THE DAY AFTER IS NOW

Winning the Race to Digital

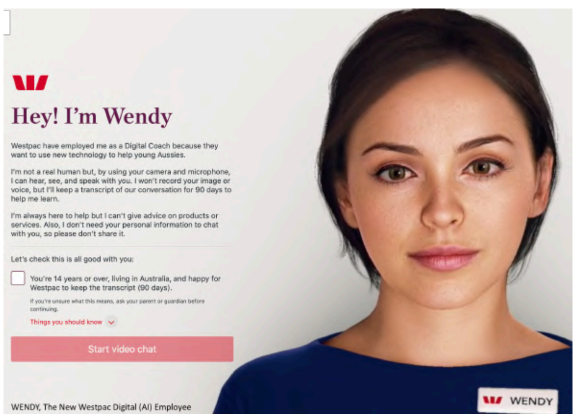
THE BANK'S DIGITAL JOURNEY (Vol. II)

Philippe Carrel, May 2020

How the crisis will speed up and generalise the digitisation of banking relationships; how tech-savvy banks can surf the wave.

THE DAY AFTER IS NOW

Wendy* would certainly agree that behaviours have already changed and there's no coming back. The new Westpac digital AI-based employee, Wendy, is capable of some degree of emotion and empathy; she looks like your typical Apple Store staff and coaches youth on finding a first job -a perfect example of how tech-savvy banks can infiltrate an ecosystem and directly reach out to a specific audience.



Brands selling clothes, music or soft drinks to teens know it well: You need to be teen yourself, impersonate, connect, mingle. Of course, the B2B economy is not (yet) directed by digital native GenZ raised with social networks. Under the guise "you don't sell bank services like a pair of jeans", the resistance to digital has been unsurprisingly a lot stiffer.

And this is about to change.

Within weeks, the pandemic and the lockdowns wiped out all forms of resistance to the digital economy and turned virtual communications into the default mode of client engagement. An entire universe of new possibilities is open.

In a world that will minimise travels and physical contacts for the foreseeable future, the appetite for digital services suddenly became gargantuan, across all segments of consumers, businesses, products or services. This includes banking and investment services to corporate treasurers and asset managers.

This paper explores the opportunities for banks and provider of financial services to leap forward by leveraging the perception shifts and the fast development of digitally delivered services, in the corporate banking domain in particular.

DIGITAL REIGNS SUPREME

Long before the pandemic, banks were courting digital natives, primarily Gen Z and late millennials, now the world's largest population. For the rest of us and B2B transactions in particular, banking as usual still prevails. At best a few desktop apps are being used for account management, whilst every serious discussion or contract signing still requires a visit to a branch, followed with hard copy document processing. Those days are over, but it is not only because of the virus.

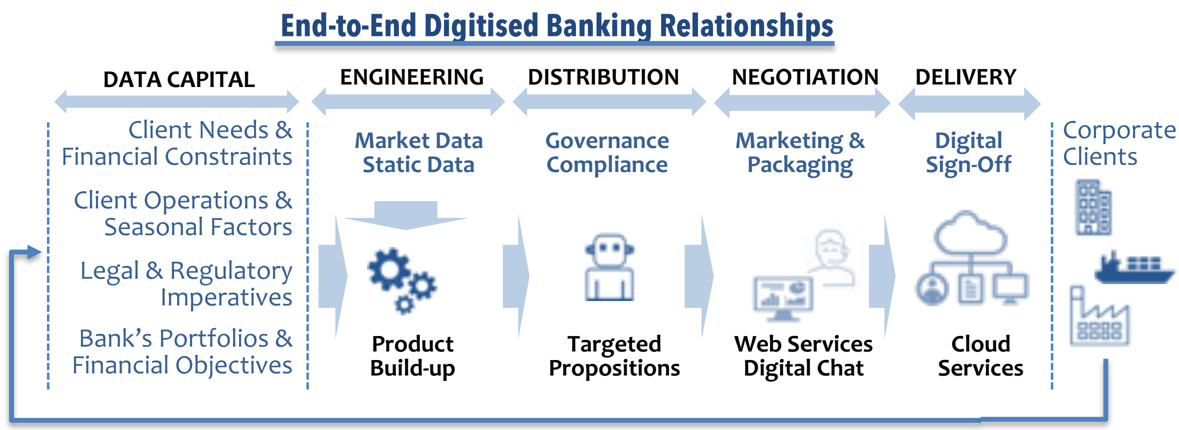
According to a McKinsey study published in 2018 (1), corporate banking activities represent 36% of the global financial intermediation system, which is slightly more than retail banking with 34%. Corporate banking activities are often more rewarding than retail in terms of both interest and fee-based revenue. Moreover, hoarding data as valuable capital about the client's daily life allows banks to join, build and stir ecosystems. In other words, there is a big slice of the pie lying right here, almost untouched. It was already on the radar of the banks' R&D and innovation departments when the pandemic crisis came to make it an absolutely compelling need.

Corporate banking hinges on enabling clients' activities, such as financing infrastructures, production and sales cycles, and of course Treasury. To some extent, payments, foreign exchange and cash management are already being carried out on line, but in most cases the offers remain focused on dealing a single asset class and fall short of relating to specific client activities. The bank might actually lose insights if digital transactions cut off the clients from their sales desks without any alternative channel to maintain the relationship. An end-to-end digitisation of the corporate banking experience shall therefore stretch the value chain from product discovery and negotiation, to orders, transactions and settlements. It also requires a broad range of instruments, such as issuances, trade finance or hedging tools necessary to liability management.

RICH DATA TRANSCEND BIG DATA

Digitising any form of transactional activity raises three types of problems: Standardisation, Jurisdiction, Scale. By definition, a pre-configured solution necessarily addresses a predetermined problem, expected to occur under a predictable alignment of parameters, within a given legal framework. To put it simply, you need to know your clients really well. The minimum data required involves their financial structures, business seasonality, funding and hedging needs, macro-geographical, legal factors and so on. Without data capital build-up, no solutions can be engineered or distributed.

The diagram below exhibits the main aspects and development stages of an end-to-end digitised banking relationships for corporate clients. Compared with a retail type of relationship, digitised corporate banking requires a lot more customisation and should focus on value rather than mass distribution.



Banks need data capital to carve out smart products, and tech talents to deliver them.

CUSTOMER EXPERIENCE OVER SCALE

For digital relationships to become the new norm, they ought to cover a majority of use cases, as opposed to be limited to the ones that are expected to scale up. How then can they be profitable? It might be less a question of cost than one of value.

Retail digital banking initiatives, heavily focused on mass distribution to justify the effort of going digital, failed to prove the profitability of their model. The Swiss based Fincog (2) benchmark reports that, as of October 2019, none of the digital-only “challenger banks” returned a profit. Although all of the 8 banks reviewed had an international reach and altogether had accrued a total client base of 200 million retail and business customers, their low levels of income seemed to be the key issue, the report explains. This highlights that profitability hinges on added-value, rather than purely on scale or the extensive use of digital channels. Even the banks who offer personal and business loans -in one case residential mortgage loans, in addition to cash services, do not seem to create enough value to propel themselves out of the red. Their aggressive commercial policies and obsessive focus on scale have commoditised the products to the point of killing their profitability.

Ever since starting their digital journey, banks are strongly advised to “turn themselves into a fintech”, to the least “think like a fintech”. Yet in their haste to tap the world’s 4bn mobile phones users, even the tech champions did not create enough profit in spite of massive investments and achieving commercial success.

What if, on the contrary, there were more value in thinking like a bank?

The Fujitsu Digital Transformation of Banking Services Report (3) reveals that out of the 90% of financial companies who have embarked on a digital journey, it was those with robust ecosystems that had achieved the best results. Focused on the core purpose of the banking business, which is to create credit out of people’s savings, they use technology to enhance their client experience and ecosystem -not to disrupt it. The mere replacement of human contacts with digital channels may cut costs (in the favourable cases) but is not in itself a generator of value. It’s by providing services that would not otherwise exist, obsoleting cumbersome processes or penetrating an entire ecosystem that a bank can create a differentiator. A good example is the app developed by the Commonwealth Bank of Australia (CBA) that returns a mortgage loan proposition out of a simple photo of a house sent from a smart phone; the service locates the house, fetches the price, identifies the negotiating agents and can eventually complete the loan transaction on the phone!

DIGITISED CORPORATE BANKING OR THE TALE OF 3 PLATFORMS

“End-to-end” client experience does not mean a mere replacement of points of contact with Artificial Intelligence (AI); nor would “digitised” boil down to mass distribution of overly commoditised products. Like Wendy*, the AI can create a custom wrap around standard services. The machine can reshuffle building blocks to build, modify or kill new products rapidly, without ever losing sights of risks. Enhancing a client experience is also to depart from that recent trend of starting everything with a Minimum Viable Product (MVP), which is like telling upfront that there is little value in it.

Three platforms are necessary to cover all flows related to trade finance, project finance, structured finance, treasury, liability management, issuances and so on, from inception to payments: An intelligent data platform to accrue, analyse and extract insights from clients’ activities. A risk calculation platform to build offers and monitor their value under scenarios. Finally, a dealing platform to trade, negotiate, execute, and settle, in a compliant fashion.

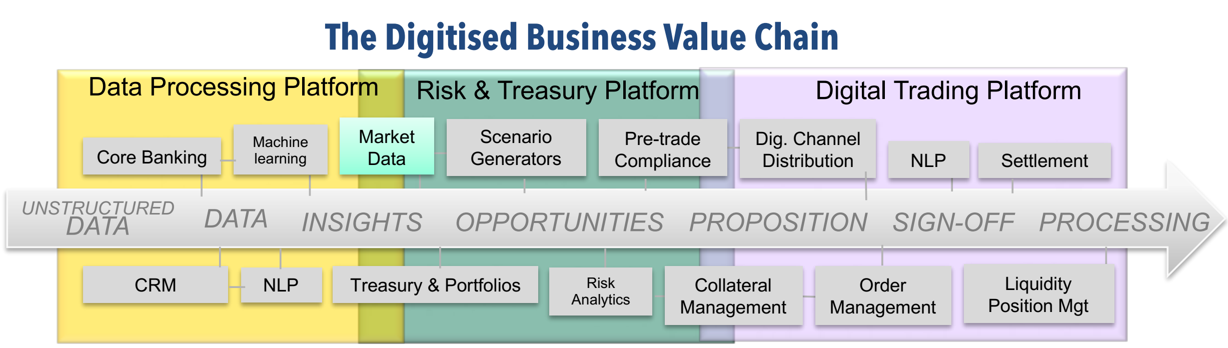
Intelligent data platforms are rooted in the CRM and core banking systems. They do not reveal the clients’ behaviour, but they contain information deriving from it. To turn unstructured data into actionable insights, technologies involve intelligent tagging, traditionally used by social media to map people, places, facts and events, as well as Natural Language Processing (NLP) to read any document, such as balance sheets, or transcript. A bank can foresee the hedging and funding needs of exporters, anticipate coupon payments to fund managers, identify issuance opportunities, collateral value changes and so on. Those are things a good relationship manager would know. For a machine to propose similar type of cutting-edge propositions, it needs to digest data such as volumes, places, counterparties, seasonality and identify whom to contact. In the process, unstructured data turned to structured data, then into insights.

At this stage, AI can tap other sources of unstructured data, such as news, reports, government filings, help prioritise the needs, bring them in context. Now the bank has turned insights into trade opportunities. They need to be priced.

The second platform is a production workbench to create products that address the client needs with matching financial flows. It finds its raw materials in the bank's treasury positions or its securities inventory. It fuels what-if scenario engines with market data processed through financial libraries, curves, volatility and correlation analytics. The platform also needs to expose the regulatory implications and the trading boundaries (credit limits, applicable rules, margin requirements) of the products under the various scenarios. The product is now ready for distribution.

The third platform allows the bank to engage clients via digital channels. It covers product presentation, negotiations, simulations, compliance checks, sign-off, and settlement. The more integrated to the production platform, the faster price or sensitivity changes can be reflected in the client proposition. Too often this is where the shoe drops. Banks would deploy incredible efforts to build a sophisticated multi-channel e-commerce, but fails to back it properly with real-time position management, 24H service or straight-through settlements. Those slacks kill the benefit of going digital. Imagine buying a song on iTune and waiting 48 hours to be able to listen to it!

The diagram below exhibits the transformation of data into insights, then into value propositions and trades, achieved with the integration of the 3 platforms. Their seamless integration is the key to developing an agile, responsive digitised banking relationship with corporate clients.



To this date, most banks have concentrated their efforts on the trading front end (the 3rd platform), which explains why the offerings were limited to simple, commoditised products requiring less support.

THE NEW DEFINITION OF RESILIENCE

As banks and corporates will weather the global recession and its fallouts, financial products will be engineered to the uneven needs of individual clients and fragmented markets, not necessarily for scale and mass distribution. So far, individual, customised or bespoke were antonyms of digital; and this is where the challenge lies. Banking services have got to become digital because all businesses will, because it provides speed, accuracy and risk controls and simply because the new generations would not understand it otherwise.

This paper has explored the main aspects of building an end-to-end digitised corporate banking relationship and highlighted the high level of integration necessary between 3 essential IT platforms for client data processing, risk calculations and trading. For most banking organisations, this is highly likely to amount to a massive simplification of the legacy architecture, typically built in layers. The transformation also involves re-approaching client needs locally, focused on service and less on the numbers game.

The crisis will eventually lead to thorough reviews of business continuity principles, geo-political dependencies, the centralisation of data and processing. This will drive to smaller, simpler more localised internal services.

More than a trend, what we’re seeing here is new definition of resilience.

REFERENCES

* https://wendy.westpac.com.au

(1) Banks in the changing world of financial intermediation, McKinsey 2018

(2) Fincog Benchmark on Challenger Banks Features and Profitability (October 2019)

(3) Digital Transformation of Bank Services, Fujitsu Future Insights