SUMMARY

Catalyst
With a tough market and tightening regulatory framework, the outlook for banks in terms of profit generation looks both uncertain and challenging, and executives are being forced to re-evaluate whether their organizations are prepared to meet the road ahead. Based on interviews with more than 250 banks, this paper examines the critical business imperatives for retail banks now in the post-financial crisis world, and explores the key technology enablers that executives should consider to prepare for both current and future requirements.

Ovum view
The financial crisis has resulted in a structural change in the retail banking operating environment, driving permanent shifts in regulator, customer, and shareholder expectations. This requires a comparable structural response by bank executives to adjust the operating cost base, prepare for a continually interventionist regulatory policy, and complete the evolution from product- to customer-centric organizations. For most banks this will require executives to shift to a transformative mindset across channels, IT, and operations. However, the path to transformation need not be a ‘big-bang’ one. Indeed, an evolutionary path that allows banks to focus on short-term requirements while moving towards an end-state goal will be a better approach for most.
Key messages

- Operational efficiency and agility have become top business imperatives in the aftermath of the financial crisis.
- Banks need to meet current regulatory demands, but must assume that the post-financial crisis regulatory wave will continue for a number of years.
- Future revenue growth will require higher customer satisfaction. This necessitates banks truly becoming customer- rather than product-centric.
- Banks need to re-evaluate customer relationship management from a multi-channel and customer experience perspective.
- Mobile banking has become a competitive requirement in most regions, meaning it must be viewed in a wider light than its direct revenue benefit and costs business case.
- Business intelligence and analytics needs to become embedded into processes and decision-making, in addition to reporting.
- This means that analytics needs to be provided in real-time, with mobile as well as online distribution.
- Banks should plan a path for banking platform transformation to enable the business to meet the broader structural change required in the post-financial crisis environment.

BANKS NEED TO ENACT A STRUCTURAL CHANGE TO PREPARE FOR RETAIL BANKING BUSINESS IMPERATIVES

Rather than just a temporary slump in the banking industry, the repercussions of the financial crisis are driving permanent change in the retail banking landscape. The shift in regulatory strategy and approach will be a lasting one, the loss of key pre-financial crisis revenue and profit growth drivers will be long-lived, and the bank-to-consumer relationship has seen ongoing change, affected by reputational damage and growing influence of digital social networks.

As a result, one of the industry key performance metrics, return on equity (ROE), has plummeted from an average mid-20s ratio in the pre-financial crisis world, to a single-digit one for most banks. Even when the overall market environment starts to pick up, market changes mean that most banks will struggle to hit the mid-teen levels. Successful banks are going need to move beyond a strategy premised on delivering the status quo a little bit better, and move to enact structural changes to their operational base, culture, and orientation to meet this new environment.

At a business objective level, the impact of this can been seen in Figure 1. This shows aggregated executive opinion on the relative importance of various business objectives on IT investment from...
an Ovum Business Trends study. This was a primary research conducted with senior IT executives of more than 250 banks across Asia-Pacific, Europe, and North America, carried out at the end of 2011. The top priorities identified for most banks in 2012 were increasing efficiency, achieving and maintaining regulation compliance, and increase customer satisfaction.

At a tactical level, these changes assemble around three key areas: creating an operating cost base that is both agile and scalable, effectively managing and leveraging new regulatory demands, and truly moving from product- to customer-centric organizations to drive customer satisfaction.

**The operating cost base needs to provide leverage and agility**

For most banks the financial crisis drove an immediate cost reduction drive. Concerns about short-term survival eroded pretensions around long-term investment, and banks generally embarked on significant cost abatement programs – in particular, seeking savings that could result in immediate
cost benefits. Cost reduction remains important for the banking sector but, as shown in Figure 1, this has fallen down the rankings as an executive priority, with efficiency instead now the top priority. What is the difference? Efficiency is about doing more with less, about creating operational leverage (growing operating income with a lower proportionate growth of operating costs), as well as ensuring that what is done is the optimum thing to do.

The catalyst for this is twofold. Firstly, as the banking industry has reached a level of (relative) stability, executives are again able to take a longer-term view. Secondly, from a tactical perspective most of the 'low-hanging fruit' of cost reduction has already been harvested. Further cost reduction for most banks requires a degree of investment if it is not to impact regulatory compliance or customer satisfaction.

For many banks, this has driven a focus on business process optimization. The major business processes in most banks (such as product origination or addressing customer queries) have tended to evolve relatively organically over time, resulting in diverse, fragmented and often duplicated processes across the different product sets and channels. This evolution has resulted in major inefficiencies, increasing overall operating costs through duplication and reducing the bank's ability to obtain operational leverage. It also represents a source of compliance risk, as controls have to be duplicated and managed across each process chain. Concurrently, it is also a driver behind low customer satisfaction. Running multiple and fragmented processes tends to reduce efficiency and effectiveness of front-office staff, with error rates also higher whenever information needs to be manually re-keyed. It also presents an inconsistent, and seemingly erratic, customer experience with service levels varying by channel and product chosen.

The route to optimization is focused firstly on process standardization and rationalization to consolidate the number of processes used, followed by process streamlining, to increase the efficiency, speed, and scalability of each process. However, while this is about process automation, a key requirement here is the need to ensure agility as well as efficiency. Part of the challenge with standardization is creating a process that can meet diverse needs of an organization, and business processes need to be designed, and managed, for change given the upcoming wave of regulatory and customer demands.

**Regulatory compliance will be an ongoing wave as well as a tsunami**

The financial crisis has precipitated one of the fastest and most dramatic shifts in regulatory approach witnessed in the banking industry in modern times. In particular, the crisis shattered the prevailing meme that banks were the best judges of their risk exposure providing regulatory incentives were framed properly. In many markets, this had led to a move towards "light-touch" regulation, where banks that adopted sophisticated risk management techniques were allowed to set their own capital reserve requirements. Regulators tended to concentrate on demonstrating
they had required controls, procedures, and governance in place across risk management and compliance objectives, rather than detailed examination of calculations or micro-level practices.

Since the crisis, regulators have universally switched from "light"- to "heavy-touch" regulation. Attention on ensuring controls, procedures, and governance remains high; however, regulators have become far more interventionist and directive in their demands, at both a macro and micro level with respect to banking practices and policies. This is particularly evident in the US where the Dodd-Frank Wall Street Reform and Consumer Protection Act has required regulators to introduce around 250 new rules, driving a huge range of new restrictions and additional reporting requirements across the banking sector. However, many of the requirements are being replicated to some degree by regulators worldwide, and along with Basel III which comes into effect at the end of 2012, ensuring regulatory compliance has continued to dominate the executive agenda since the financial crisis.

Looking at the operational implications of this on banks, the immediate impact has been notably felt around a greater regulatory reporting burden. Banks have seen significant changes in regulatory reporting demands, particularly around:

- **Frequency** – information demand timescales have shortened significantly, shifting from annual or quarterly reviews to far more daily, and even intra-day, reporting
- **Speed** – the freshness of data required has intensified, with a move for banks to ensure information is as current as possible
- **Breadth and depth** – the number of information areas requested has increased as has the level and comprehensiveness of data required for each area. This includes a shift in focus from transaction-related data to more event- and process-driven information (e.g. operational losses, business process, or control effectiveness)
- **Transparency** – quality, accuracy, and reliability of data is paramount and regulators are focused on how data for reports is collated, how information is analyzed, and operational controls in the reporting processes
- **Heterogeneity** – in addition to growth of standardized reporting requirements, banks need to meet a far higher number of ad-hoc requests for information.

However, while reporting requirements have intensified, the more pressing concern by regulators is that this additional management information is used by the banks to drive decision-making and ensure behavior, processes, and practices are managed accordingly. Rather than just feed into regulatory reports, business information has to be more effectively fed back into business processes, management and relevant workforce, with positive feedback loops created. Governance and policies remain critical, but the focus is on ensuring that these are working, rather than that relevant frameworks are in place.
That said, the greatest challenge is perhaps the increasing realization that this current regulatory drive is more than just an initial tsunami in response to the shock of the financial crisis. While there has been an initial tidal wave of requirements, this is not a one-off event that will then abate, but rather the start of ongoing demands that will continue for at least the next three to five years. Banks have to prepare not only for current demands, but assume that demands will evolve, intensify, and grow.

**True customer-centricity requires culture, understanding, and processes**

The drive for customer-centricity is not itself a new one in banking. For years, banks have struggled to move from the product-orientated legacy of history towards a stronger customer orientation; a growing requirement as banks moved from limited to broad financial services product providers. Indeed, most banks have at least some organization structure reflecting their primary customer groups, and mission statements and visions will often speak of serving the customer. However, almost universally, banks are tolerated rather than loved by their customers. Customer advocacy is at levels that most banks survive because others are just as bad. There are some exceptions, particularly in the lower-tier/community banking segment (for example, Umpqua Bank on the US west coast), but most banks have been unable to complete the transition to true custom-centricity, and customer service and satisfaction suffer as a result.

The challenge for most banks is that the customer does not lie at the heart of the enterprise. Despite organization restructuring, priorities and culture within the bank tend to focus on efficiency and revenue growth over customer satisfaction. Even when the front office is concentrated on the latter, back-office systems and the main supporting business processes are fragmented and non-standardized, as well as chiefly orientated around products and/or channels. This often means that the front office has an incomplete view of the customer-to-bank relationship, that it provides an inconsistent experience to the customer (often dependent on product and/or channel) and, in many cases, that it provides a poor one.

The issue is that bank-to-customer relationship is now rapidly evolving. Firstly, the growth of online, and increasingly mobile, commerce is significantly raising general customer expectations around customer service, responsiveness, accessibility, and quality. Secondly, the growth of social media is changing the relationship dynamic from predominantly a bank-to-customer one, to a bank to customer network one. Customer dissatisfaction can be communicated and spread far more pervasively and rapidly across a bank’s existing and potential customer base. The impact of poor customer service and low customer satisfaction is becoming much stronger, and banks need to complete the journey towards true customer-centricity.
This move requires a transformation of the organization across people, processes, and systems. Culturally the move to customer-centricity needs to extend across the whole bank workforce. Business processes, especially customer-facing ones, need to be streamlined, standardized and focus on service as well as efficiency. Banking platforms similarly need to enable this, supporting rather than inhibiting a full view of the customer and allowing banks to manage the customer rather than the product.

**KEY TECHNOLOGY ENABLERS FOR TRANSFORMATION**

The structural response required to tackle requirements around operational efficiency, regulatory compliance, and customer satisfaction demand change across the entire bank, impacting people, processes, and systems. However, at the technology level, industry innovation has resulted in a number of key IT enablers that can play a vital role in enabling banks to meet these challenges. These include multi-channel customer relationship management (CRM), mobile banking, enterprise-wide delivery of analytics, real-time decision support and banking platform transformation.

**Delivering consistent customer service through multi-channel CRM**

One of the prevailing challenges for banks over the last few decades has been the move from a branch-centric retail distribution model to a multi-channel one. For the most part this transition has occurred relatively slowly with the emergence of the call center in the 1990s and online channel in the 2000s. However, the number of channels is set to proliferate as mobile banking becomes mainstream (introducing a huge range of mobile devices) and social media networks start to become channels in their own right.

Banks have tended to add new channels in operational silos, often later integrating them with back-office operations and systems – and then, but to a lesser degree, with other channels. This has produced an inconsistent customer experience, and resulted in duplicated and fragmented business processes.

Rather than develop new channels in isolation, banks need to move towards adoption of a multi-channel platform, where the main customer-facing business processes, and customer information and interaction history, are architected into a channel-agnostic layer that supports all channels (existing or new). This allows processes to be standardized and a consistent feel delivered. It also facilitates introduction of new channels, as only the channel-specific services (such as presentation) need to be created.

Banks also need to take a second look at CRM. For many this concept is still somewhat sullied by initial attempts at CRM in the 2000s, where sales and marketing automation tools were often
foisted upon unwilling and untrained front-office staff, with limited attention to people or process change. Unsurprisingly this resulted in expensive IT project failures in many cases. However, CRM has evolved at both the concept and technology level, with focus now far more on customer experience management across multiple channels. Similarly, the focus is now on driving customer-centricity rather than just automating front-office processes (many which are in fact largely internally-orientated, rather than customer-orientated in reality). Of course, people and process change remains crucial to success of multi-channel CRM, but as bank-to-customer interaction moves increasingly from physical to digital channels, CRM technology will have an increasing role to play.

**Mobile banking can drive customer satisfaction and operational efficiency**

One of the key social changes over the last five years has been the rapid uptake of the smartphone, which in a short timeframe has reached significant levels of market penetration. Customer adoption is already over 50% in North America, and close to breaching this level in Europe. With the corresponding rapid growth of mobile app usage, consumer expectations around mobile-based access for business-to-consumer interactions have changed dramatically. Consumers expect 24×7 access through an intuitive, easy-to-use interface that is tailored to their mobile device and that is low cost or free. Increasingly they also expect, and are vocal in demanding, that businesses maintain pace with innovation in this space.

These consumer expectations apply for retail banking, although bank responsiveness to this has varied considerably across regions. Banks across Asia-Pacific have largely been focused on mobile banking for a numbers of years now. Particularly for developing markets, mobile penetration is often greater than online within the banking population, and mobile devices have therefore seen stronger attention as a prime customer channel. North American banks were initially slow, but have seen strong innovation over the last few years following rapid customer uptake, which has sparked a competitive race. Many South American markets have seen similar rapid uptake, particularly since 2010, with Brazilian banks starting to catch up with the strong consumer demand in this market.

In contrast, European banks have generally been much slower to focus on mobile banking, with momentum only starting to build over the last year. European banks largely have mature online banking usage, and banks have typically viewed the business case for mobile banking investment in isolation as a channel. With consumers generally reticent to pay extra for mobile access, the costs of supporting a breadth of mobile devices have made the case weak.

However, while the provision of mobile banking does require investment, it can be a driver of higher customer satisfaction, a source of customer differentiation, and improved operational
efficiency. With the broader benefits and impact considered, this invariably will mean that there is a strong business case for mobile banking. On the customer satisfaction side, high consumer demand has meant that mobile banking (even if initially basic) has been positively received. In fact, in many markets, quality and breadth of mobile banking functionality have become key criteria in banking provider selection. As such, for markets where mobile banking is immature, mobile banking provides a strong potential competitive differentiator, at least in the short term. For many markets, the significant competitive and positive brand impact has spurred swift catch-up investment. However, being the first-mover has stronger brand benefits.

While the revenue uplift from mobile banking is general rather than channel specific (it drives provider selection, but customers are reluctant to pay extra for mobile services), it can also catalyze cost benefits in other channels, in driving high levels of customer self-service and self-administration. In particular, mobile banking can reduce contact center volumes, although ideally banks should look to consider mobile banking in conjunction with this channel so that customers can move seamlessly between automated and personal bank to customer interaction through the mobile device.

More significantly, the role of mobile has moved beyond being just a new channel for banking, into one that has high potential to disrupt the electronic payments sector, with or without the banks being involved. Mobile money has gained strong traction in a number of African and Asian markets, such as Kenya and the Philippines, with the mobile also opening up new opportunities to service the unbanked population in many of these markets. Interest in mobile payments is also starting to attract serious attention in many developed markets, with an array of initiatives around person-to-person (P2P), mobile wallets, and contactless payments.

Overall, mobile banking has become the top investment priority for 2012 for the banking sector. Figure 2 shows analysis from Ovum’s Business Trends study (as also shown in Figure 1) based on a combination of two questions. The first (shown on the x-axis) asked banks to identify the location of their three top IT investment projects (based on overall size of investment). The second (shown on the y-axis) asked banks to indicate whether they were increasing, maintaining, or decreasing spend on each area shown. The bubble size shows the relative investment priority based on the sum of these two questions. While online banking is a strong secondary priority, mobile banking is a top project for nearly two thirds of banks and an area where banks are nearly universally increasing investment in 2012, even across regions such as Asia-Pacific that have already made significant investment in prior years.
Moving from reporting, to analytics and action in risk and compliance

Regulatory reporting demands have intensified significantly since the financial crisis, and banks have been forced to devote significant resources to managing the greater frequency, depth, and calculation/methodology transparency of information required. This has driven investment in creating a reporting information management layer (such as an enterprise financial/risk data warehouse) as well as reporting automation tools in an attempt to control operational cost growth around these requirements.

However, while regulators have undoubtedly required more information, one of the crucial changes since the financial crisis has been attention on ensuring this management information is fed back into the business. Rather than just create risk reports, regulators want this information to actually drive decision-making on the ground and ensure the appropriate management action is taken when deficiencies are identified. Indeed, regulators are demanding reporting around the effectiveness of controls and on ensuring there is ongoing improvement of risk and compliance.
governance and control processes. Key to this is shifting the accessibility of information and analysis created for reporting from its historic hard-copy, large-report format legacy, which was restricted to a relatively low number of users, to a more dynamic format that is available, and that can be fed into business processes, across the enterprise.

This requires a focus on the distribution side of business analytics, with a move to open up access of information housed within data warehouses and/or other information systems through use of business analytic portals. These allow users across the business to access information (subject to status and defined need to ensure data privacy and security). These should include an array of output tools, to include visualization, dashboard, drill-down and tracking/monitoring tools which allows users to obtain information across user types (e.g. from specialized analysts to general users). Ideally this should also include some ability for users to create user-defined reports, customize output to their own requirements and support ad-hoc queries that can be driven and accessed immediately by the user, rather than have to loop through specialized IT/business analyst teams to obtain. It will also be increasingly important for this information to be accessible through mobile devices (tablet or phone) in addition to traditional online channels.

**Decision-making needs to incorporate intelligence in real-time to improve performance and customer service**

Consumer expectations around responsiveness and service speed have accelerated with the advent of digital commerce. Particularly with online or mobile interactions, customers are not willing to wait significant lengths of time for information requests or confirmations on online transactions. This has transferred to some extent across all channels, with customers increasingly frustrated with long wait times with the contact center or branch, and importantly for sales-related transactions drop-off rates can be significant if applicants have to wait or return later to complete an order.

From a bank’s perspective, this need for speed is countered by the desire to move towards more intelligent decision-making. Banks are looking to make better use of information and analytics to ensure the optimum choices are made. For example, around pricing, risk profiling, fraud detection, or product approval. With this, banks are often looking to utilize a broader information set (often spanning external and internal data sources) and use more sophisticated analytics. This will typically demand a trade-off between responsiveness and decision robustness, with stronger analytics requiring more processing time and a more notable customer interaction lag.

In many cases this means that banks end up with reduced new business (due to customer drop-off or higher refusals due to use of basic, rather than sophisticated, approval) or results in banks evaluating decisions post-event, rather than during the initial interaction. For example, cross-sell promotion is most effective during initial account opening process, rather than as a separate
initiative after opening. This is also particularly relevant around fraud detection, where suspect fraud is for the most part identified after the transaction has occurred, rather than at the time the transaction takes place. Current systems may flag up the likelihood of fraud, but because of the huge pressure to process payment transactions as quickly as possible, banks are typically unable to conduct more sophisticated analysis to block fraud as it occurs (at least not without incurring a significant false positive rate).

However, this trade-off is reducing as underlying technology speeds up, allowing the amount of information and level of analytics to be increased with reduced latency impact. For areas that require real-time, or near real-time, decision support, this issue has been alleviated with development of in-memory database technology as well as data compression techniques that can significantly reduce processing latency, and allow banks to incorporate use of analytics in operational processes rather than provide post-event feedback. With the rapidly decreasing cost of memory, the application of this is extending outside high-value areas, such as trading systems that demand ultra-low latency, to wider usage across banks, such as underwriting, offer management, fraud analysis, and risk management.

**Platform transformation can drive business process streamlining**

Business process optimization has become a top strategic priority for most banks, given the need to deliver greater operational efficiency. For most banks, this involves a move to standardize, and streamline the main business processes, with customer-facing processes the starting point for most given the ability to drive both operational leverage and higher customer satisfaction in these areas.

The issue for most banks is that most significant customer-facing business processes (such as origination or customer administration) span the front and back office, and impact the middle office. Particularly for larger banks, this will invariably mean that the end-to-end business processes will pass across multiple technology applications. For example, product origination will typically touch front-office systems, business operations processing systems (such as for loan processing) and product administration systems (typically referred to as “core systems”).

This results in a number of challenges. Firstly, controlling automation flows across multiple applications is generally problematic unless the relevant applications are architectured to form part of a larger process. Secondly, many application systems used by banks, particularly with core systems, were designed many decades ago, and workflow, transactions flows and business logic within these systems are often hard-coded. This makes process modification complex, costly, and time-consuming. It also often means that processes are shaped by input and output constraints rather than meeting true business requirements.
While banks can, to a degree, still drive some business process optimization without transformation, re-engineering or replacement of the underlying systems that support the main business processes, a “banking platform” will enable far greater optimization scope. Perhaps more importantly, over the longer term, platform modernization also provides the basis for driving operational agility as well as efficiency.

RECOMMENDATIONS

Transformation needs to start now

Given the current operating environment and in response to the financial crisis, most banks have become highly risk-averse, with a focus on getting back to basics. This has translated into caution around both new business acquisition and with internal responses to improve efficiency and customer service, with most banks seeking low-risk, quick wins rather than embarking on wider programs. However, while a focus on back to basics isn't necessarily a bad strategy by itself, banks need to re-examine what the basics are and whether current systems, process, and practices really deliver what is required to drive customer service and operational efficiency excellence with these basics.

With this, banks need to move into a transformative mindset now. Banks that are able to make this post-financial crisis transition will be the winners as the operating landscape improves. Conversely, banks that fail to look beyond the short term will struggle, particularly as the financial support provided directly, or indirectly, by central banks and governments in many markets is reduced over the coming years.

For most banks, transformation needs to be evolutionary rather than "big bang"

Moving into a transformative mindset in the current environment is not an easy or obvious move. Banking platform transformation in particular is deemed costly, a major source of operational risk, and likely to be hugely disruptive to the business. In the risk-averse and highly cost-conscious post-financial crisis landscape, this remains an unattractive option.

However, given the wider need to deliver structural change to meet the equivalent degree of change in the operating environment, executives need to focus on the path to transformation to overcome the traditional barriers. For many banks, a large-scale, "big-bang" approach is going to be both unfeasible and unattractive. Rather, banks need to develop an overall business and IT enterprise architecture (i.e. spanning business processes and IT systems), and then look to modularize and phase transformation, through systems consolidation, re-engineering or replacement over time. Having a broad picture is important as it helps avoids the common
approach of replacing one siloed application with a newer version. In many cases a like-for-like upgrade will not remove many of the wider pain points around integration, duplicated functionality, and lack of business process control.

**IT-enabled change needs to be led by the business as well as IT**

The maturity of the business to IT relationship varies by institution. However, for the most part the banking sector is more mature than many. Banking products are highly transaction- and information-intensive, and hence benefit significantly from IT automation. As a result the banking industry has one of the highest "natural" IT intensities across different industries (i.e. IT spend as a proportion of operating cost base).

However, while IT spend by banks is often significant, the perceived value of IT by the business does not often match its relative input. For many banks, IT is seen as the inhibitor, rather than enabler, of change, with change demanding IT time and cost. Partly this demands stronger business and IT communication, and governance, however, business executives also need to recognize that this outcome is a result of a continuing cost control focus by the business onto IT, combined with often rapid time-to-market requirements that have forced siloed development. For many, transformation of IT will be a long-term enabler, and in fact a prerequisite, for wider business transformation.

The challenge for IT strategy is that this transformation cannot be led solely by IT. While transformation has some advantages for IT, such as improved maintenance costs, the majority of benefits from IT transformation come from the ability of business to change its practices, processes, and behaviors. IT transformation needs to be part of wider transformation strategy, and led by the business, to be successful.
APPENDIX

Methodology

The Business Trends: Retail Banking Technology study referenced in Figures 1 and 2 involved a primary research program of 256 banks conducted during the fourth quarter of 2011 across Asia-Pacific, Eastern and Western Europe, and North America.

Author

Daniel Mayo, Practice Leader, Financial Services Technology
daniel.mayo@ovum.com

Disclaimer

All Rights Reserved

No part of this publication may be reproduced, stored in a retrieval system or transmitted in any form by any means, electronic, mechanical, photocopying, recording or otherwise, without the prior permission of the publisher, Ovum (an Informa business).

The facts of this report are believed to be correct at the time of publication but cannot be guaranteed. Please note that the findings, conclusions and recommendations that Ovum delivers will be based on information gathered in good faith from both primary and secondary sources, whose accuracy we are not always in a position to guarantee. As such Ovum can accept no liability whatever for actions taken based on any information that may subsequently prove to be incorrect.