facing an unprecedented regulatory onslaught in the wake of the financial crisis. Banks are juggling multiple regulations of varying applicability and evolution, such as Basel III, which pertains to banks around the world and will culminate in a few years; MiFiD, which has regulated investment services in the European Economic Area since 2007; Volcker Rule, a U.S. regulatory work in progress; and various laws at local level.

The provisioning of larger capital and liquidity is placing great strain on banks' balance sheets, coming as it does on top of shrinking fee incomes and cost inflating consumer protection regulations. A global consulting firm makes an estimate that Europe's largest banks would have earned a mere 6 percent return on equity in 2010, instead of the actual 10 percent, had all the regulations in the pipeline been applied.

Apart from complying with increasingly intensive and interfering regulation, banks must also provide more information, faster. With the risk of overregulation looming, banks are finding it difficult to interpret some of the new, ambiguous laws as well as manage the impact of compliance on the business. Needless to say, the cost and time to compliance is a source of grave concern.

Today's banking

Business drivers & strategic requirements

Key considerations	Strategic initiatives	Operations & IT asks
Macroeconomic uncertainty	Reconfigure Business Model	Enable Business and Operational Agility
Regulatory demands	Enhance ROE-mitigate impact of increased capital & liquidity requirements Compliance & Risk Management	Operational Efficiency; Enable Right Sell, Reduce Cost, Time to Compliance
Competitive Threats	Build capability for Innovation	Accelerate Innovation Execution
Demanding Customer	Focus on Customer Centricity and Customer Experience	Enhance customer experience and engagement across channels
Technology Evolution	Leverage emerging technologies	Leverage technologies like SMAC

Macroeconomic uncertainty, slower growth

Few could have predicted the extent of the impact of the financial crisis, and the protracted period of recovery. That the troubles are far from over is evident in the United States' continuing battle with unemployment and other travails and in Europe's teetering economies. Now, the emerging markets too have started to slow down. In July 2013, The Economist reported that the IMF expected China to grow just 7.8 percent in 2013, vis-à -vis 14.2 percent in 2007; India, Russia and Brazil will likewise grow slowly at the rate of 5.6 percent, 2.5 percent and 2.5 percent respectively.

For an industry whose growth mirrors that of the macro economy, the slowdown is devastating. Profitability, at about 8 percent remains significantly below the pre-crisis levels of 14-15 percent. Revenue is growing feeble in most developed economies and declining at many Western European banks. The cost to income ratio stands stubbornly at nearly 60 percent.

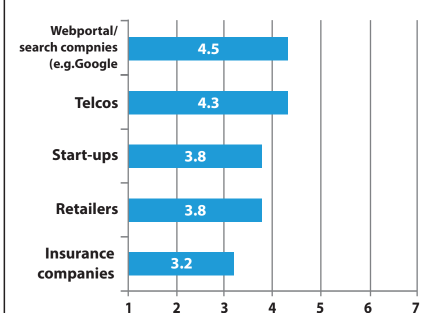
Worse, the challenging macroeconomic factors are negating banks' initiatives and obscuring the visibility they need to place proactive bets.

Changing competitive landscape

Today's banking landscape has not only grown fiercely competitive, but also developed facets that never existed earlier. One of these is the entry of non-banking players, especially from the retail or telecom space, riding on nimble, cost efficient business models. The EFMA Infosys survey sheds some light on this issue – even today, banks perceive the threat from outside players like Internet firms or telecom companies to be only moderate. Granted that many of these players – such as M-Pesa, PayPal, Google Wallet and Square – largely operate within niches today. But they do have the potential to disrupt the market completely in the future, and therefore cannot be taken lightly. However, research indicates that traditional banks may not be fully ready to compete in the changing circumstances.

Perceived Threats to the Banking Industry

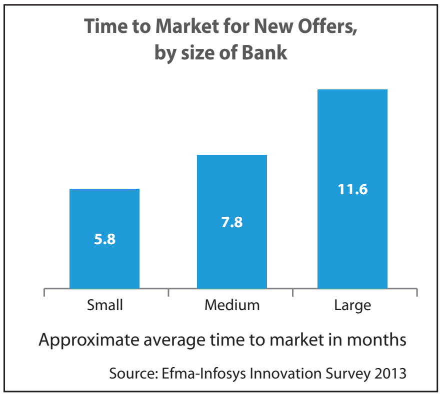
On a scale of 1 to 7, where 1 is low and 7 is high



Source: Efma-Infosys Innovation Survey 2013

Time to market for new products is a pain point for over 80 percent of the banks today. The "Innovation in Retail Banking 2013" study presented jointly by EFMA and Infosys, reveals that small banks are much faster at taking new offers to market, needing 5.8 months on average, exactly half the time taken by big banks.

Essentially, what these findings are saying is that banks need to become more agile, more innovative and more flexible very quickly in order to defend against new competition.



Rapid technology evolution

We are living in times when technology is progressing at an unprecedented pace. Innovative technologies – such as mobility, social media, analytics, cloud and digital commerce – disrupt the way consumers interact with banks and the way businesses are run.

This evolution will continue to change forever the way we bank. Just look at mobility, for instance.

- By 2017 an estimated 1 billion people will use mobile banking. It has already become a way of life for many of us – 1 in 3 persons in the U.K. & U.S. already banks using the mobile.
- Mobile payments are expected to cross USD 1 trillion by 2015.

Today, Facebook has more than 1 billion monthly active users, who have grown at the rate of 40 percent over the past 2 years. With customers making their way into social media and demanding that services be provided out there, banks are finding ways to fulfill those requirements. DenizBank – the winner of the BAI-Finacle Global banking innovation award last year – is a great example.

DenizBank, headquartered in Istanbul, Turkey, introduced the 'Globally First Ever' Banking Platform on Facebook. The platform provides Turkey's Facebook users (nearly half of the country's 74 million population) with full online banking functionality.

Banks that effectively use new technologies to better understand and serve their customers will emerge as leaders in the industry and continue to gain a competitive advantage. These technologies will also disrupt traditional business models and lower the entry barriers for new competition.

Strategic initiatives

To counter these challenges, Banking business leaders are working relentlessly to create sustainable business growth in these challenging times. Most of the banks are seeking to –

- Reconfiguring the existing business model to adapt to the new normal and leverage emerging opportunities is a top priority. However, banks need to make their business operations and technology more agile before they can be in a position to make swift adjustments.
- There is focus on maximizing revenue and reducing operating costs to enhance return on equity.
- Leaders are also intent on building superior capacity for innovation & developing value based partnerships with other ecosystem players. Accordingly, they are increasing investments – 77% of banks in the EFMA Infosys study are doing this – and accelerating innovation execution, so that new offerings, both homegrown and co-built with partners, can be taken to market faster than even before. Customer centricity is top of mind, as leaders look to make business truly customer specific and create opportunities for deeper, more valuable customer engagements. Operations and technology teams have a mandate to create customer centric processes and systems, which can offer a unified view of clients across the enterprise, deliver actionable insights to win higher wallet share and enable differentiated experience across all the customer interactions.
- Banks are also cognizant of the importance of being a first mover – or at least a fast follower – in leveraging emerging technologies, such as Mobility, Social, Commerce, Cloud and Big Data towards the above goals.

However, the severe complexity of their business, operations and technology is impeding their march. The world's leading IT research and advisory company estimates that almost 84 percent of annual IT budgets are spent on simply supporting existing business operations and organic growth. This essentially leaves little for business transformation or the creation of new revenue streams. Complexity of business technology is a major cause of this imbalance.

Although one may argue that complexity is an outcome of sophistication and is desirable to differentiate products and services, it is not necessarily true. Research indicates that a significant chunk of complexity does not add value.

A study of the Global 200 companies, which includes 26 banks, reveals that a majority of global banks are close to or beyond the complexity tipping point - where complexity adds cost and destroys business value. Data shows that excess complexity is already destroying shareholder value in over 40 percent of the banks. In addition, nearly 20 percent of the world's biggest banks are close to the complexity tipping point.

Simplified banking - vital for building tomorrow's bank

A research study estimates that reducing the complexity in banking could result in a nearly 20% increase in profits. Another leading consulting company estimates that an effective simplification of IT can reduce application and infrastructure costs by up to 50 percent and total IT spend by as much as 30 percent.

Fundamentally, simplifying banking is essential for –

- Reducing costs to compete effectively
- Bringing customer centricity to the business to retain customers and acquire new business
- Becoming agile to innovate faster than peers

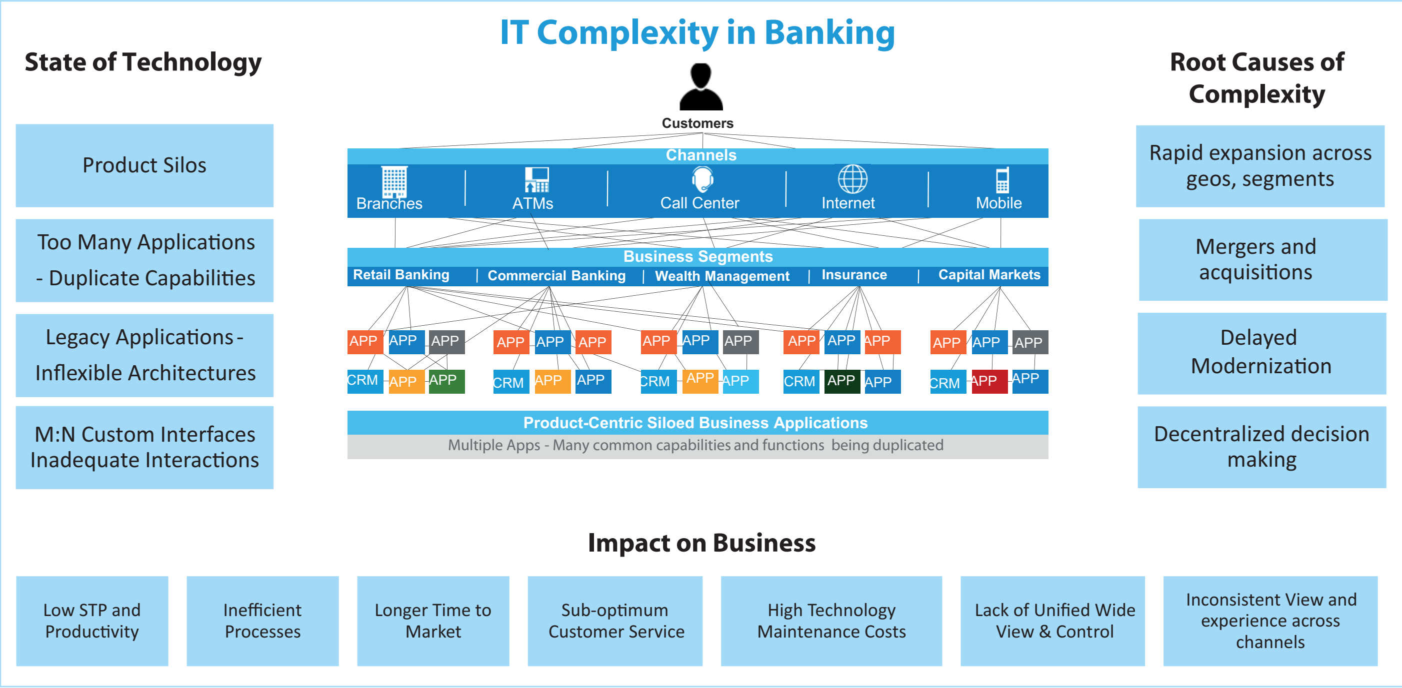
What caused this complexity?

Let's take a step back to understand how banking became so complex. In a bid to improve competitiveness, revenue and profitability, banks progressively added products and services lines, distribution channels, customer segments and geographic operations. They adopted both organic and inorganic means of growth and expansion. The growth necessitated additions of new applications, processes, channels etc. which eventually increased the complexity of operations. In case of inorganic growth, the integration of merged organizations brought in unique challenges. In many cases, banks have struggled to rationalize the products, processes and applications – leading to integrations been either inadequate or incomplete. As a result, financial institutions have started to resemble like a union of smaller incoherent businesses. This has further escalated the complexity of operations and have increased the pressure on the balance sheet.

As banking became more complex, so did the technology landscapes powering the business. In the days when banks organized their operations around products – deposits, payments, mortgages and so on – they aligned the related IT applications such that they could run the processes for each product from end to end. Although this approach was well suited to banks' product orientation, it led to the rampant duplication of applications and processes across these product lines.

The proliferation of channels brought its own complexity in the form of interfaces with product centric systems, which were necessary for delivering customer services. With customers becoming more demanding, banks could no longer work with applications built around rigid product silos. They needed operations to be flexible to create a customer-centric organization. As banks made the shift towards customer centricity, they took several tactical decisions, which added to IT complexity; delay in systems modernization didn't help either. The complexity brought on by merger and acquisition was discussed earlier; geographic expansion had a similar effect, as in the absence of IT governance and centralization, each location installed its own systems.

The problem has grown so big that technology, once considered the enabler of innovation, is today, an impediment to it. Our research in retail banking innovation shows that banks of all sizes rank IT systems among the top two barriers. Large banks are the worst hit, with their silo-based IT systems making a significant impact on time to market as well as on the cost and functionality of innovation. These banks rate the impact on time to market greater than 6, on a scale of 1 to 7. On an average, they take 12 months to launch new offers, twice the time taken by small banks.



Transforming the banking platform is a critical step in simplifying banking, but it is also a demanding task.

Despite the strong arguments in favor of banking platform transformation, many banks have held back, fearing the challenges and risks that modernization itself brings. Managing large and complex transformations, which are multi-year programs involving frequent changes, while ensuring that all business benefits are realized is indeed an uphill task. To top it all, justifying the business case for large transformations in challenging times is never easy. Unlike yesteryears, business cannot wait 3 to 5 years to reap the benefits of transformation.

This is reflected in the findings of a study on European core systems transformation that Infosys commissioned through Ovum, which say that 79% of bankers chose either implementation complexity or insufficient readiness as the key barrier to core systems replacement.

The good news is that there are ways for banks now to mitigate the complexity, challenges and risks of transformation en route to simplified banking.

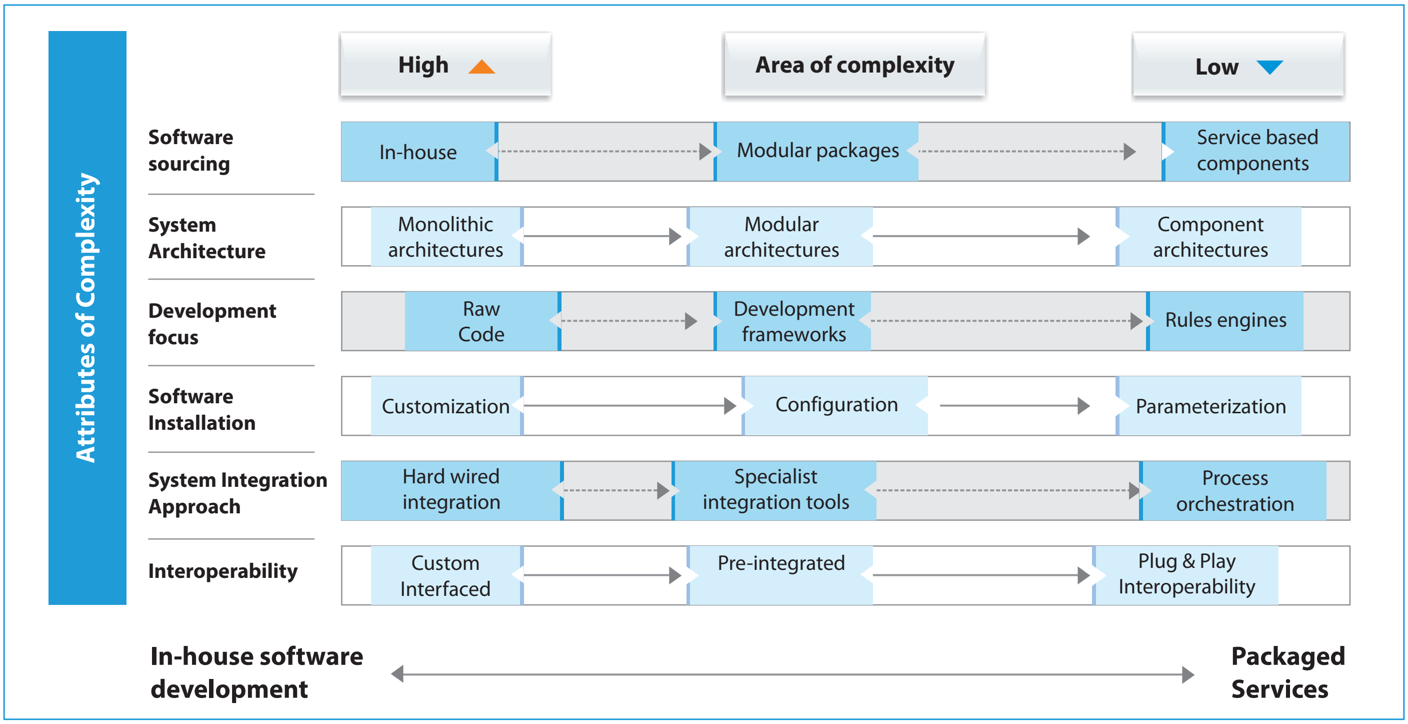
Pathway to simplified banking

It is abundantly clear that banks need to simplify their business across the board.

However, in this Point of View, we focus only on the simplification of two aspects – banking technology & operations, and banking transformation.

Simplified banking technology and operations

The evaluation and adoption of relevant architectural shifts is an important step towards defining the simplification roadmap. The below diagram shows how a shift from monolithic product-centric architecture to componentized architecture, can mitigate the factors of technology complexity.



Currently, most banks find themselves in the left half of the spectrum, trying to move towards the right. They are doing this in several ways:

- By seeking not just modular packages, but also service-based components as an alternative to homegrown software applications
- By breaking down monolithic architectures into components
- By changing the paradigm of software development from raw code to the use of development frameworks and business rule engines, thereby enabling even business users to modify rules
- By replacing hard wired system integration with point to point integration and progressing towards the usage of specialized tools and process orchestration
- By achieving application interoperability not through custom interfaces, but rather through pre-integration, and the adoption of standards facilitating plug and play

These efforts are creating future looking architectures, which are highly agile and cost efficient, and also enable systematic, standardized reuse with the help of business components.

Technology landscape assessment is the next step towards simplifying banking technology and operations. One way to do this is to assess the existing technology infrastructure and applications from the standpoint of whether they constrain or enable the bank from adapting, managing and leveraging the key trends mentioned at the outset. For instance, is the technology landscape supportive of compliance needs and a source of competitive strength? Or is it the opposite?

Banks must apply this thought process carefully to their individual circumstances, and based on what they find, decide which technologies and applications they will retain, which ones they will retire, and which ones they will integrate into the system within a certain time frame. Rationalizing the application portfolio and limiting variability in the underlying technology platforms delivers direct benefit in terms of a simpler IT landscape and lower IT costs.

Here, the case of Emirates NBD Bank is worth citing. After the merger, the Bank was saddled with superfluous processes and applications. It took the route described above to optimize its landscape.

Emirates NBD - The largest banks in UAE

- Merger between Emirates & NBD announced when Emirates was performing core transformation
- Despite of merger increasing the project size by more than a double - the program completed with only 7% schedule slippage
- Transformation Costs - Costs exceeded the initial estimate for transformation by only 18%
- Time to market for new products dropped from 3–4 months to only 7 days.
- **More than 600 businesses processes rationalized and streamlined to 325**
- Cost savings of around USD 5 Mn annually

Source: Celent Research

Sharing and standardizing technology invariably simplifies it. Banking operations usually extend to a very large number of entities, which is one of the reasons why they are so complex. The flip side is that for this very reason, banks have several opportunities to share and standardize technology, services, processes and infrastructure across the organization.

However, the starting point can differ across banks. Some banks may begin by standardizing processes and supporting applications across various business units at one location, before replicating the above in their national and international subsidiaries. Others may choose to standardize across lines of business first, and then across business units. In either case, creating centralized processing hubs for common processes is a critical and rewarding way to simplify operations.

The availability of enterprise-class banking components can simplify the bank's journey in this direction. These enterprise components boost operational efficacies by centralizing business operations across product lines. They also reduce technology management costs by replacing multiple systems, which are currently doing similar tasks. Last but not least, enterprise components offer a unified view of data and better control over operations by breaking down the silos in banking environments.

Banks, such as Rizal Commercial Banking Corporation, have improved operational efficiencies by creating a centralized hub supporting the core banking processes of their banking and thrift subsidiary's operations for multiple business lines. The results are indeed encouraging for other banks looking to leverage similar approaches.

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Rizal Commercial Banking Corporation - Philippines

Boosting profitability with technology simplification and modernization

Annual ROI	Payback Period	Average annual net benefit	Cost Reductions by 5th Year
54.4+%	**2.07 Years**	**PHP 608 million**	**PHP 2.1 billion**

Profile
- **4th largest bank in Philippines**
- **400 Branches, 3000 users; 6 Million accounts**

Results
- **Teller-based transactions costs -** 10% reduction
- **Straight-through processing - 25%** costs reduction
- **Teller productivity increase - 33%** increase
- **Internet banking transactions -** 300% increase without staff additions
- **Loan processing - 24.7%** increase volumes without staff additions

Annual ROI calculated for first 3 years. It's expected to increase significantly as the scale increases.

Source: Aite Group, RCBC Bank

Simplified banking transformation

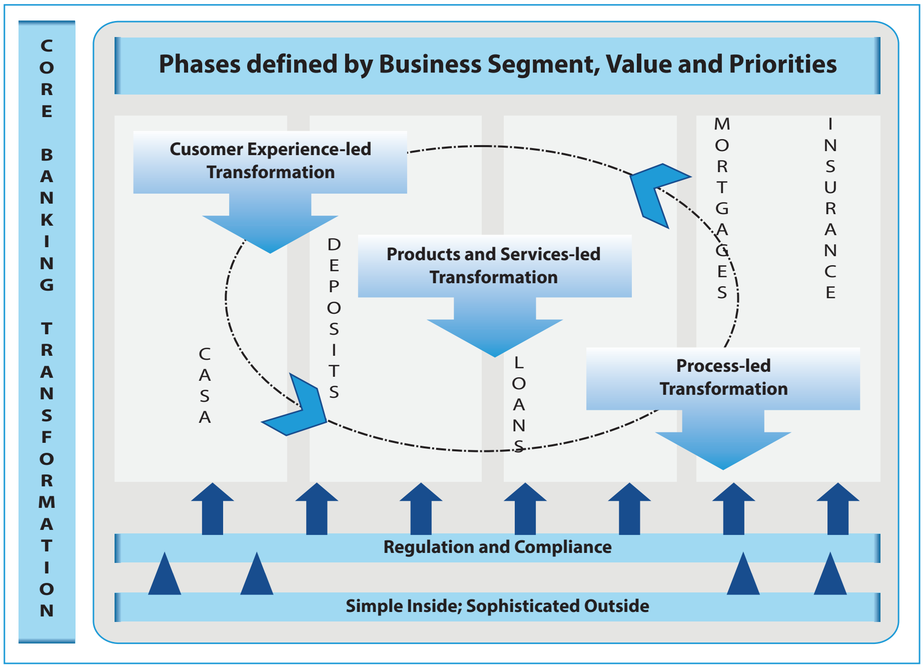
Banks have tried varied approaches to technology modernization with packaged solutions. Some have taken the traditional, 'big bang' approach, which encompasses enterprise-wide transformation with an integrated suite and is well suited for banks with relatively small and less widespread operations. The obvious advantages of cost optimization, operational ease, and uniformity of experience are offset by data migration, change management, and knowledge transfer challenges. An alternative approach is that of a phased rollout leveraging a componentized banking platform. This approach enables banks to modernize at a pace suited to their context. Further, they can sequence the deployment of components as per their needs to meet short and long term business priorities. This minimizes business continuity risk, eases transition management and simplifies the transformation journey. Importantly, with progressive transformation, banks can start realizing the business benefits of modernization faster as compared to traditional approach.

Bancolombia's modernization approach is a good example of this. The Bank chose to undertake phased transformation in its home country, but undertook big-bang integrated deployment in its international subsidiaries to bring in standardization and cost efficiencies. This balanced approach enabled the Bank to reduce transformation risks while meeting business priorities.

Irrespective of the way in which it is ushered in, transformation encompasses the following interdependent perspectives:

- Customer Experience-led Transformation – enabling banks to meet the demands of customers for personalized products and services, greater responsiveness, convenience and transparency, consistent cross-channel experience
- Process-led Transformation – empowering banks to streamline and optimize processes across channels and entities to increase agility and lower costs
- Product and Service Innovation-led Transformation – empowering banks to rapidly design and distribute custom-bundled offerings and relationship and preferential pricing, while efficiently

Simplification is a challenging, but very rewarding exercise. It increases agility, brings in cost efficiencies and makes an organization customer centric – the key requirements for building the banks of tomorrow.



But banks also have another key imperative, namely to comply with regulatory mandates. The banking platform must enable this by incorporating processes and operations that are not only duly diligent and compliant with existing law, but also with emerging regulation. Above all, it must manage the response to emerging compliance mandates with agility and minimal business disruption.

Conclusion

Transformation shakes up the organization from the core. However, the progressive path to transformation and technology modernization mitigates risk and ensures that banks enjoy modernization benefits faster. The overriding principle is to keep things simple. Since complexity comes at great cost, the goal should be to simplify technology and operations, without compromising sophistication. This is exactly what progressive, componentized modernization aims for. Even as it simplifies technology architecture on the inside, it presents itself as the next step in core banking technology evolution, to provide banks a platform to differentiate themselves in the marketplace. Simplification is a challenging, but very rewarding exercise. It increases agility, brings in cost efficiencies and makes an organization customer centric – the key requirements for building the banks of tomorrow.

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Infosys Finacle partners with banks to simplify banking and arms them with 'accelerated innovation' to build tomorrow's bank, today.

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