

Strategic trends and opportunities in banking

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Ask any banker what issues keep him or her awake at night, and the answers will be almost identical, comprising an array of several intractable and seemingly conflicting forces that have swelled to industry-wide proportions in the past decade. The list includes the heavy increases in regulatory compliance requirements, competitive pressures to shave margins and squeeze operating efficiencies, investor demands for stronger and more transparent governance, and continuing customer insistence on more convenient and accessible services. While it is true that the U.S. banking industry has posted record earnings levels for several years running, the situation is similar to saying that the demolition derby industry has been drawing record gate receipts. From a driver's perspective, life can still be extremely dangerous.

The same holds true in banking, an industry in the midst of a transition aided and abetted by the Internet, globalization, and the rapid pace of technology change. Unlike earlier industry changes, this transition is not an incremental one through which organizations, processes, and technologies evolve in linear fashion into more advanced, but still familiar models. Industry observers anticipate that this transition will be much more radical and constitute a complete metamorphosis of banking's entire business model, realigning everything from its strategic business orientation to its technology architecture to its value proposition to its customers.

There are degrees of opinion about the full scope and timing of this transition, but there is a nearly universal consensus that the primary agent of change, both as the catalyst in making the transition inevitable and the enabler driving the new model's design, will be technology. For the vendors, the implications and opportunities are enormous.

The shape of things to come

Two overarching features define the banking industry transformation currently underway and serve as 'ground zero' for the arguments made in this article. The first, more universally recognized and understood, has already been analyzed for several years, which is that banking is moving incrementally but

unmistakably away from a model based on products, transactions, touch points, and internal departments toward one based on customers, processes, integrated experiences, and the enterprise-wide value of information. The new strategic center is not an institution's asset size, market share, revenue growth, or operating efficiency, but the "customer experience" the institution provides to consumers. Whether a seismic departure in focus or simply a more pronounced emphasis on an existing strategy, many banks have decided this is their destination.

Banks subscribing to this approach no longer think in terms of selling products and making transactions, but rather in terms of acquiring, satisfying, and retaining customers. They are realigning their system architectures to recognize, integrate, and monitor business processes that span departmental boundaries and consider customers from a company-wide perspective. The resulting systems provide customers with tools to conduct their own banking business on their own terms, in their own time, and through whatever channel they happen to access.

This shift in strategic focus has already had a profound impact on the way that banking's role and value to its customers have evolved, leading to the second feature of the industry's transformation, which is that banking is no longer seen as purely a financial transaction, but rather in a broader and more significant way as a financial information business. This distinction may sound like splitting hairs, but the eventual effect on the banking industry will be nothing short of transformative. To better adapt and accommodate this shift successfully, banks will have to reconfigure and upgrade their entire IT infrastructures.

Current issues and trends in the banking industry

Several forces are propelling this transformation, in many respects making it almost inevitable. The competitive pressures that have squeezed the banking industry for the past decade show no sign of letting up, principally due to the banking industry's continuing consolidation. In the U.S., the number of commercial banks has dropped to fewer than 7,500

from 12,000 in only 15 years. Many industry analysts are expecting another round of large bank merger announcements, with the additional element of international banks involved in cross-border mergers. We have seen the beginnings of that trend already in Europe, with the acquisition of Abbey National (U.K.) by Santander (Spain) and the protracted dispute between Dutch bank ABN AMRO and another Spanish bank over two Italian banks. One important ramification of the continued growth of leading banks will be their ability, based on their sheer size and higher efficiencies, to invest in world-class data storage, management, and analytical capabilities, thereby extending their dominance by the development of innovative revenue-generating products and services. The transition to banks as primarily an information source has helped lower the barriers to entry in the financial services industry, opening the banking arena to a host of new, non-bank players. The current alarm among banks and their regulators about Wal-Mart's efforts to obtain an industrial loan company (ILC) license in Utah is the most visible manifestation of that trend.

The second major force driving banking transformation stems from the increasing commoditization of financial transactions. Banks can no longer distinguish themselves on the basis of product set functionality or operational excellence. Commercially available systems have perfected virtually all the important functions in basic transactions, including payments, deposits, funds transfers, and account reporting. The maturity of technology in these areas has made both functionality and pricing nearly uniform among leading vendors.

Third, the sheer volume and scope of regulatory requirements has imposed on banks an unprecedented need to develop transparent systems and processes, along with more effective and reliable means for collecting, storing, and manipulating information. Going forward, banks will need to develop an approach to their IT infrastructure that places a premium on flexibility, adaptability to rapidly changing market circumstances, and the ability to integrate information from multiple sources currently isolated from each other.

Command of information will drive IT spending

The real value proposition that banks offer now is in the information they can provide about financial services and transactions, from a perspective of accessibility, speed, convenience, granularity, analysis, and so forth. In other words, the important question to ask banks now is "how quickly, accurately, deeply, efficiently, transparently, and finitely can they capture, parse, store, identify, access, retrieve, sort, match, analyze, aggregate, present, share, distribute, and protect data?"

Therefore, leading banks are basing new technology strategies on transforming and enhancing their command of information. Although they already sit atop vast amounts of data about their customers, banks in many respects are unable to identify and/or retrieve it with any degree of precision. With banking's future growth and profitability dependent on the ability to aggregate information across systems and reorient it by customer instead of product, technology spending decisions will henceforth be guided by how well a proposed solution furthers a bank's command of information.

Focus on data management

What does 'command of information' really mean, and how should vendors incorporate it into technology development? At the very least, it implies the following system capabilities: to capture (automatically as much as possible) descriptive and associative information about customers, transactions, and workflow circumstances as distinct data fields; to identify, access, associate, aggregate, sort, and display data from disparate sources; to exchange, transfer, compound, and deconstruct data freely across system boundaries; to normalize, integrate, and analyze that data for a specific purpose and for a specifically designated market segment; to drill down and parse data into ever more discrete units that can be segregated and analyzed; and to manage all of the above in near-real time through centralized database management and automated business processes with rules-based workflow and exception management.

That is a far cry from many banks' present capabilities and a

tall order for technology vendors. Initiatives and architectures not built on a sophisticated data management core will provide only limited benefit, since sooner or later they will be unable to integrate fully into a bank's overall architecture scheme. Wasteful duplication of spending and resources will continue, thereby denying banks the operational efficiency they need to rebuild margins and provide meaningful value to their customers and shareholders.

Banking technology priorities 2006 - 2011

All of the strategic imperatives above will require banks to adopt flexibility, speed, and transparency across operations. This will require a technology orientation fundamentally based on horizontal integration and spanning multiple business lines, rather than vertical integration within individual business lines. The priorities for banking technology in the next several years will be data capture and management across geographies and business lines, mining and analysis of customer information to enable more customized service and profitable relationships, more efficient and scalable business processes, and nearly foolproof regulatory compliance. Meeting these objectives will significantly reduce a bank's IT cost base through the use of competitive, low-cost technology and allow banks to move forward with architecture upgrade initiatives by replacing application modules rather than risking full-scale system replacements.

While banks are still several years away from realizing these wholesale changes, there are a number of areas where technology is already beginning to enable a longer-term transformation. These are the hot technology priorities for banking in the short-to-intermediate future.

Customer management

The maturity of transactional banking services is forcing transaction fees downward in tandem with narrowing interest margins and driving the need to understand customer profitability and risk more accurately, over and above the more direct objective of raising customer satisfaction and loyalty. Strengthening the overall relationship with the customer is

one of the highest priorities for virtually all banks.

Developing a single view of the customer with consistent and up-to-the-minute information across all business lines is driving the next generation of customer relations management (CRM) technology. Despite earlier negative experiences by some banks, CRM is nevertheless a four-star strategy and will be a top technology spending priority at many wholesale banks. It comprehends multiple aspects, from the straightforward quality of the service provided to customers when they interact with a bank, to the capability to provide tellers and call center agents with real-time information about customer relationships, to analytical software that can provide cross-sell opportunities by modeling and predicting customer financial needs, to sales force automation technology to improve the tracking and follow-through of customer leads and complex accounting applications to measure customer profitability.

Enterprise architecture

Virtually every bank cited in articles, surveys, and research papers believes that the one absolutely essential element for fulfilling their transformation vision is developing enterprise architecture. This is the practice of applying a comprehensive and rigorous method for describing a current and/or future structure and behavior for an organization's processes, information systems, personnel, and organizational sub-units, so that they align with core goals and strategic direction. Banks are aggressively pursuing this goal via SOA, the most widely known format.

Service-oriented architecture

SOA expresses an approach to software architecture that defines the use of loosely coupled software services to support business processes requirements. In an SOA environment, network resources are made available as independent services that can be accessed without knowledge of their underlying platform implementation (i.e., cross-platform). SOA can also be regarded as a style or philosophy for information systems architecture that supports the creation of applications built upon interoperable services.

Banks are pursuing objectives of integrating their vendor supply chains and ultimately plan to offer such capabilities to their corporate customers. Business lines in trade finance, cash management, and commercial lending will offer attractive opportunities to network a client's supply chain seamlessly from 'their suppliers' suppliers to their customers' customers,' thereby opening avenues for financing, inventory management, and imaged document exchange. Some banks still seem wary of the media and trade hype surrounding SOA, albeit unnecessarily so, taking a go-slow approach and adopting SOA one business line at a time. Thus, the most likely progression of SOA adoption will begin with consolidating business processes within single business lines internally. Banks will then expand to integrate other in-house systems and databases before venturing to connections with trusted outside partners or customers, before ultimately offering web service connections to the public.

Process management

In the context of the industry's fascination with SOA, it is important to remember that SOA is an architectural philosophy and not an end in itself. The technology objective that banks will seek to achieve in specific lines of business will be the automation of business processes that are now done manually, through the auspices and utilizing the principles of SOA. Connecting and integrating complex business processes, including exception management, policy rules, and workflow management, will be among the banks' premier objectives. Process automation will not only yield significant cost reductions by eliminating the banks' need for large segments of administrative support staff, it will also further streamline risk profiles and more easily satisfy compliance requirements.

Current bank efforts are concentrated on transferring checks and other paper documents to electronic images, spurred by the Check-21 legislation. Paper-based processes will remain embedded at banks for years to come, but banks are moving toward fully automated processes with single points of capture at presentment for checks and other paper transactions, while gradually developing electronic origination capabilities

across the branch, contact center, broker, and online channels. Advancements in check imaging will increasingly ensure that paper processing will become the exception rather than the rule.

Development of process management capabilities will advance in two concurrent stages at banks – straight-through processing (STP), which is focused primarily on reducing manual intervention in linear business flows within business lines, and business process management, a more robust path incorporating business rules, workflow management, and cross-business integration. Prime candidates for such re-engineering are those in which the overall 'front-to-back' process typically involves multiple systems, such as consumer lending, mortgage lending, and trade finance.

Information

The development of enterprise architecture and process automation alone will not provide the necessary components for complete horizontal integration. As banks evolve their business strategies by placing the customer rather than the product at the center of the banking transaction and as the demand continues to increase for regulatory compliance, banks will need to ensure a seamless integration of information across product, system, and business lines.

The onus of recent enterprise-wide regulatory requirements, such as Basel II, Sarbanes-Oxley, AML, and BSA, will force banks to evaluate their data retention capabilities, including data integrity, cross-system consistency, storage, accessibility, and retrieval. To provide enterprise-wide presentation of information, banks must be able to identify, classify, parse, store, and aggregate data residing in multiple applications and databases and potentially on multiple operating platforms. In such a framework, all tasks and transactions that come into the bank must be managed in real time, and the data stored and made available for reuse to core banking applications, risk assessment, and customer management purposes.

The concept of 'reusability' drives a need for further breakdown of transactions into more finite and discrete units of data, a process called 'atomization,' which means that more finite data elements related to a given transaction or document, which may not be immediately relevant at the point of entry and therefore not captured, will now become necessary. Trying to enter these elements at later stages for compliance or customer-related purposes does not preserve the integrity of the original transaction and simply involves more manual intervention. This requirement will tax the present capabilities of most banks to capture and store data. In this entire context, banks will need to develop an integrated data management framework that can leverage regulatory compliance as an opportunity for improving the overall data management capabilities within an organization, instead of treating it as a short-term imposition.

Payments

Many varieties and visions of future payments services abound, all more or less focused on the dominance of card-based electronic payments, including new technologies such as 'contactless' payments, biometric security and authentication, smart cards, chip cards, and the like. In some cases, these models are several years away from practical implementation and still face the gauntlets of standardization, customer acceptance, legal challenges over patent rights, and more. In the more immediate future, banks are focusing their attention on removing overlap and duplication from existing payments systems and trying to rationalize enterprise-wide payment strategies. The objective is an integrated, universal payments platform or hub that would essentially blur the operational distinctions among payment types and enable banks to process payment transactions much more efficiently.

Implications and opportunities for technology vendors

For purposes of planning new avenues and possible organizational structures to address this new banking model effectively, technology vendors should consider the following statement made by an industry analyst: "Any dollar spent on

technology in the future must be evaluated in terms of the needs of the enterprise, not a single line of business." The implication for our business is that we must begin to think of a bank as an organic entity, with one or more business problems that need solutions.

The answer to these and other challenges in providing technology that strengthens the bank/customer relationship – while at the same time overcoming the ongoing commoditization of financial transactions and meeting increasing regulatory requirements – is through SOA. Such systems provide the flexibility and customer orientation that banking requires. Add to that the growing need for customer-centric services among banks of all sizes and SOA becomes more than just another technology solution. When properly applied, SOA enables banks to get closer to customers, providing the technologies necessary to help institutions remain competitive now and in the future.