

# FinTech and the Push for Transformation Readiness

by Michael Heffner, Global Industry Practice Leader, Appian Corporation

The future has always been a moving target.

It's like a hockey game, where the puck moves in every direction, fast and furious.

Wayne Gretzky attributed his success at the game to advice he received from his father: "Skate to where the puck is going, not where it has been." <sup>1</sup>

In financial services, going to where the puck is going has become problematic. For years, financial institutions reacted to changes as the need presented. They responded to changing customer demands with new products, satisfied regulatory challenges with new reporting capabilities, and grew their asset base with new acquisitions. But, in doing so, they created a problem: silos and patched systems unable to communicate with each other, with both customers and external systems of checks and balances growing more and more demanding.

So what is the equivalent of Gretzky's Zen-like ability to be ready and know where the puck is going?

A platform of robust connections, as well as a flexible development environment that delivers the needs of the moment easily and quickly, that's what.

Let's take a deeper look.

## READINESS: PREPARING FOR THE FUTURE

In sports, business, and life, there are two basic ways to prepare for change. The first is to prepare for a linear, predictable change. The second? Prepare for possibilities—that is, anything that might occur.

As it turns out, responding to predictable change requires different capabilities than planning for unknown change.

**Planned Changes** are defensive strategies that respond to a certainty or near certainty. This is also known as transitional readiness. For example, consider the hypothetical reasons behind Netflix and their success transitioning to a streaming model. Envisioning that physical DVDs would follow a similar path to—video tapes—and be phased out by consumers in exchange for the next great technology, Netflix planned a heavy investment in their streaming business while concurrently reducing focus on their physical DVD rental model. Similarly, the repeated switch from Daylight Savings (or Summer Time) to Standard Time requires coordination and communication. All are made simpler because the schedule is fixed. Prior experience makes both the costs and benefits predictable.

**Planning Possibilities** resemble offensive strategies. They depend on flexible systems available for deployment as circumstances change. Such flexible systems create a state called Transformation Readiness. For example, the Internet's flexibility enables it to grow the number of users and new service capabilities. Similarly, a flashlight prepares you for the event there's no light.

Two approaches illustrate the differences in these readiness capabilities. In 1965, Gordon Moore, founder CEO of Intel, noted that computing power within a single transistor doubled over regular time intervals, an observation that came to be known as Moore's Law.<sup>2</sup> This assumption guided long-term targets in the industry until, in 2015, Intel confirmed that the pace of advanced development in semi-conductors had slowed, forcing management to seek new growth opportunities. At Xerox PARC, on the other hand, Alan Kay<sup>3</sup> and the scientists learned a different lesson. Moore's observation signaled to scientists at Xerox PARC that their present design and development efforts could safely build on certain future capabilities—specifically, faster, smaller, and considerably cheaper processing capabilities than what was presently available. Their transformational readiness coined its own phrase expressed by Alan Kay in 1971: “the best way to predict the future is to invent it.”<sup>4</sup>





## TRANSFORMATIONAL CHANGE

Thank the Internet, and its ever growing connectivity, for enabling further digitization of business processes. Digitization makes it possible for more information to move from one location to another faster, better, and cheaper. Add to that the changing landscape in which physical and digital environments are coming together, and you get to where we find ourselves today. A look at Uber and AirBnB, among other examples illustrates the point. Uber owns no cars; AirBnB owns no hotel rooms. Yet, they compete against traditional businesses with physical assets. There's an important lesson here for Financial Services institutions.

**The changing operating environment allows these businesses to offer customers enhanced convenience.**

In fact, unlike the early days of e-commerce, which assured users security and privacy, new offerings stress *convenience*. New digital capabilities include the abilities to:

**Transformational Change is All Around Us**

1M rides per day		Owens no Cars
37M rooms rented a year		Owens no Hotels
\$360B sales made a year		Holds no Inventory
900M page views per day		Creates no Content

- Deliver high volume services, globally in the physical world.
- Displace inventory and significant fixed assets once deemed necessary to run and sustain the business.
- Deliver convenience and value by taking advantage of the inherent capabilities of digital channels often overlooked by existing market players.

Recognizing a transformation can be tricky. Identifying a one-off insight, such as a pain point, or technical advance, for example, creates some value; however, it could lead to a “fad” with no scalability or longevity. Amazon’s transformational readiness comes from both systems planning and analysis capabilities. Their ability to connect information at multiple levels makes their execution significantly more effective than those using traditional planning and transitional readiness.

**MACRO LEVEL TRENDS**

There is growing awareness around flexibility and convenience that warrant greater understanding of macro level trends and their effects on Financial Services.







Specifically:

- Simplified customer experience.
- Digitization that connects.
- Compliance that enables strategy.

**Simplified Customer Experience**

*Simplifying the customer’s experience can be challenging in banking.* Documents require collection and independent review before authorization and finalization of the transaction. Digitization allows a bank to minimize back-office challenges through increased connectivity and processing tools. It allows them to focus on improving every step of the transaction and making the customer experience more magical.

**Simplified Experience**

 <b>SIMPLE</b> Budgeting / Planning / Saving with a beautiful app	 <b>OnDeck</b> Instant loans for small businesses	 <b>wealthfront</b> Algorithmic investment advice wealth management from \$5,000
 <b>robinhood</b> Commission-free, retail brokerage	 <b>HOLVI</b> One-stop shop banking for small enterprises	 <b>shake</b> Mobile app to create, sign and send legal contracts

New businesses derive benefit by narrowing their focus. **Wealthfront** optimizes investment needs while **Shake** assures the validity of documents. Each solves problems by making the customer experience the top priority. Their development uses simpler internal processes, delivers elegant solutions, and assures superior experiences.

Banks deliver multiple services equivalent to customers using several applications; they now must find ways to be more seamless end-to-end.

### **Digitization That Connects**

*Digitization—a broadly applied term—in this case describes the convergence of retail financial services with social media, mobile, analytics, and cloud technology.* It applies to banks and non-bank service providers, as well as pure technology providers catering to the Financial Services space. For example, McKinsey & Company helped a European bank digitize its processes. The account opening process was reduced to less than ten minutes by collapsing the separate physical and digital processes that used to take several days from start to finish.<sup>5</sup>

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Fintech [and Digitization] is empowering new competitors and start-ups to move into parts of the banking business but, paradoxically, it is also helping banks to create better, more convenient products and services for their clients.<sup>2</sup>

– Julian Skan, Accenture managing director overseeing the FinTech Innovation Lab London

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An even broader term, **FinTech** (short for Financial Technology), represents the range of Financial Technology firms challenging incumbent financial service providers in everything from money transfer fees to loans, as well as personal and investment banking. FinTech is also highly relevant to the institutional side of Financial Services with many new concepts challenging the old ways and allowing firms to envision new ways of transacting business. Glaring inefficiencies and pain points overlooked by one provider now create opportunities for FinTech firms to step in and increase value in multiple ways. Using Digitization, they extend the range of connectivity across platforms and open access to internal data, long held in untenable silos. They also offer opportunities to use additional marketing channels, richer data handling, and management tools to distribute the data as a product unto itself. Firms like **SWIFT** and **Markit** offer simpler solutions, greater access, and removal of the barriers of functional/specialized operating silos. This makes it easier to plan and create new business models.<sup>6</sup>

In a report released by Accenture and the Partnership fund for New York City, FinTech investments in the US nearly tripled in 2014 to a high of \$768 million and a total value of \$9.89 billion. Investments in Europe added another \$2.31 growing 215% over the previous year.<sup>7</sup> No doubt, the inefficiency in this sector mentioned earlier has fueled the boom.

From technology incubators to large board rooms, both Digitization and FinTech pop up frequently in discussions of digital transformation.

### **Compliance That Enables Strategy**

*Today, the trend towards digitization—end-to-end exchanges of information across the business service lines—is reaching the worlds of compliance and risk analysis.* Since risk analysis and internal control capabilities don't easily transfer, a firm's compliance readiness, when also transformational, delivers a distinct competitive advantage.

Even the large institutions are recognizing the advantage as reported in **The Wall Street Journal**:

“J.P. Morgan has talked for years about working to build up its fortress balance sheet. [Its Annual shareholder letter] acknowledges a new focus, building a fortress of compliance and controls that it hopes will prevent it from paying big fines to regulators.”<sup>8</sup>

## THE CHANGING MARKETPLACE IN FINANCIALS

As all three trends illustrate, the Financial Services space is a busy and growing sector. Financial Service providers continue to respond to evolving customer needs by increasing the sector’s diversity of offerings. Peer-to-peer trends in FinTech extend beyond retail financial services and cut across asset classes including FX, Equity, and Debt. It all raises a strategic question: Are these narrow service offerings merely repeating the errors of the past, making the next phase of consolidation more costly?

Traditionally, the core institutions and the ring of regulatory, supplier, and support services focused on three things: licensing; customers; and the ability to affect financial transactions. Processing priorities and systems focused primarily on delivery that was efficient and effective; accurate; and auditable. The bank was synonymous with its core data and event handling capabilities.

Today, customer experiences command considerable attention and priority. This change in focus represents a transformation in service delivery in this sector to match expectations and standards established by other sectors—in retail, that means Amazon; in research? It’s Google.

Customer experience goes beyond the visible contact touch points. The experience includes the ability to create and sustain relationships, which depends on effective management of multiple and diverse transaction events and data. These tasks are not simple niche, one-off specialization services narrowly delivered. Bank customers expect more fully integrated services and support on their terms. How will banks deliver and permit customers to manage savings and borrowing, wealth and investments, payments, and insurance all through a singular, centrally coordinated, and layered solution?

In order to retain the leverage and resources that their branded reputations earned by making offerings sticky and relevant, they are pursuing multiple paths at once.

## EVOLUTIONARY MOVERS

Responding to the increased comfort levels of consumers transacting online and the growing digitization capabilities, a few new entities have moved more aggressively to create a fully digital bank, with no physical footprint. **Fidor Bank in Germany** focuses on e-commerce and uses the mobile Internet to deliver services. Start-up technology companies like UK **Starling, and Monese** also characterize themselves as challenger banks.

But, **digitization opportunities go far beyond a snappy front-end user experience.** These tech savvy startups build in an advantage over their traditional bank counterparts, delivering the benefits of simplification by fully using their end-to-end digital capabilities. These emergent specialty providers address and solve real business problems. They deliver innovative solutions and high-value digital experiences equal to other industries.

Start-ups naturally play offense. **These new entrants see certainty where others see risk, and their proactive effort to skate to where more consumers are going has untapped a new source of value.**

Though niche players today, their business model takes advantage of growing customer dissatisfaction described in CapGemini's 2015 World Retail Banking research report.<sup>9</sup> **Increasing numbers of customers said they were unlikely to stay, refer, or buy products from their existing financial service provider.**

Non-banking experiences of customers and employees make them hungry for greater access, flexibility, price transparency, and general convenience not available in conventional banking applications and interfaces.

## MOVES BY INCUMBENTS

Incumbent players to date have been slower to respond to this news. Savvy, incumbent players capably manage their risks with the diversity of their product mix. The sources of their competitive advantage depend on risk management flexibility, investment acumen, and asset strengths. Notably, CapGemini and McKinsey<sup>10</sup> uncovered additional opportunity and value available to banks leveraging "integration" enhancements.

Any automated process that can select, combine, and merge data offers double value. The same processes used to discern customer needs, both expressed and latent, can proactively respond. In other words, the same digital touch point can equally request or deliver information. In one such integration effort, Cap Gemini<sup>11</sup> reported institutions realized 50% lower maintenance costs and increases in straight-through processing.

Another path taken by leading financial service institutions leverages their assets and establishes new operations from scratch, AKA **Greenfield** models. These investments further seal these institutions' global reputations and brand recognition as innovators. Additionally, they allow experimentation and direct learning opportunities related to alternative customer experiences.

## STRATEGIC BETS

The absence of a clear vision around the ideal financial service experience makes the future an open space. This creates gaps in which many find themselves vulnerable to multiple competitors operating across their network of services. To strengthen their position, institutions are hedging, placing bets on two strategic approaches: Acquisition & Syndication, and Internal Build.

The choice a financial service firm makes considers three things: its diversity of its present service offerings, risk appetite, and asset-based size. Understanding internal readiness would be a wise addition to this list. Both approaches set their sights on the future by enabling transformation and integration with legacy spending decisions.

- Irrespective of their bet, strategically no institution can afford to operate without flexibility associated with their readiness posture. **Acquisition & Syndication** responses naturally leverage venture capital models by using in-house capabilities. Part opportunistic and protectionist, internal venture capital organizations apply their investment acumen to buy and sell securities and/or build a portfolio full of FinTech firms. This approach offers diversification; an ability to capture reasonable returns; and a capability to escape the burdens of actually operating these businesses.

It's worth noting that internal investment portfolios have doubled in the past year.<sup>12</sup> Established players going this route lend both support and financing to a variety of startups, thereby benefiting in multiple ways. Not only do they gain indirect knowledge about industry innovation, customer behavior, and attitudes, they also share in the promise of financial rewards.

- **Internal Builds** work a little differently. Institutions favoring this path may have an internal venture group, but they also have an innovation side. This alternative team may partner with external FinTech providers in order to bring together a combination of skills and an ability to deliver services. This approach also allows the institution to learn what the FinTech providers learn but in real-time and without any filters.

Both internal venture and innovation teams help the institution assess which proven developments may be right for them. They also help add or build them into the existing portfolio of banking services. That is, they do so if they also possess the right mix of internal talent. Advancing technology skills that focus on understanding and incorporating changes in user experiences differ from data modeling and prediction capacities. The sudden spike in demand for “data scientists” exposes additional vulnerability to attract talent that cuts across every industry.

**Those firms able to both spot and understand emerging trends and then leverage their intersection and inter-relationship will create a renewable source of competitive advantage.**

## INTEGRATION

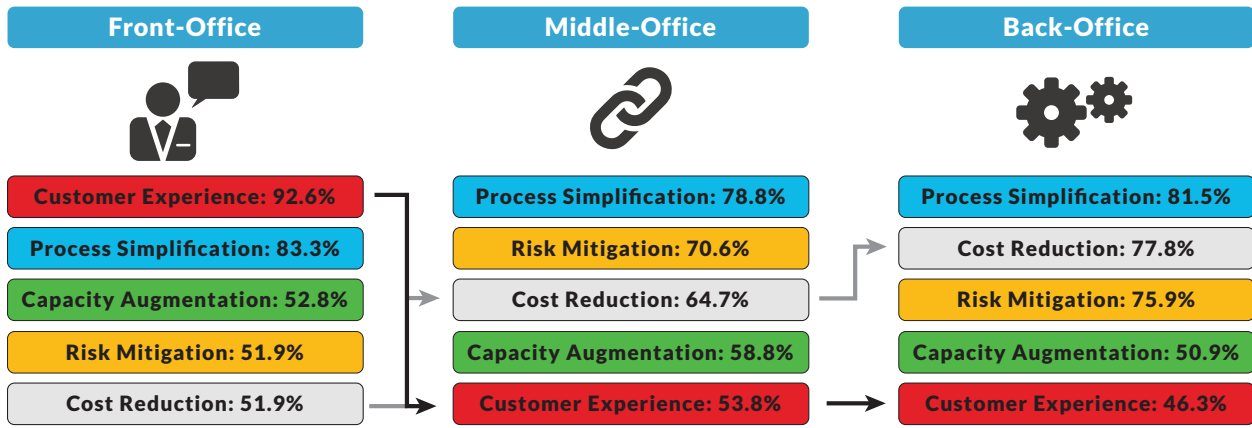
Though faster and less risky than direct innovation, the bigger problem of scaling success remains. **The learning, evaluation, requirements, and execution process loop attached to your expansion may not be fast enough.** As the Economist Business Intelligence Unit Survey 2013 reported,<sup>13</sup> only 7% of executives in every industry find their internal change processes effective. Over a three year period, the success rate for strategic initiatives averaged 56%.

In other words, lack of readiness or effective internal change processes may prevent these organizations from benefiting from the integration we’ve been discussing. They may also limit their abilities to expand and extend results learned from small tests and acquisition of narrow niche products/services.

Bets take time to play out, and pursuing the previously listed initiatives won’t resolve current, more pressing demands, or spare you from the fallout of the external digital transformation now underway. Lest you forget, you still must address the demands of running your everyday business. Investments still must support and sustain legacy systems, maintain vigilance against cyber security, and support smaller modifications or report requests too.

The increasing value customers get from Internet- and technology-focused firms less frequently match consumers’ banking experiences, which they find slow, less useful, and less intuitive. The very qualities that built strong relationships also matter less as consumer expectations change. Too many institutions—lacking transformation level readiness—fail to meet them.

Banking executives drove 92% of front office investments in digital by recognizing the need to improve customer experiences. At the same time, 85% of the middle and back office area digital capabilities were basic to mediocre.



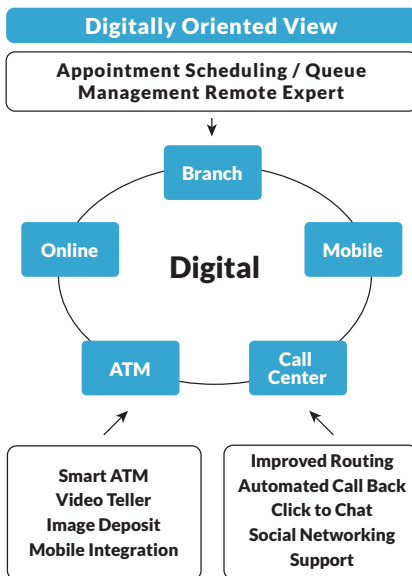
60% of negative customer experiences emanates from the back-office.

Development initiatives to improve middle and back-office capabilities, however, expect even less investment in the next three years. Cap Gemini’s survey results<sup>14</sup> found that banks plan to reduce projected investments targeting back-office priorities in favor of boosting the front office.

Without linking the transformation, this switch will do little to relieve the dissatisfaction that the majority of customers experience.

**There is an alternative.** Transformation Readiness offers a different leverage play to those who seek to optimize investments that both strengthen and enhance internal innovation capabilities.

In their study of top retail banks, **Boston Consulting Group (BCG)** found that top-quartile institutions which blended their unique abilities gained considerable advantage. Nicknamed “bionic,” these organizations use both digital functionality and thoughtful and caring human interaction options for customers who need it. These bionic capabilities deeply embed the digital capabilities through to the back-office operations, which allow them to deliver integrated experience on a focused set of services. **They outdo their peers** by meeting client expectations for service-speed and convenience.



### DIGITIZATION: THE CLEAREST TREND

As both studies and leveraged-bet examples signify, Digital increasingly seems to be the glue holding Financial Service institutions together. Digitization capabilities helped transition institutions from geographic or product-centered service delivery to execute “bionically” with excellence using customer-centric service approaches. They’ve also enabled players to cut costs by giving consumers digital and mobile access while closing branch offices.

This change in orientation represents the growing realization that digitization makes process simplification possible; and, it can simultaneously deliver benefits to both internal and external users. Success flows not only with plans to advance technical capabilities, but the transformation readiness described earlier.



Renewed attention on customer, product, location, and employees offers a design synergy that reduces preparation time and increases opportunities to focus on moment of arrival rather than the path to get there.

## OWNING UP TO DELIVERY OF CUSTOMER EXPERIENCE

Planned possibilities come to those who use a comprehensive, flexible platform that connects any and all activity—from front-to-back and end-to-end—into a singular process. Digitized capabilities are cross-channel aware. They allow a singular focus on customer experience while tying together process and data. The Economist survey respondents that outperformed their peers described the approach that offered “better feedback mechanisms, more resourcing ...and more robust processes”<sup>15</sup>

The old branch- or product-centered orientation of data, as well as organizational structure pushed services through customized applications to fit the different channels, like mobile, internet, ATM, or the call center. The new transformational view orients around an awareness of digital capabilities with some significantly different advantages. It also raises key questions:

- A Digital view provides platform flexibility to connect and integrate data, no matter its source and form. Does such a platform exist?
- Are you looking to optimize or merely accommodate product innovation activities?
- Do you also want to integrate existing processes, data, and communications fully—including any internal collaboration capabilities, external interactions and social media connections?

The complexity of your environment doesn't disappear because you buy a platform, nor does it guarantee transformation readiness. When evaluating the choices, fast integration must be a given in your review of vendors eager to enable both process and data management needs.

Simplicity and flexibility permit rapid development and put you distinctly in the transformation versus transition camp. Imagine less initial code, that once built lends readily to reuse and permits visual drag and drop design to document the emergent process as you go.

Regardless of the future and your choice of strategic bets, the clock to deliver on customer expectations keeps ticking. The fastest way to align without heavily investing in re-architecture remains the choice of the right modern application platform.

## ABOUT THE AUTHOR



Michael Heffner is Appian's Financial Services Global Practice Leader. Mr. Heffner is responsible for driving Appian's growth and aligning Appian's vision to the challenges faced by today's financial services sector. This includes using IT to drive business value, increasing operational excellence and driving new levels of customer engagement. Mr. Heffner is a seasoned veteran who has helped organizations across the financial services industry achieve success through innovative approaches to problem solving. Prior to Appian, Mr. Heffner was Managing Director, Business Transformation at State Street Global Markets. He has also held management positions at Accenture's Creating Financial Markets Advantage practice and Charles Schwab & Co. Mr. Heffner earned a BSBA in Economics from the University of South Carolina and an MBA with concentration in Finance from Babson College.

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