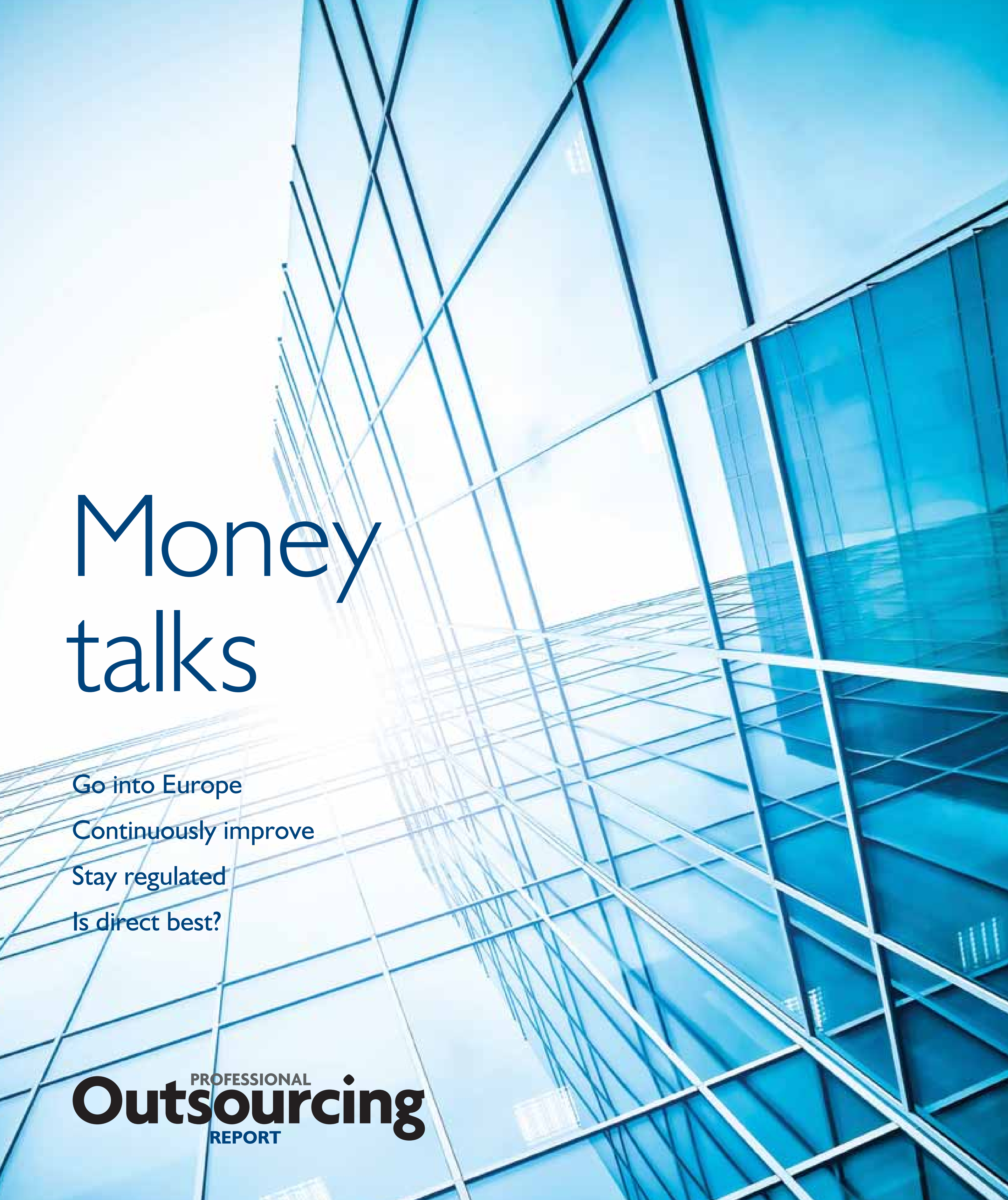

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Money money money, it's a sourcing world

Financial function outsourcing appears to be booming on spite of the world's finances. Guy Clapperton, POM editor, considers.

It's a little strange to be writing about the financial sector and the opportunities it offers given the current state of the world's finances. As I type, Greece has just said a firm "no" to further austerity and the finance minister, having been so gung ho about the "no" vote, resigned immediately. Closer to home all eyes are on what George Osborne will do with the budget; people are expecting austerity to continue in the UK, although the pain points are nowhere near Greek proportions.

To put it another way, the world and its money have rarely seemed this insecure. Half a decade or more after one of the most substantial crashes we've seen, the recovery looks fragile. It's not so long since the European Troika applied to more than one country on the mainland and yet none of the articles assembled here speak of crises.

Far fom it, a number of them identify financial services outsourcing as an area in which growth is anticipated. They may cover regulation and changing patterns of working but there's nothing about the industry being doomed - and as per usual, we've avoided contributions from anyone with vested interests.

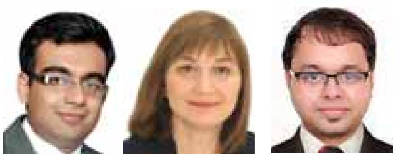
We have an extensive piece on the emergence of digital technology in retail banking and how it's going to change the model, for example. We also have a piece on the changing regulatory framework but this sees the future as bright. There is an article on the prospects for continuous improvement in the financia areas in organisations and we even have Deloitte confirming its view that this could become a boom time for outsourcing in the banking sector.

None of which suggests that we're in any trouble at all, which is curious when you read the papers and reflect on the market into which these services are being sold. Arguably if financial services are to continue they need to be more efficient and less prone to human error, which is where the standardisation and automation should become essential parts of the cure.

Guy Clapperton

First published Summer 2015

Enabling digital effectiveness in banking



All banks are digital but some are more digital than others: Jimit Arora, Sarah Burnett and Aaditya Jain took the temperature at the Everest Group APEX Matrix™ for Digital Effectiveness in UK Retail Banking

Banking organisations globally are focused on the triple mandate of run, manage and change, which align with the three strategic priorities of efficiency, compliance and transformation, respectively. Technology plays a significant role across these priorities and there is a fundamental shift in the nature of technology adoption in banking. As opposed to being an enabler of efficiencies and operations (i.e., reduce costs), technology is now the fundamental differentiator for a bank that is responsible for revenue growth (i.e., increase market share).
In this article, we:

- Evaluate the digital functionality and the associated business impact of nine leading UK banks and share the results of the inaugural APEX Matrix™ for Digital Effectiveness Banking
- Provide lessons from the leaders in digital retail banking in UK
- Examine sourcing implications for succeeding in the new normal of digital technologies

Digital revolution – It's all about the growth

Technology has an impact on businesses in two distinct ways. Digital technologies that include cloud, mobility, social media, big data & analytics, and the internet of things help create new businesses for enterprises and contribute to revenue and market share expansion. On the other hand, technology developments such as service delivery automation (SDA), robotic process automation (RPA), artificial intelligence (AI) and a variety of "as-a-service" models (e.g., BPaaS and SaaS) increase the efficiency of service delivery and help reduce costs.

In a highly mature and competitive market that is characterised by low differentiation for products and prices, and negligible switching costs, banks are making significant investments in digital technologies to keep up with the next-generation consumer base and ensure market relevance. Globally, banks are aligning their technology priorities around digital transformation and are formulating their go-to-market strategies with customer-centric offerings. The growing importance of millennials (the digital natives) disrupted traditional banking channels and caused significant investment in omni-channel initiatives. Direct channels such as mobile and the internet have become increasingly mainstream for retail banking. At the same time, there is a growing focus on mobilising the power of social media networks to engage with millennial customers, while promoting their brands.

APEX Matrix™ - All banks are digital but some banks are more digital than others

Orwellian references aside, Everest Group conducted a first of its kind "open-source" evaluation of the digital effectiveness of the largest retail banking operations in the UK. The banks have been mapped on the Everest Group's

"In a mature and competitive market characterised buy low differentiation for products and prices and negligible switching costs, banks are making significant investments in digital technology to keep up."

Ability | Performance | Experience (APEX) Matrix, which is a composite index of distinct metrics related to each bank's consumer-facing digital investments and business impact (Figure 1).

The X-axis measures digital functionality across mobility, social, online and branch/ATMs from the vantage point of a consumer. The Y-axis measures the business impact of these investments and assesses adoption levels, customer experience scores, brand perception and financial impact. Across the two axes, we evaluate nine retail banks in the UK over more than 70 parameters to identify the leaders, innovators, optimisers and the aspirants for digital banking capabilities.

Before diving into the results and key takeaways, it is important to clarify two important aspects of our methodology. First, all of the research is "open source", i.e. consistently leverages information available in the public domain. This becomes important for the second reason – the evaluation is from the lens of a consumer; i.e., what digital functionality does a consumer get when she interacts with these channels? Given that a significant portion of the digital investments made by banking organisations are targeted at their consumers, it is natural that we pivot our evaluation around the consumer engagement and experience dimension.

The nine banks are segmented into four categories:

1. Leaders (high across both axes – digital functionality and business impact): Barclays, Lloyds, HSBC and Santander UK
2. Innovators (high in digital functionality but low on impact): Royal Bank of Scotland
3. Optimisers (achieved relatively higher in business impact with relatively lower digital investments): Nationwide Building Society
4. Aspirants (low across both axes): Allied Irish Bank, Co-operative Banking, Clydesdale Bank

Lessons from the APEX Matrix: Lesson #1. Richer customer experience is the Holy Grail

Banks now understand that their digital initiatives focused on consumer experience can make or break their competitive positioning in the marketplace. Retail banking leaders are adjusting to this paradigm by changing their organisational design and rolling out customer-centric products and services. For instance, Lloyds Bank has announced an investment of £1bn during 2015-2017 in digital banking capabilities, with the primary focus on creating the best-in-class customer experience. Barclays has launched a new video banking service on mobile devices (smartphones, tablets) and computers that claims to enable face-to-face conversations anytime, anywhere, conveniently. Such digital investments have aided Lloyds and Barclays to report the highest adoption levels among consumers and achieve top quartile scores across multiple assessment dimensions.

> **"Traditional differentiators such as a wide branch network, extensive ATM spreads and mobile transactions have become commonplace."**

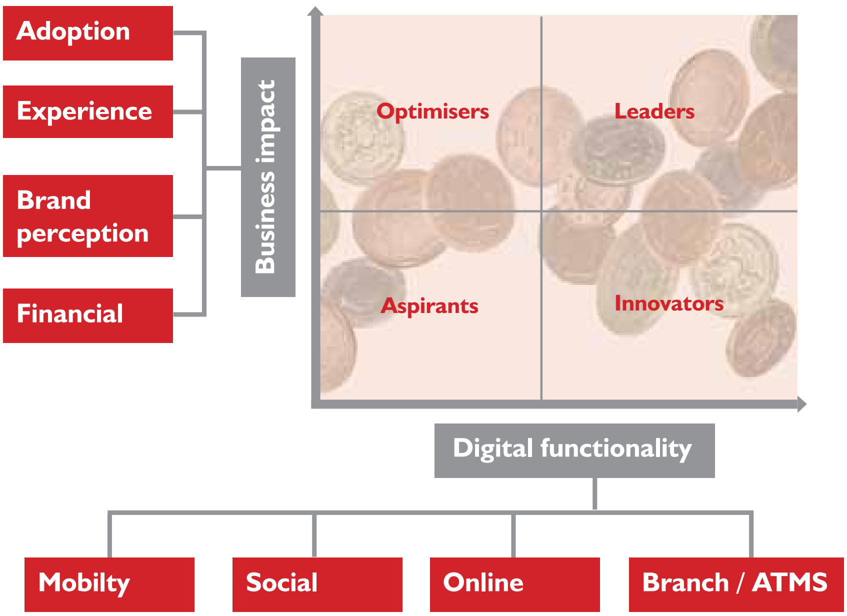
Lesson #2. Moving beyond transactional convenience to contextual engagement

Banks operate in a highly mature and competitive environment. Traditional differentiators such as a wide branch network, extensive ATM spreads and transactional functionalities within mobile and online banking have become commonplace. With low switching costs, customers are increasingly looking for value-added functionalities and specialist features such as customised budgeting tools, spending reports and augmented reality to locate the nearest branch or ATM through online/mobile channels. Customers today expect financial firms to leverage social media to provide customer service and financial advice, share financial offers and upcoming events, and allow them to provide feedback about bank's services and products on a real-time basis. Lloyds Bank and Nationwide Building Society heavily leverage Twitter (more than 100 tweets in a given day) to post promotional/educational content in order to encourage retention and loyalty of the customer base.

Lesson #3. Omnichannel is the new multichannel

Leading digital-native banks need to provide a seamless experience to allow consumers the choice of channel that provides them the most value and convenience. This poses a significant challenge to retail banks as they need to integrate their back-end systems (systems of record) with a multichannel

Fig 1 - Everest Group Ability | Performance | Experience (APEX) Matrix for Digital Effectiveness in Retail Banking



front-end (systems of engagement) for end-to-end integration. Banks are moving their customers to low-cost, high-convenience digital banking channels, while significantly focusing on creating a "branch of the future" with interactive touchscreens, media walls, self-service kiosks, 3-D virtual assistants, video conferencing capabilities, etc. HSBC, Nationwide and Santander have partnered with UK payments infrastructure operator VocaLink to enable consumers to purchase products using their smartphones. Barclays has aggressively cut down on its branch network and is focusing on training its cashiers as iPad-wielding community bankers. Nationwide's Remote Assist Video service is similarly innovative, offering a complete end-to-end mortgage advice/application service at more than 60 branches.

Lesson #4. Consumers don't forgive big failures

Royal Bank of Scotland (including subsidiaries NatWest and Ulster) is an interesting outlier. While the bank scores in the top quartile from a digital functionality perspective, it is assessed significantly lower for business impact. The bank was one of the first to offer its customers access through fingerprint biometrics. Further, the bank differentiated itself by providing value-added services such as monthly budgeting tools.
However, RBS has struggled on a string of technology challenges – regular website failures, fund transfer delays through online and mobile channels. Clearly, consumers and regulators are not forgiving for these failures and the assessment shows a marked difference in the business impact assessment for RBS.

Sourcing implications – No longer the same old same old

Digital disruption not only changes how banks think about technology, it also requires a fundamental fresh look into the enabling outsourcing and offshoring strategies. As technology shifts from an enabler to a differentiator, banks need to re-examine their sourcing strategies and design a new sourcing approach that aligns to the new normal of digital banking. Based on our research, we identify five strategic implications for banking IT outsourcing.

1. Recognise the true effort of digital transformation – iceberg up ahead!

Most conversations regarding digital initiatives tend to focus disproportionately on the app eco-system or the systems of engagement with the consumer. For sure, this is important as it forms a large part of the consumer experience. However, the app is less than 10% of the overall technology effort and an iceberg analogy fits perfectly (Figure 2). Approximately 90% of the technology effort in digital initiatives lies below the surface. Enablement and integration with systems of record is a non-trivial task and organisations planning for large-scale digital transformation should recognise this total effort (and hence total spend).

Incidentally, this is one of the key reasons why IT organisations and the CIO organisation in banking continue to remain relevant despite all the conversations about shadow IT. Lines of business IT groups can definitely fast-track the app development life cycle but fail to factor in the integration, compliance and security needed to deliver the desired consumer experience.

2. Customise sourcing guidelines and priorities across the layers of the iceberg

What is becoming apparent in the current technology landscape is that service providers' capabilities across the different layers of the iceberg are not consistent. Providers that are strong in the enablement and implementation layers may not necessarily have the best offerings in the CX/UX (customer experience/ user experience) space to build the most effective app for the consumers.

One of the lessons learnt from the leaders is their ability to leverage service providers according to their strengths and capabilities. Most sourcing organisations are also realising that the traditional rules of sourcing do not apply for digital technologies. For example, several sourcing organisations have had to relax rules regarding revenue size, ownership, etc., to work with smaller companies whose offerings are more compelling than traditional IT services companies.

In the new normal of digital, we are increasingly seeing a trend towards more defined portfolios with different sourcing rules and guidelines across the run, manage and change the bank functions along, with different criteria of inclusion across these categories.

Finally, some banking organisations are rethinking their fundamental sourcing approach as it pertains to the transformational, change the bank initiatives.

As technology becomes a C-Suite agenda in its ability to influence market shares, a number of banks want greater control of their technology outcomes and are therefore looking to insource these strategic functions. Consequently, even for organisations that are working with service providers for their digital enablement functions, the focus is on capacity-based staff augmentation versus managed services engagements.

Selecting the right service provider for the right function in the right engagement model is therefore becoming a critical ask for IT sourcing groups to ensure success in the digital arena.

3. Force churn in the portfolio - rationalise the tail to strengthen the core

Even though digital technologies influence revenue growth and market share outcomes, technology budgets to enable these investments are still constrained. A number of leading banking organisations are looking to fund (at least partially) investments in digital technologies, by aggressively focusing on cost takeout in the legacy IT budgets.

> **"Most outsourcing organisations are realising that the traditional rules of sourcing do not apply to digital technologies."**

Banks are driving this through a combination of ways:

a) Demanding SDA – IT services companies are investing in significant automation and analytics capabilities to eliminate the need for labour for a variety of services such as testing, L1/L2 tickets in production support/infrastructure operations. Banks are demanding these automation capabilities in their sourcing contracts to reduce costs by 30-40% and using these savings to drive digital investments.

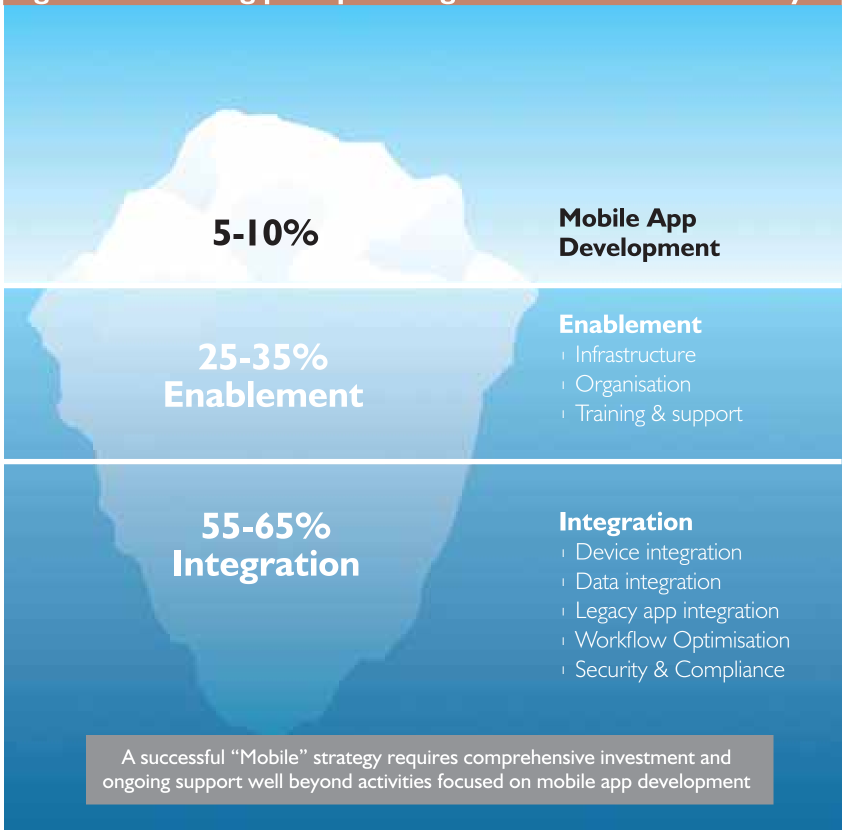
b) Rationalising their tail-spend – a number of banks are aggressively looking to reduce the number of service providers and contractors they are working with, especially for legacy and commodity services. Rationalising this tail of spend and consolidating with the strategic service providers not only provides economic benefits on lower unit cost, but also results in simplified governance and compliance. The consolidation of spend also allows the incumbent service providers to offset portions of the volume reductions due to automation and ensures alignment of objectives.

These initiatives focused on driving greater efficiencies and cost savings in run the bank are fundamentally contributing to the budgets for the transformational change the bank priorities.

4. Prepare for M&A within your portfolio

The digital revolution represents a point of discontinuity in the IT services industry and marks the end of the labour arbitrage era that witnessed the growth of a number of Indian-heritage companies. While offshore-based delivery continues to be important, it has now →

Fig 2 - The Iceberg principle of digital enablement in mobility



become table stakes and does not offer meaningful competitive differentiation in the marketplace.

Consolidation in the services landscape will accelerate and a number of the companies that were leaders in the labour arbitrage market are not expected to survive in their current shape and form. For the cynics out there, only one of the leaders (IBM) in the traditional data centre outsourcing market survives today. ACS, EDS and Perot were acquired as the offshoring wave became stronger and CSC is about to split into two.

As events such as Capgemini's acquisition of IGATE become larger and more common, banks need to continuously evolve their sourcing strategies and guidelines. Concentration risk thresholds, champion-challenger models, are having to be increasingly revised as M&A accelerates. Proactively preparing for this unintended consequence of digital disruption is becoming increasingly important.

"Consolidation in the services landscape will accelerate and a number of the companies that were leaders are not expected to survive in their current shape or form."

5. Drive change top-down

Finally, most banks are recognising that the fundamentals of sourcing and IT are changing. These changes require a different approach to … pretty much everything. Team structures, resource profiles, service providers, locations, pricing models, contracts; all need to be modernised and represent a massive change management exercise.

Most organisations resist change and while consensus and bottom-up engagement are important, designing a successful digital sourcing programme will require syndication, buy-in and stewardship of the most senior executives. Real change management cannot happen unless it is a structured exercise with executive championship.

Conclusion

As the Borg in Star Trek professed: "Resistance is futile". The digital juggernaut is very real and any bank that does not rapidly embrace change is destined to fail. Fortunately (or unfortunately), the rate of change in technology means that relative positions are exceedingly dynamic; laggards can rapidly become leaders and vice versa. What will the APEX Matrix™ for Digital Effectiveness in Retail Banking look like in 2016? Watch this space for more.