

IN DEPTH ARTICLE

Banking's competitive landscape – what can smaller banks do to thrive?

January 2021

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SIMPLER PROCESSES.
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Banks are continuously evolving in this digital world

With competition emanating not only from fintechs but also leading technology companies, it has become extremely difficult to grow or even maintain margins. The banks have the advantage that they have the customer base, however the advancement in technology is reducing the barriers to offer different financial products by fintechs and technology companies. We have already seen the proliferation of a variety of players in the payments space offering digital wallets, merchant services, payments rails, for example. PayPal, Square, Stripe, etc. The same is happening within the credit space with buy now pay later firms popping up, technology companies like Apple offering cards and even retailers offering their own credit facilities, thereby eating into the margins of the banks. Even Google has plans to introduce checking and savings accounts in tie-ups with banks. Smaller banks, at times are further disadvantaged especially in terms of funding available to invest in technology and innovation.

What it all means is that banks need to be extremely responsive to both customer stated and latent needs as well as keeping a close track on the emerging competition. Banking business has evolved over the years based on prevailing market conditions, customer needs and growth strategies. The business focus has evolved from products to channels to customer to enhanced experience and self-service models. The user experience and the self-serve models are where the technology players have an advantage based on the number of users on their platform (e.g. Amazon, Google) and the trove of data that they have providing meaningful insights. Competing with these players would mean that banks itself need to continuously review their systems and technologies, be more agile and create an ecosystem to be responsive to customer needs.

Technology challenges facing banks today

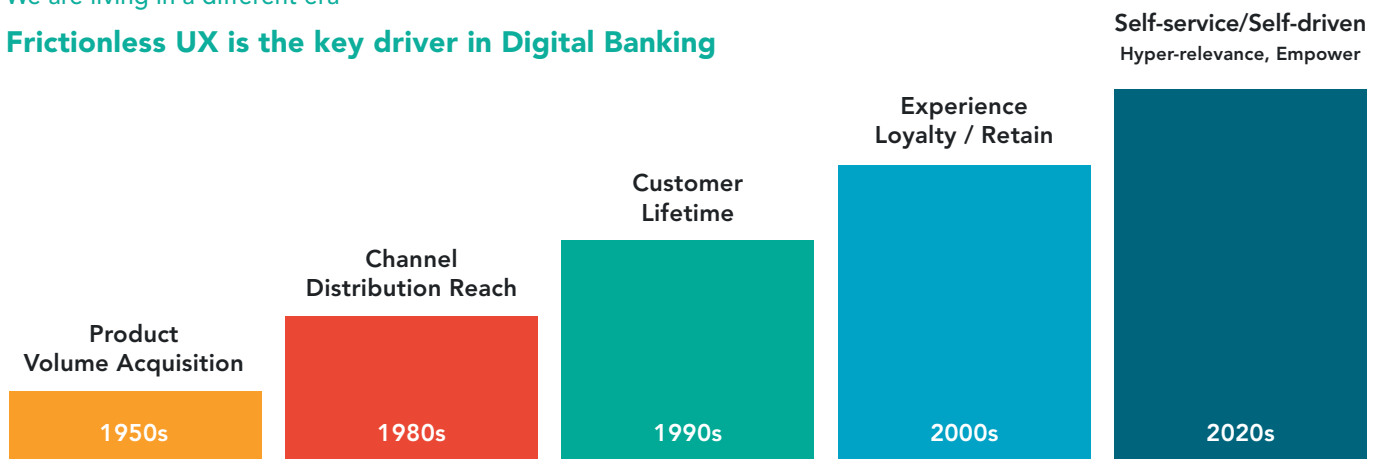
Banks have multiple technology challenges to resolve before they can really tackle the competition. The traditional Go To Market (GTM) model based on a loyal customer base, cross-selling, and up-selling is no longer effective as customer profiles have changed. The younger generation have been exposed to the best of digital technologies and the level of loyalty may not be at par with previous generations. Additionally, it's difficult to differentiate on banking products as those can be easily replicated by competition. The low interest regime has further put pressure on what a bank can do on the pricing strategy for their customer base. The ability to retain the current customer base in itself is a challenging task, hence banks should look at what they can do to maintain their customer base and also achieve growth. Lower tier banks are at disadvantage vis-a-vis their larger peers when they are also targeting mass market and have lower investment appetite across different parts of business including technology.

Technology plays a key role in banks today to offer the products and services to the customers. Banks have typically created a two speed IT environment over many years. First, we have the back-end systems that are expected to be stable, change less frequently, and require more effort, time and cost to be upgraded. And secondly, you have the customer facing applications that are expected to be agile and responsive to the customer needs, e.g. the digital channels.

One of the reasons for the establishments of such environments has been the legacy core banking systems that banks have invested in over the years. Core banking systems were designed with stability in mind and expectation of less frequent modification. There were additional systems built surrounding the core banking function to support different processes.

We are living in a different era

Frictionless UX is the key driver in Digital Banking



Traditional core banking systems come with a range of product and process functionalities and were also customised to meet specific needs of the banks. While these systems provided multi-channel experience, and real-time processing, they are not agile enough to support an open banking, lean and fast organisation. Build and deployment time can be lengthy at times due to multiple factors such as complex code & processes, lack of documentation, and availability of skill-sets, doing, thereby impeding the speed to introduce new features and capabilities. This creates a two-speed IT organisation, where the back end is not able to keep pace with the digital front end systems, which may be moving at a quick pace based on customer needs.

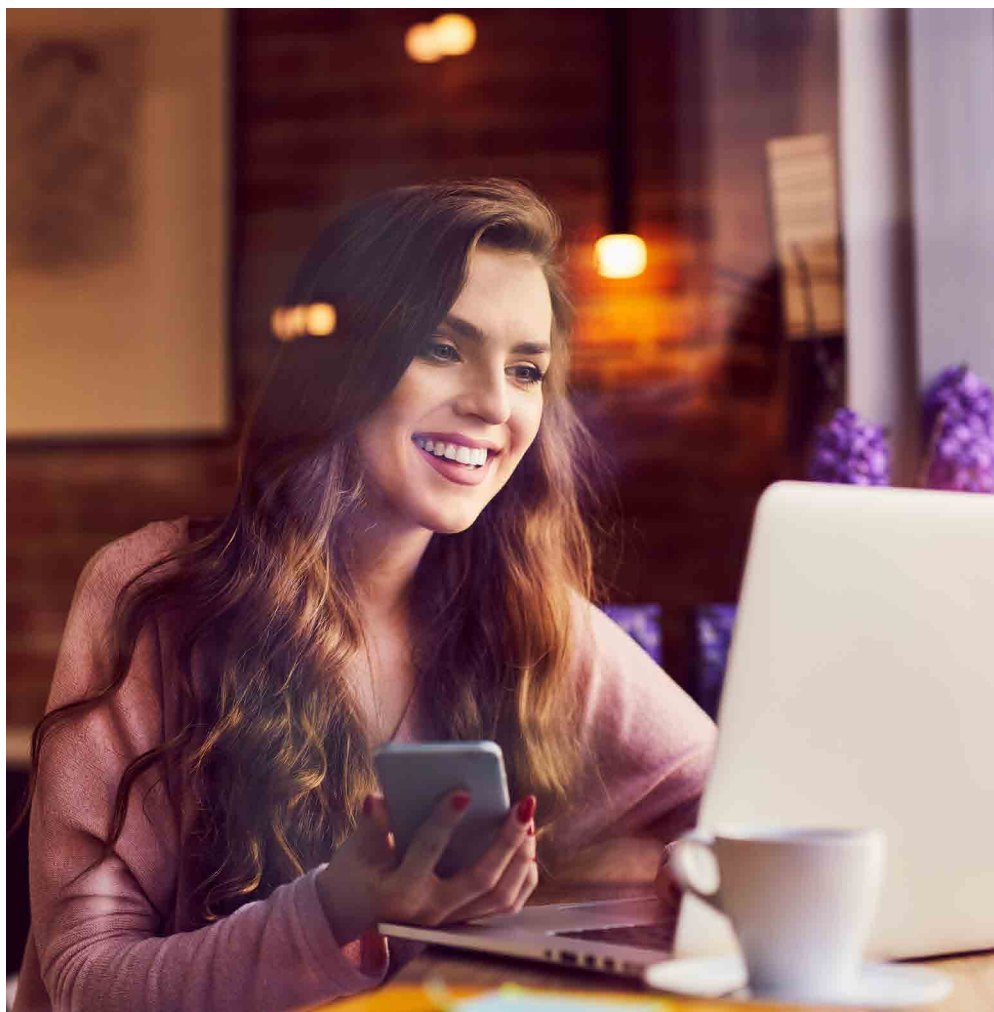
There is also quite a bit of customisation within the bank's existing IT environment. Various factors such as meeting urgent business needs, lack of funding, legacy and complex code base and even regulatory pressures have led to this. There are new regulatory pressures on banks around reporting, making the data accessible, and maintaining uptime. Banks have been carrying out patchwork solutions to manage some of the regulatory requirements as the legacy technology doesn't make it easy to implement some of the changes.

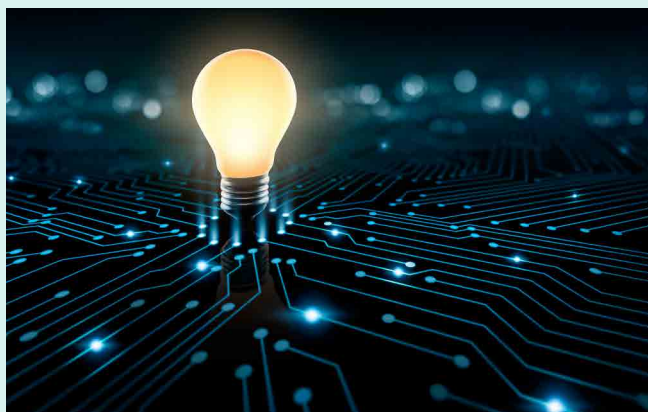
The other challenge facing the bank today is the IT talent pool. The talent pool is dwindling when you are looking to those who can support the legacy systems. Additionally, as many banks have carried out multiple customisation over the years there is often a lack of documentation to help support ongoing change requests.

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Smaller banks have a different challenge, where the inhouse IT staff or funding is small and skill sets are limited. In many cases they have been using the vendor packages for both the back-end core and the digital front end (web and mobile app). They may even be using the SaaS offerings from the vendors. While SaaS packages offer the advantages of modularity, lower cost and scalability, it can reduce the

responsiveness to customer needs as the offerings tend to be standardised and are not flexible or open. It can further impact the competitiveness of lower tier banks if they are stuck with standard capabilities and are not able to respond to the changing consumer needs or differentiate themselves from the competition. A few of the lower tier banks have also adopted a multi-vendor approach to go with specialist providers, for example the digital front-end provider is different from core banking providers. While this approach provides them the flexibility in terms of managing the digital front-end experience through the capabilities of the specialist provider, the challenges they may face will be in areas of vendor management especially when upgrades or new features are being introduced.





What are banks doing?

Core Banking transformation is complex. It's costly, time consuming and success rates are low. According to a Cognisant report, *Understanding-Failed-Core-Banking-Projects*, 25% of core banking system transformations fail without any results while 50% do not achieve the transformation objectives – costs and implementation times are double or triple. Only 25% of the transformations can be called successful. Hence, banks rightfully view core banking transformation projects with an element of caution, carefully weighing up any potential risks against the perceived value. The larger banks have been adopting an agile approach across both their front-end and back-end systems and are moving away from the two speed IT. They have the money and the appetite to take up the transformation journey and have been adopting different approaches based on their specific requirements and organisational goals. For example, BBVA rolled out digital core banking in the US. A digital core enables third parties to access existing bank customer data and onboard new banking customers, allows multiple third parties to read and write data to the same customer record, and also enables customer record to be accessed / updated in real time.

In another example, Westpac, who had been using Hogan (core banking), has moved all its core banking applications into its brand new private cloud environment. They are also building a new digital banking platform to offer "Banking as a Service", leveraging cloud-native technology from UK-based 10x Future Technologies. The new digital banking platform allows the bank's partners to offer banking products and services, such as transaction accounts, to customers. In fact, they have onboarded Afterpay as the first partner on their new platform. While partners such as Afterpay will manage the look and feel of the customer experience, Westpac – as the licensed authorised deposit-taking institution – will hold the direct banking relationship with end customers.

NAB has also adopted the strategy of migrating its Core

Banking to cloud and focus on innovation around customer. NAB Digital Strategy accelerates shift from in-person banking to Online. It announced that small regional branches would be open only from 9.30 am until 12.30 pm and all support outside this period would be via digital and phone banking. In terms of innovation around customer, NAB has introduced multiple digital banking features recently such as online cheque deposit, iMessage chat support, restriction of gambling transactions, WhatsApp chat support, voice recognition authentication and partnership with Pollinate to bring insights to small businesses.

ANZ is building a new banking platform ANZ that would be integrating with its core systems including Finacle core banking, while also providing the necessary ecosystem for innovation and improving customer service 10 fold.

CBA has already been reaping the benefits of their core banking transformation along with a shift to cloud infrastructure. In 2020 their investment in technology has continued with the partnership announcement with Klarna, the global online shopping payment company, and the unveiling of X15 Ventures, which is planning to launch 25 new customer-focused businesses over the next five years.

Banks with deep pockets maintain a large UX and IT team to innovate and work continuously on consumer needs.

When looking at tier-2 banks, Bank of Queensland has embarked on a 5-year digital transformation journey with one component being the core banking replacement leveraging the Temenos platform. Another tier-2 bank, ME Bank, did a core banking transformation and migrated from Ultracs to Temenos.

It can be observed that the larger banks (tier-1 and tier-2) are trying a multitude of strategies such as moving their core banking to cloud, building a next generation platform focused on customers that can easily integrate with back end systems, and some banks are even replacing the core banking with a digital core that is flexible, open and agile.

Another point of observation is that the front-end digital experience has generally been controlled by the banks themselves (especially the larger banks), or they have heavily customised vendor digital banking platforms. Banks with deep pockets maintain a large UX and IT team to innovate and work continuously on consumer needs. Whereas, the banks using digital platforms from vendors (in particular the lower tier banks), tend to partner with their provider in collaboration and innovation to meet their consumer needs. They are reliant on their partners / vendors to enable the digital transformation.

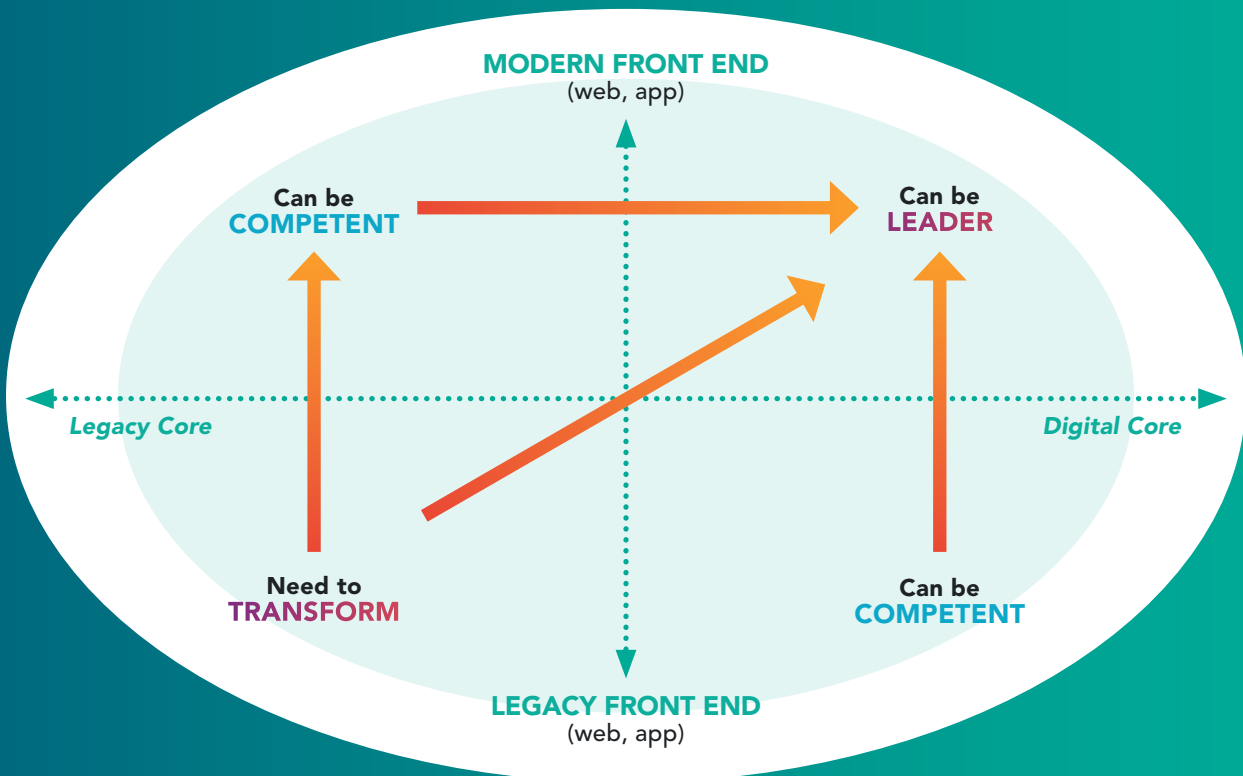


What is the way forward for smaller banks?

The lower tier banks tend to be dependent on their platform providers to keep them competitive. They have adopted the approach of either going with a single provider offering both core banking and the digital front end (if the supplier has that capability) or having a specialist digital front-end platform provider and a core banking provider. In the majority of cases, the core banking systems at the smaller banks would need to fit into the definition of a digital core that we have discussed earlier. The core banking systems are stable, provides the products & process functionalities, however time to market for new products is slow, is less flexible, agile and open - and all these need to be modernised. However smaller banks need to assess the investment and risk involved in the modernisation. One strategy can be to do incremental

enhancements around the core, such as API based messaging between systems, user friendly UI, modernise specific areas post decoupling (E.g. data layer or user interface) and partial automation on pipeline. In addition, these banks can select specialist digital front-end platforms that are open, flexible, provide the bank with the option to manage the user experience, and can easily integrate with different systems thereby bringing agility in responding to customer needs as well as the competition. If banks are locked into vendors that provide legacy core banking as well as less flexible digital front end, they can start thinking about breaking that coupling by choosing a more agile digital front end platform, while also making incremental enhancement on core, or even replacing the core. One benefit to this approach is the lower cost involved in change requests as front-end specialists provide the bank with the flexibility and agility to meet customer demands in this open banking environment.

Figure 1: Bringing in agility to enable digitisation



As can be seen in Figure 1: Bringing in Agility to enable digitisation, a host of strategies can be applied by a lower tier bank depending on their digital front-end channel and their back-end core. A modern digital banking platform along with digital core can make them ready to meet customer demand as well as face any competitive threats. They can also look at incremental enhancements around core while simultaneously modernising their digital front-end platform. This enables quick time to market, ease of configuration and the ability to offer new services.

Conclusion

In this highly competitive open banking landscape, it's imperative for lower tier banks to sustain their customer base. They need to have a strategy in place to modernise their systems or at least create a banking ecosystem, where they can easily offer a multitude of products and services to their customers. This can also enable them in market expansion and growing their customer base. These banks can look at specialist providers for their digital front-end and to define their journey towards a digital core, either adopting a digital core solution or working with their core providers to enable incremental changes that can enable flexibility and agility.

Digital banking solutions

Sandstone Technology's BankFast eXperience Platform (BXP) and BankFast Mobile App provides bank's with the modern digital front-end to meet market demands, while easily integrating with any core banking or third-party systems. BXP provides bank's with the control to define the user experience and configure new products and services, thereby providing a true omni-channel experience and quicker time to market.

This article was authored by Ranjan Kumar, Product Consultant – Digital Banking at Sandstone Technology. Ranjan has over 15 years of program management and business consulting experience within the finance and technology industries. For further information contact the PR and media at media@sandstone.com.au.

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About Sandstone Technology

Before “fintech” was a thing, our founders were dreaming up new ways to transform banking, simplifying the customer journey and the employee experience.

More than 20+ years Sandstone Technology is still leading the charge, innovating and evolving as the industry evolves. Our high client retention rate is our proudest achievement with 40+ financial institutions across Australia, New Zealand, Asia and the United Kingdom placing their trust in our solutions.

From digital banking and digital onboarding to origination and AI-based data analysis, with cloud-based or on-premise deployment, we create flexible, robust, end-to-end solutions using a multi-channel approach that gets our clients to market faster.

Seamless customer experiences start with Sandstone Technology.

Your trusted partner in the banking revolution.

Contact us today for further information or free product demonstration.

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