

## Executive event: Digital & Innovation in Banking

### *Innovating the Banking Sector*



Due to digital disruption, an important dichotomy erupts: banks have more interaction with customers than ever but customer have increased number of choices to fulfil their financial needs. As customers prefer choices and experience over being locked into single suppliers, banks need to transform striving to give customers “Choice” which turns the financial services market into a supply side market.

#### Past, present and future of banking

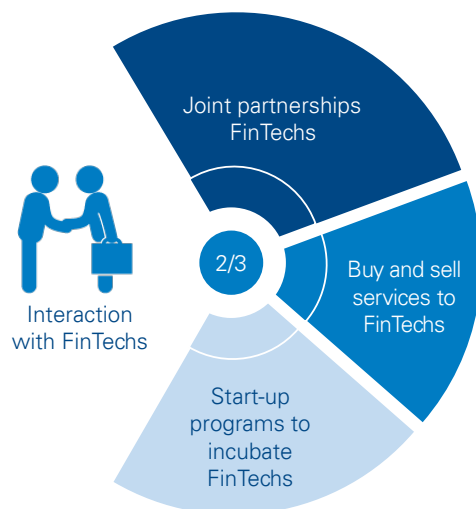
Overall, the Financial Services industry has presented several changes since the last century where banks transactional model began to experience the maturity and decline of their previous achievements (ATMs and Bank branches will represent year by year a less significant client interaction channels). 1999 set a tipping point in the banking industry by introducing the seeds of mobile banking through SMS as a channel for client’s interactions. Managing strategic decision in a fast-paced technological environment had forced banking to evolve into a new era, the era of Digital Banking where competitors are not going to be the traditional financial institutions, where clients’ loyalty will be ephemeral and expensive. An environment whose pillars stands in “Choice” and “Technology”.

#### A significant portion of banks are not prepared for digitalization

A new study by Arthur D Little has been performed during the second quarter of 2028 and shows some interesting aspect around the three areas strategies related to digitization, aspects of FinTech arrivals, and digital technologies. A key outcome is the non-preparedness of a significant portion of banks when it comes to digitalization, e.g.:

- 38 % of banks still have not implemented a specific digital strategy.
- 91 % of bankers believe in the profitable impact of digital innovation in legacy banks.

- 15 % of banks have a poor level of digital transformation.
- Just half of the banks institutions are well prepared for new cyber threats.
- Over a half of bankers believe that FinTech’s most important impact is meeting the changing needs of customers.
- Over a half of banks have zero revenues from participating in external platforms / eco-systems.



Source: Arthur D. Little

### 5 forces to drive open banking

By now, there is no uncertainty as to the open banking trend itself. There are five forces that will continue to drive open banking:

1. Customers continue to expect digital enhancements from their banks.
2. Financial services incumbents continue to push process digitalization.
3. FinTechs continue to innovate in all areas of banking.
4. Regulatory pressure to open banking to third parties continues (e.g. PSD2 initiative).
5. New technologies continue to emerge.

A lot can be learnt from players in other industries. So banks should innovate the user experience, highly efficiently onboard and integrate others' products and ride someone else's wave.

*“Open banking really does 3 things: Innovate, Globalize and Disrupt.”*

– Bela Virag (Partner Austria),  
Arthur D. Little



### Value Creation by Digital Innovation

For most banks, “innovating the banking sector” is not a strategic priority. But if only half of the ambitions shared in this survey come true, digital innovation is to become integral to business. There are very few theoretical limitations to what digital technology can contribute to solving innovators' most pressing needs. Realizing the full potential of digital technology requires needs-based digital thinking and alignment on vision and strategy – both of which are not easy to come by. It is important to note that, digital technology is just technology. Deploying digital technology faster and more effectively than others will make the difference.

Arthur D. Little believes that there is an opportunity for all banks to unlock the enormous potential of digital innovation, internally

as well as externally. Unlocking the potential of digital innovation will require a new approach to managing innovation by

- Anticipation of the “world of tomorrow”;
- and transformation of banks' innovation engine and organization accordingly.

*“Banks should leverage big data to cope with innovation and use their market advantage.”*

– Dean Brabec (Managing Partner CEE),  
Arthur D. Little



### It is not just Regulation such as PSD2 – it is banking as a whole

First, there are relevant regulatory efforts to increase the openness of banking. The revised Payment Service Directive (PSD2) started as an innovation that aims to create a unified payment market among the European Union and therefore encouraging innovation, competition and efficiency. However, as the discussions around PSD2 evolved it became clearer that the impact of PSD2 may be a game changing in banking business models as it enables consumers and business to use third-party providers not only for payment but for information intermediaries, as well – PISP and AISP. The implementation of PSD2 compliance started in 2018 among the EU member states, creating the baseline for future Open Banking developments, the regulation will benefit the new banking trends based on:

1. Standardize Access
2. Improve Security in Information Flow
3. Develop of New Business Models
4. Reducing entry barriers
5. Interface with clients

Even though PSD2 is a European focused regulation, there are similar regulations or regulatory bodies pursuing similar

initiatives elsewhere – CFPB in the US, CMA and OBWG in the UK or similar initiatives in Asia.

This lends itself to the emergence of GAFAM to explore financial services, the up-rising of challenger digital banks (i.e. Number 26, Tandem, Starling, Number 26, and Fidorbank) and the eruption of Telecom Financial Services pioneered by Orange Bank. New digital banks are winning the customer perception race compared to traditional banks as shown by the recent J.D. Power 2017 U.S - Direct Banking Satisfaction scores higher than traditional retail banks - 865 out of 1,000 points, 49 points higher than conventional banks - though they currently represent just 6% of total bank deposits in the United States.

Thus, banks must take advantage of their pivotal role in customer relationship by investing in clients experience and satisfaction, leveraging Open Banking models into their offering of products/services.

*“Banks have the big advantage of trust.”*

–Tomás Hládek (Senior Manager),  
Czech Banking Association



Tomáš Hládek, Senior Manager of the Czech Banking Association was talking about the implementation of the PSD2 in Europe and the Czech Republic more specifically. In Europe, seven member states do have no implementations yet, four only have partially implemented the regulation.

As of third party providers of payment services, so far there are only three applications for new licenses and two applications for “license upgrades” in the Czech Republic. All licensing processes are still on going, none have been completed thus far. Several banks started to play the role of an “Account Information Provider”. But Mr. Hládek pointed out that even once the issues around registration of third party providers have been settled, when it comes to non-cash transactional business, banks will still be relevant winners as they can leverage their trust advantage over new entrants.

As for yet open issues, one noteworthy is that PSD2 should have been accompanied by 11 technical guidelines and regulatory standards of which three are still missing. RTS on Strong Customer authentication and secure communication will come into force in Sep 2019. The Czech standard is currently being implemented.

New competition leads to banks’ eagerness to have instant payments, e.g. EPC and its SEPA CR Inst project. Czech national bank is the provider of the interbank payment system, where 13 banks are still participating.

### Different Focus Points to be Fit-for-Digital-Future by our Clients

The presentations provided by RBI and Erste nicely contrasted the innovation focus. While Raiffeisen presented their very successful implementation of an accelerator and corporate venture capital program for integration of FinTechs that mainly operate on the client facing side of banking, the keynote given by ERSTE Group focused on Innovation and Digitalization applied to back office operations.

The key challenges of vertical digitalization according to ERSTE Group is to transform operations beyond its current role, to change responsibilities of current staff in the wake of increasing automation and to implement a governance model for the various automation programs particularly as they scale enterprise-wide. Topics that occur during back office automation are digitalization of documents, automation of processes, roles & responsibilities, people skills & attitudes and capacity management. ERSTE Group gave several examples of the back office operations:

- Gamification
- Robotic automation journey
- Cognitive solutions and AI for corporate lending
- Open APIs
- Blockchain

Core elements of the Raiffeisen concept are

1. Prototyping its strategy. Companies should test and refine their products as well as their strategies.
2. Disrupting the business before others do. There is a strategic advantage by leveraging existing strengths and customer relationships, as well as on brand recognition.
3. Furthermore companies should digitalize there core business and make it leaner, more agile and cost effective.

4. Finding ways to better use internal and external data to generate higher revenues and come up with more innovative project ideas and capabilities is also one of the key elements Raiffeisen emphasized.
5. The fifth element was to position the business in a broader ecosystem. As ecosystems are becoming essential companies should create new relationships and capabilities as well as use platforms that allow to work together in new ways.

Both presentations highlighted that importance of securing senior management support, including CEO and the executive board, to ensure success in digital transformation. This and the active management of the right skill sets seem paramount.

### The Future of Banks in the Digital Landscape

Banks have the potential to offer growing opportunities among the financial service industry. Despite all the challenges and threats new players might represent, there are several ways to achieve an Open Banking strategy, fitting to the current competitive advantage and interest. Customer's preferences, new regulation resolutions, technological trends and players will establish the grounds for the beginning of a new era among banking.

We want to say "thank you" to the speakers, supporters and visitors who made the evening a memorable event.

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### Arthur D. Little

Arthur D. Little has been at the forefront of innovation since 1886. We are an acknowledged thought leader in linking strategy, innovation and transformation in technology-intensive and converging industries. We navigate our clients through changing business ecosystems to uncover new growth opportunities. We enable our clients to build innovation capabilities and transform their organizations.

Our consultants have strong practical industry experience combined with excellent knowledge of key trends and dynamics. ADL is present in the most important business centers around the world. We are proud to serve most of the Fortune 1000 companies, in addition to other leading firms and public sector organizations.

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