



The Digital Transformation of Financial Services

Though there continues to be debate in industry media concerning the future of branches, they clearly belong on the endangered species list. The [most recent industry data](#) indicates that the pace at which branches are being closed has reached an all-time high. In the United Kingdom, financial institution branch closures are progressing at an even brisker rate, with an [average of 60 brick and mortar operations being shuttered each month](#). While the consumers being inconvenienced by this trend are voicing their displeasures, the commercial realities have and will continue to carry the day.

“If you are a banker and you are not uncomfortable, you may not be a banker much longer.”

Jim Marous of The Financial Brand

The decline in branches here and abroad is just one example of a sweeping change in how, when, and where consumers can access products and services from their financial institutions. The cause of this change can be witnessed in almost any public setting. Just look around an airport, restaurant, waiting room, or mall. There will be more people looking at their smartphones than at one another. Some are on social media, others texting and more than a few are checking their account balances, reviewing recent transactions and/or paying a bill after receiving a mobile alert reminding them of the possibility of a pending late fee.

Baby Boomers have had a front row view of this revolution. Members of this generation bought the first personal computer and can remember something known as a “floppy disk.” On the other hand, Gen Y (Millennials) and especially Gen Z consider the ongoing digital transformation of society as the norm. Most will seldom darken the door of a bank or credit union branch. Yet, these generations will eventually find themselves in the same position as Boomers, amazed by the pace of innovation and its impacts on the lives of its adopters.

In the financial services industry, many of the traditional players, e.g., banks and credit unions, have been slow to leverage technology to deliver services. To fill the void created by these risk adverse institutions, FinTech startups have entered the fray; providing consumers with new ways to leverage digital that increase convenience and reduce complexity.

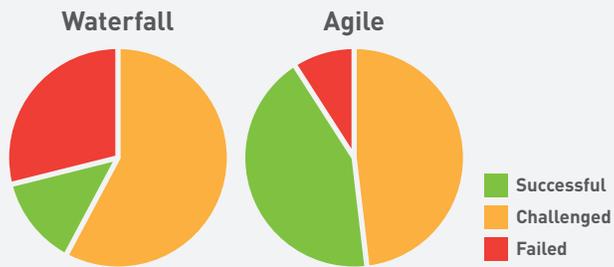
Originally competitors to banks and credit unions, many of these FinTechs have become a key part of some financial institutions’ strategies for keeping pace with the digital revolution. Others have remained adversaries, choosing to attack the most lucrative aspects of a bank or credit union’s business and, consequently, circumventing the relationship these institutions have with their customers and members.

Though financial institutions have been slow to embrace the technologies consumers consider to be mainstream, many have started to take the steps required to control their own digital destiny. To do this, banks and credit unions have had to accept a level of risk that is unfamiliar and uncomfortable. This risk is a byproduct of the fact that the most innovative FinTech’s working with banks and credit unions are early stage companies without the balance sheets and public ownership that institutions prefer their vendors to have. There also are other sources of risk that play a role. These dwell within the financial institutions themselves; i.e., legacy IT infrastructures that are incompatible with modern and internal processes as well as structures that cannot keep pace in the technology age.

In this report, we'll explore some of the legacy processes most banks and credit unions need to reevaluate; shed light on the technologies and industry trends poised to transform financial services; and suggest areas institutions should prioritize in honing their strategies.

THE NEED FOR CONTINUOUS INNOVATION

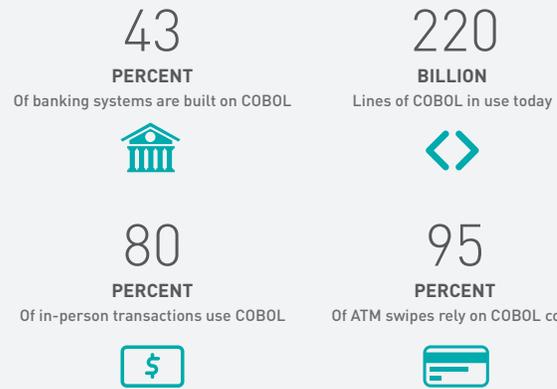
For decades, IT development in most enterprises adhered to a “waterfall” model. This approach involves assembling large teams of developers to tackle a long list of requirements and other upgrades scheduled for batch delivery in 18 to 36 months, a timeline that often proves to be a “best case scenario” rather than the actual timing for delivery of the final product. NASA’s 1960s space program is an example of this model. There were few interim milestones for a deliverable a decade in the future with room for only minor course corrections along the way.



According to studies conducted by the Standish Group, projects that use the Agile development methodology are three times more successful and a third less likely to fail than those projects using the Waterfall approach.

Recently, financial institutions and the third party vendors they rely on have been integrating Agile development methodologies into their operations. The differences in the Agile approach compared to the standard waterfall model is expressed in the terminology used by its practitioners:

- Scrums (small work teams);
- Sprints (compact deliverables measured in days/weeks rather than months/years);
- Stand ups (brief daily meetings in which everyone attached to a project convenes to confirm the day’s objectives and critical success factors); and
- MVPs or Minimum Viable Product – the notion that it’s more important to get something into market for customer feedback and incremental improvement than to wait years for mythical perfection, at which point the market opportunity may well have passed.

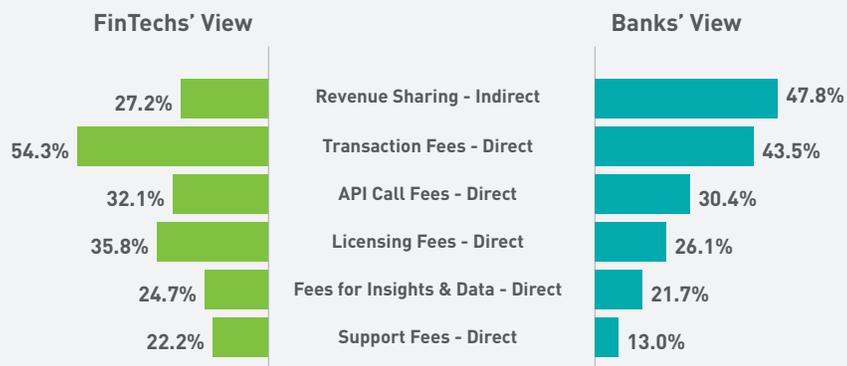


According to an analysis by Reuters’s FinTech correspondent, Anna Irrera, the dependency of financial institutions on COBOL stretches across a number of critical systems.

An Agile approach enables banks and credit unions to adopt a “continuous release” cycle that dramatically reduces time to market. This allows financial institutions to introduce new features in weeks or months rather than years. Though very different from the way financial institutions have functioned in the past, Agile is the standard practice for Uber, Airbnb, Venmo, and other leading digital brands that are influencing consumer expectations on mobile devices.

The underlying software framework used by many of the newer digital companies also plays a key role alongside development methodology. A surprising number of banks continue to operate on a COBOL (Common Business-Oriented Language) backbone, a computer language dating back to the 1960s. Chris Skinner, an industry thought leader who consults with financial institutions around the world, estimates that [80 percent of all transactions](#) conducted by FIs remain dependent on COBOL.

While no programming language is completely bulletproof, the battle-tested aspects of COBOL are clearly beneficial in a regulated, trust-based industry like financial services. However, finding [COBOL talent is difficult since the language](#) is akin to ancient Greek from the perspective of today’s technologists. Perhaps most importantly, this legacy language can impose significant limitations on banks or credit unions striving to respond to the digital needs of consumers. COBOL was not built to sustain itself in a world where billions of individuals carry powerful computers in their pockets.



APIs and the data behind them are expected to provide financial institutions with new ways to generate revenue. FinTechs are well ahead in realizing this goal. Because banks and credit unions are slow to make changes in their processes, it will take a while for them to realize optimal monetization models for different types of engagements.

Cap Gemini Financial Analysis Report, 2017

For example, many newer banking products feature application programming interfaces, or APIs. Think of APIs as conduits (some “open,” some proprietary) providing hooks and allowing new apps to connect more easily into the existing IT environment. Social media apps like Facebook have embraced this approach to enlist a wide array of companies to interoperate with their “mothership”, allowing the social media giant to create an enormous ecosystem to attract and retain its two billion plus members.

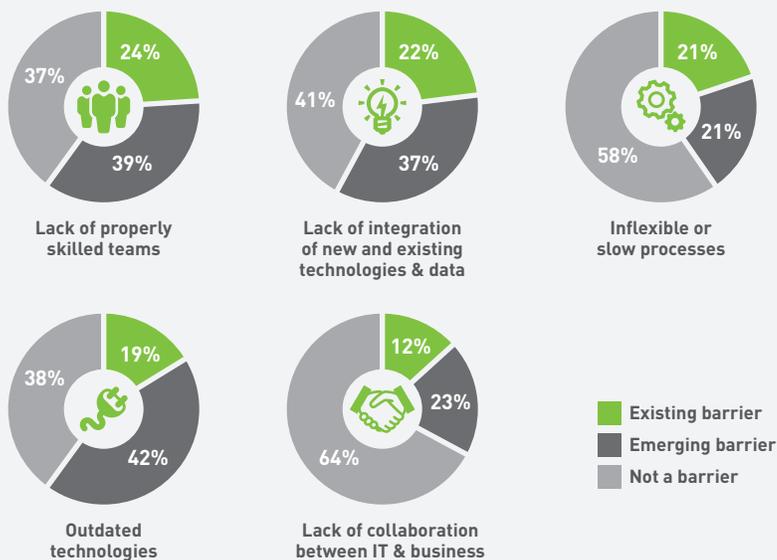
THE SAFE CHOICE — OR THE EASIER ONE

Over time, large, publicly traded companies have emerged as the “safe choice” for financial institutions looking for partners to provide the required software and services to keep their systems current and running smoothly. However, the underlying code base and architecture of the products offered by these large conglomerates was established decades ago, making these solutions inflexible and difficult to upgrade.

However, many legacy systems lack the functionality and/or architecture to take advantage of APIs, thus limiting the financial institution’s reach into the market. These constraints are costly to overcome and add complexity to the IT environment - requiring workarounds for the traditional “interface” model of the past. APIs allow financial institutions to offer digital users the services they want, quickly, and within the existing customer experience, all while mitigating much of the drag created by legacy systems. (We’ll further explore the concept and potential of APIs later as part of the SRM Academy report series.)

As if adopting entirely new programming languages and development methodologies weren’t enough, successful, competitive digital offerings also require a new approach to vendor relationships beyond these foundational requirements.

What are the obstacles to digital transformation



Source: PwC December 2017 The Financial Brand

To overcome the obstacles to digital transformation that financial institutions are facing, they will need to partner with emerging companies. Though riskier than the more staid legacy vendors in the industry, those institutions that do not find a way to do so will suffer a slow decline in the attraction and retention of customers and members.

For example, making a simple change in a disclosure statement within many legacy online banking systems routinely takes 30 days, and the institution gets the pleasure of paying for it as well. More substantial changes – such as revising the online or mobile banking templates with new logos after a merger or acquisition – takes far longer and costs much more. Adding new features and functions involves similar timelines and challenges, if they can be added at all.

The absence of digital banking offerings with the flexibility, extensibility, and scalability needed to respond quickly to evolving expectations of digital savvy consumers has resulted in the rise of a new breed of vendor. These companies are using modern development tools, Agile methodologies, and tech stacks built on API-driven architectures. Their solutions allow financial institutions to establish a foundation on which to build a digital strategy.

In order to leverage the new digital banking technology available from these vendors, banks and credit unions have to become comfortable with the risk that comes from partnering with startups and early-stage companies. A few financial institutions have chosen to make that leap of faith and are now deploying digital banking solutions with quantifiable improvements, thus, gaining a competitive advantage in the marketplace. Those institutions that continue to hope the large, established conglomerates will offer the system compatibility necessary to meet their digital banking needs are destined to watch customers and members migrating to banks or credit unions that have opted to “place their bets” with the new kids on the block.

INACTION IS THE RISKIEST ACTION

The digital revolution in financial institutions began ten years ago with the introduction of the smartphone. This was the dawn of a level of mobile connectivity that surpassed anything prior. Over the last decade, other innovations have extended that reach. We are now connected by an array of devices including smartphones, tablets, smart watches, internet-enabled personal vehicles, smart appliances, and whatever is next; and, the one thing certain is that there will be something next.

However, this revolution is about far more than mobility, accessibility and convenience. For the first time in many industries, consumers now have the leverage to call the shots. This leverage is not immaterial. It has deconstructed and reconstructed entire verticals including music, transportation, and financial services. The first two industries have come to realize they must give consumers what they expect, need, and want. The financial services industry, especially legacy banking service providers, have been slow to arrive to this conclusion.

In particular, too many regional, mid-tier, and community-sized institutions have not demonstrated the commitment required to remain competitive in the digital space. They answer survey after survey stating that digital is their main area of focus, but knowing where to start is difficult and has kept many banks and credit unions running in place. This is understandable given that consumer expectations will continue to be driven by the online and mobile magic of the best consumer products and services. Imagining a path to digital transformation that successfully meets this challenge is complex, especially given that achieving this goal will require changes to the IT infrastructure, organizational chart, and budgeting process.

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Yet the riskiest, and most deadly, path is to do nothing. This is particularly true in the mobile arena, where consumers have come to expect the latest features and functions to become available instantly. A recent Harris poll indicated that more than 30 percent of digital banking users - a growing demographic - are willing to change financial institutions for a better digital experience. Financial institutions must stand ready to partner aggressively with vendors who can help them deliver the latest new capability that gives consumers the convenience they demand.

The situation for smaller banks or credit unions is even more perilous. The largest financial institutions have enormous scale, allowing them to expand their market share and gain \$2.4 trillion in deposits since the last financial collapse. This scale gives them the ability to place multiple bets internally and externally with third parties. Smaller banks and credit unions, meanwhile, are more dependent on outside help, both to develop new solutions and to ensure interoperability of these solutions with existing service providers.

The new programming languages, development methodologies, and API-based architectures being introduced by emerging companies provide a way for these institutions with options for competing with the biggest institutions for customers. Failure to explore these options will ultimately lead to digital death either through the outflow of customers and members to the national nameplates, failure to attract younger demographics that will soon be the majority financial services consumers, or, most likely, both.

DON'T GET TOO COMFORTABLE

It is important to reiterate that these challenges are not going to dissipate like a passing summer rain storm. If anything, the need for rapid response will heighten in the coming months and years, given all the variables in play. Then there's the approaching wave of open banking- which we'll discuss in the next report- bringing even greater urgency for financial institutions of all sizes to deliver the digital banking experiences consumers want and expect.

The banks and credit unions who continue to think it adequate to use the old game of "set and forget" or "wait and see" will find this quote by Jim Marous of The Financial Brand relevant. "If you are a banker and you are not uncomfortable, you may not be a banker much longer."

This may seem overly dramatic. However, any impartial observer of how difficult it is for financial institutions to embrace change knows that the digital world is as much a threat as promise to these organizations. The requirements for success are non-trivial as they involve embracing major technology changes - a mindset more similar to a retailer than the stereotypical banker.

There is much more to discuss, of course, which is why the SRM Academy's next report will dig further into Open Banking, APIs, emerging technologies like voice recognition and artificial intelligence, and how financial institutions can leverage these capabilities to strengthen their competitive advantage further by delivering a digital experience that evolves with the consumers expectations.

SRM's 25 years of experience in contract negotiations provides financial institutions with the benchmarks and processes necessary to improve their bottom line. More than 700 banks and credit unions have received savings of more than \$3 million for every \$1 billion in asset size. In total, SRM has helped clients gain \$2.2 billion in projects across business areas including cards, payments, core processing, and more. SRM's compensation is performance-based with the firm's fees dependent upon its clients' actual, measurable savings.

