

FINACLE CONNECT

Connecting The Banking World



**Delivering Business Value
through Innovation**

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The market is changing, and customers too; technology is growing by leaps and bound and the same competitors who spell threats, strangely enough, are collaborators too. The troughs and peaks of this dynamic environment have shaken the foundations of even the most prepared organizations. In short, the banking business has been compelled to adapt itself to a 'new normal'. When so many banks have fallen by the wayside, those that remain, in the survivors' world, have proved their mettle indeed. Now, the challenge before these survivors is to sustain and grow business momentum in a vastly different world propelled by constant changes, each posing threats as well as opportunities.

Their future depends upon how successfully they meet key expectations around managing consumer-driven sales, stemming erosion of customer confidence and coping with organizational restructuring. Survivors must also comply with emerging regulations, tackle disruptive competition, improve efficiency and resource optimization while smartly adopting cross-industry best practices.

To fulfill what seems like a rather tall order, I believe innovation-driven transformation is in order, to withstand further tremors, counter market forces and create competitive advantage to ensure future sustainability. However, banks must be careful to invest their energies in meaningful innovation, which contributes to agility, efficiency, growth and value creation for both the bank and its customers. They must also align their product, service or process innovation initiatives with the new reality defined by higher customer expectations, tighter resources, fiercer competition and stricter regulation.

While prescribing a make-over in mindset for banks, I also deemed it apt that FinacleConnect moves into the next phase of its evolution. My sincere thanks to our reader community for having shared their invaluable insights, without which, this new adaptation of FinacleConnect would not have been possible.

I am happy to mention that, with a view to make the journal a more relevant read, several new sections have been introduced. In addition to the regular sections, FinacleConnect now brings together perspectives from global industry leaders on topics around business strategies, organizational behavior, operations management, regulation and compliance, and the future of banking. I believe you will find these new sections – Stratagem, People Perspective, @Work, Statute, Standpoint and Big Bet – both insightful and pertinent.

Inside Talk, in this issue, brings to you perspectives from Anthony Thomson, Chairman, Metro Bank and Gökhan Mendi, Retail CEO and Executive Board Member at Fortis Bank, Turkey. And, completing the read is In Focus. Author, Chris Skinner takes us through the journey of how technology has transformed banking and what this progressive role of technology means for strategy and innovation at banks.

And as it has always been for us, this time around too, it's your suggestions and feedback that'll mould the making of FinacleConnect next.

Till next time!

Haragopal M

Global Head - Finacle

Infosys Technologies Limited



How Technology has Transformed Banking

Précis

Over the past 50 years, automation has revolutionized banking from a secure, closely controlled activity to one that is more open and integrated. Banking technology has gone through a five-stage evolution cycle, each stage leaving a transformational impact on the business.

Stage 1: Automating the drudge of large-scale manual paper processing (1950s - 1990s)

Stage 2: Reducing servicing costs through ATMs and call centers (1990s - 2000s)

Stage 3: Empowering the customers through the self-service channels (1990s to now)

Stage 4: The customer in control, empowered by Web 2.0 (2000s to now)

Stage 5: The componentized bank - Decomposition into small, easily usable 'plug and play' parts (tomorrow)

The bank of tomorrow is all about flexibility, agility and adaptability. It will ensure that all customers can mix and match functionalities

from various providers, and that banking service and functionality can be easily adjusted to changing business.

On the flip side, evolution has clearly created a challenge for mature banks, such as those in the U.S and Western Europe, which have transitioned between each of the five stages by adding technology, layer upon layer. This technology now forms an almost unbreakable foundation at these banks. However, the foundation needs to be broken due to the subsidence of the underlying technology structure, which is inadequate to support a type of banking where the Internet and customers have the upper hand. New and recently overhauled banks, particularly those in emerging markets which have leapfrogged the intermediate stages of evolution have relatively smaller constraints, and as a result, enjoy a massive competitive advantage when it comes to componentizing their functionalities. They will be the ones delivering 'everything everywhere real-time' banking, going forward.

For the past fifty years, technology has inexorably automated many aspects of banking but, as each technology wave evolves, the transformation is moving banking from being a secure, privately managed operation to being an open and integrated space. This creates huge challenges for banks, and many are not dealing with these challenges well. For the few that are, however, the rewards are immense. What is actually happening?

It's banking everything, everywhere.

Fifty years ago, way, way back in 1960, banks were making their first tentative movements towards automation. Systems were slow and centralized, and banks were heavily oriented towards clerks keeping accurate books of accounts. Half a century later, banks are efficient, lean and mean automated machines. The progress and process of automation has gradually taken humans out of the process. It has not achieved that dream or nightmare yet, but it is the ultimate ambition: to create a completely automated bank.

This process of automation has been a naturally occurring and evolving movement in banking and can be best illustrated by considering this to be a five-stage cycle of technology evolution and innovation:

- Stage One: Automate the Drudge
- Stage Two: Reduce Servicing Costs
- Stage Three: Empower the Customer
- Stage Four: The Customer in Control
- Stage Five: The Componentized Bank

These five stages are seen in most banks, although banks in emerging economies such as China and India appear to be leapfrogging this process from stage one to five far faster than their Western counterparts, who are handcuffed between each stage.

In order to understand this process of evolution, we need a brief look at each of these stages of evolution.

Stage One: Automate the Drudge (1950s to 1990s)

Back in the 1950s, banking was a book-

keeping process. Little changed over the previous century, banks were based upon large contingents of record keeping clerks receiving paper confirmations and cheques from counterparty banks overnight by secure transport and road systems. These papers would be reconciled and detailed in the books of the banks and counter-signed by managers and then by the Central Bank.

The history of this process dates back to the 18th century practices in the U.K, when clerks of each bank visited all of the other banks to exchange cheques and kept a tally of balances between them until they settled with each other. In 1770, this practice changed as it was realized it would be easier to meet in one place and settle balances in cash. In other words, some form of central clearing system. This was when the formalized cheque clearing system started in London at the Five Bells Tavern – a bar is always a good place to transact business!

By the 1950s, the volumes of cheques being cleared this way had become unmanageable. Admittedly, you could have a large room full of pen pushers keeping the records, and settlement could be made via cheque rather than cash, but it was getting over-loaded.

Therefore the drudge was automated and punch cards operators put cheque details onto punch cards, processed on large mainframe computer systems in batch overnight.

Credit cards were evolving the same way. At this time, banks would offer credit cards, such as the Bancamericard which later became Visa, and they would operate via paper slips of payments from the card being sent into a central processing centre where office clerks would write the details into accounts books.

Automation revolutionized this practice to create the modern credit card system whereby the raised numbers on the card create a carbon copy foil that can be automatically read in automated systems. This all took place in the

1970s under the watchful eye of Dee Hock, the founder of Visa, and the modern credit card operations started.

Meanwhile, bank branches were manual record keeping centres to meet and greet customers and administer to their needs. Just as with cheques and cards, branches gradually received IBM 3270 green screen terminals and systems to further automate the process and reduce the drudge.

And this was the focus of most bank automation between 1950 and 1980: remove large scale manual processing of paper, and automate this wherever possible, initially through data entry – taking the paper information and typing it onto the system, just as they used to do with paper records where slips and cheque information would be rewritten into central books – and, today, through direct entry of details at point of action thanks to ATM, POS and more.

These latter innovations came around in the 1970s and 1980s as we moved towards our second stage of technology deployment based upon office automation.

Stage Two: Reduce Servicing Costs (1970s to 2000s)

Once banks had tackled the large volumes of manual book and record keeping, they started to consider using technology to reduce the costs of customer servicing. This move led to many innovations, such as the launch of the ATM and the introduction of call centres, but when these were launched they were not seen so much as service improvements but cost saving programs. For example, the ATM was exactly that - an Automated Teller Machine. In other words a machine to get rid of the costs of having human tellers in branches. This is why banks had concerns about customer reactions to such technologies: would they use them, could they remember PIN numbers, what would a customer feel like when dealing with a bank machine, and so on.

These thoughts may seem unnecessarily cautious today but, back in the 1970s, computing was purely about mainframes: large, centralized, processing machines that were alien to anyone other than those who worked with them.

Gradually, during the decade of transition between 1970 and 1980, new firms were being launched that focused upon office automation technologies and putting computing power into the hands of the average person, with Microsoft leading the pack.

This move from centralized machines that automated manual drudgery towards office automation using minicomputers and, later, personal automation using desktop computing meant that banks found themselves transitioning from automating drudge with a cost saving focus, to improving customer service.

For example, telephone banking first appeared at the end of the 1980s thanks to the office automation computing capabilities of minicomputers. These computers offered the ability to produce standardized letters at the push of a button, without the need for a typist. They allowed banks to deal with customers over the telephone by having staff type into screens in a central location rather than in a distributed branch location.

The initial reaction to these technologies was cautious: did customers have the technology to dial in and would they feel comfortable dealing with a detached voice rather than face to face?

Again, the technology proved its worth as customers found the process intuitive and, before long, banks had moved from using technology to reduce servicing costs to deploying technologies that would allow the customer to serve themselves. The self-service revolution of the Internet was underway.

Stage Three: Empower the Customer (1990s to now)

Obviously giving customers' self-service, via Internet banking and mobile banking, has lowered cost overheads for most banks as this channel should remove transaction requirements in other areas, such as branch. Conversely, these services assist the customer too, in feeling that they are more in control, but this has not been a simple process as outlined above.

It took the march of technology to get there.

First, there was the automation of the drudge through mainframe computing, and then office automation allowed improvements in servicing costs and structures. Now, the mixture of home computing combined with the Internet allowed the new wave of bank automation to ensure, with online banking creating a wave of change.

Initially, banks got it wrong however. They saw this as further cost reductions through technology, and many tried to close branches and layoff branch staff, using the Internet as a channel to replace such servicing structures. At the time banks tried to do this the technology was not ready. For example, many banks closed branches through 1998-2002 as Internet banking entered mainstream banking. Equally, banks tried to offer mobile banking back then using the Wireless Application Protocol (WAP). The fact these technologies potentially could work as solutions for online and mobile banking seemed attractive, once again as a cost reduction process by eliminating branches and branch staff. However, many customers resisted the offer of Internet banking, because they felt it was insecure and too difficult. In fact, some customers still feel this way today. More importantly, Internet access was based upon dial-up lines and slow communications back then, and WAP was counter-intuitive as were many of the bank's sign-on processes to their online bank capabilities.

As a result, the early days of empowering the customer to self-service were fraught with challenges.

This has changed, thanks to the introduction of broadband technologies and smartphones which support mobile Internet services. Equally, banks' understanding of how to use the Internet as a channel has improved immensely over the last decade, such that financial institutions now see the Internet as their most critical customer connection. This is because, for those who are highly mobile, Internet-savvy customers, they have not just found this demographic demanding but, by offering them the tools to be in control, these customers are fully empowered and in control of their bank relationship.

The 'customer in control' is one step beyond 'empowering the customer', as it now challenges the bank to be responsive, not just available.

Stage Four: The Customer in Control (2000s to now)

After forty years of technology implementation, banks are far more efficient and capable in processing every customer transaction first time, every time for every nickel, dime and cent.

Throughout this process, banks have focused upon cost avoidance and reduction but, as times change and technology progresses, there has been a symbiotic development of improvements in customer service and empowerment of the customer to be in control.

Until the introduction of broadband and mobile Internet, banks were fully in control of how the customer received financial services. This is because service was offered to the customer to use the bank's channels under the bank's control and guidance. The issue today is that banks are no longer in control of this relationship.

Specifically the introduction of social media and mobile applications, in the widest sense of the word, is revolutionizing how banks and customers connect.

Take the developments of Web 2.0 as illustrated by Facebook, Twitter, social media and social networking for example. Fifty years ago, the customer's social network was their local community; today, it is their global community through blogs, YouTube and continuous life streaming of views and news.

Broadband processing, in particular, has allowed the customer to access unlimited knowledge from anywhere on the planet at the click of the mouse. This is why we now talk about word of mouse being stronger than word of mouth.

With this mass of communication, most banks have taken a long time to get to grips with these technologies, with very few examples of a Bank 2.0 in this world yet. In fact, most banks appear to be in denial of the customer being in control thanks to Web 2.0, with many not using Facebook, Twitter, YouTube or other services to communicate. In fact, the majority do not even have a blog.

By not communicating with customers in the age of Web 2.0 and the customer being in control, banks are missing a trick. For example, a bank that blogs and uses social media extensively is Wells Fargo. Why? Wells Fargo believe that if they don't, it is like everyone on the Internet is having a conversation about Wells Fargo, but Wells Fargo had not bothered to turn up. The result? Everyone talks about you behind your bank. That is, Wells Fargo uses these channels of communication to reach out and talk, because it is a far more courteous conversation if you are at the party engaging with your customers in a dialogue, than not being there.

Even more fundamental is the change we see happening thanks to the combination of mobile access to the Internet.

Stage Five: The Componentized Bank (Tomorrow)

Mobile banking has come of age at the end of the 2000s. From SMS text messages allowing

emerging markets to connect all towns and villages for mobile payments to pieces of financial functionality deployed as an iPhone or Android app, the mobile is dramatically redefining the banking offer.

Specifically, banks have realized, that these new mobile devices offer far more than simple mobile access to browse Internet pages or access online banking. Thanks to Apple's iPhone and Google's Android mobile operating systems, the mobile Internet is now realistic as a branch in the hand 24x7.

For example, the Spanish Bank BBVA launched an application for their customers in the summer 2008 called *Tu cuentas*, Spanish for 'you count'. What is interesting about the *Tu cuentas* service is that it offers a range of apps for customers to find, design and create the functionality they desire:

- **Mobile bank applications:** Obviously the service provides the typical range of mobile bank services from balance checks to transaction services
- **Aggregation applications:** If you are a user of Santander, BNP Paribas, Deutsche Bank or others, you can include access to their balances and services via apps that integrate their services with BBVA's
- **Budget applications:** The budget applications analyze buying, spending and budgeting behaviors of the customers and compare those with other BBVA customers to make recommendations as to how they could more efficiently manage their finances based upon 'people like them' (this is very similar to what the U.S website MINT does)

There are more apps provided, but you get the picture.

What this really portrays is the breakdown of banking into components of functionality. Some technologists might consider these to be

objects, modules or parts of a Service-oriented Architecture (SOA).

However you term such services – for the rest of this document we shall call these components – the deconstitution of the bank into parts which are then deployed as a small but easily usable component, means that the bank of tomorrow will be very different.

For example, it gives us the ability to create location-based components of functionality that are relevant at the point of action.

It gives users the immediate access to pieces of functionality on demand.

It makes using the Internet on the mobile as simple as touching a screen.

That is a revolution of technology and consequently next generation banking.

For example, if banks are component-based and each bank offers different components and usability, you will end up with millions of banking components and customers will download and design their bank service around their lifestyle. This means that customers are not only in control, but banks will start competing to provide the best mobile banking components, the best aggregation components, the best budgeting components and so on. In other words, banking components of functionality - their apps - will be interchangeable. If I don't like using BBVA's savings component anymore, then I might switch to Santander's. If the Deutsche Bank budgeting component provides better information and servicing than BNP Paribas, then I will switch to their service.

Everything will be plug-and-play, interchangeable, on the mobile 24x7.

In commercial banking, banks will offer a liquidity risk component, an e-invoicing component, a supply chain component, a cash management component, an accounts payable component, a foreign exchange component and

so on, to their corporate customers.

In investment banking, there will be equities components, trading components, portfolio analytics components, hedging components and so on.

Everything will be a component of functionality that can be plugged into the corporate and consumer network as easily as an iPhone app or a Google gadget.

Customers will then take these components and use those that work best for them.

The critical point in this logic is that, by making banking component based, banking will be very different:

- Banks will be able to ensure that even the most unskilled bank customer can use them
- Bank customers will be able to mix and match components and component providers - banks - to best fit their personal lives or business model
- Bank functionality and servicing can easily be adjusted to suit business changes over time, because this is all plug and play secure, up-to-date through downloads with centralized control in real-time 24x7

All of the above will give the banks and their customers incredible flexibility, agility and speed to adapt to changing circumstances.

It's Banking Everything Everywhere.

What Does this Mean for Strategy and Innovation?

This paper has chartered the course of bank automation through a five stage cycle:

Stage One: Automate the Drudge via Mainframe Computing (1950s to 1990s)

Stage Two: Reduce Servicing Costs through Office Automation (1970s to 2000s)

Stage Three: Empower the Customer with Personal Computing (1990s to now)

Stage Four: The Customer in Control due to Online Self-Service (2000s to now)

Stage Five: The Componentized Bank created by Mobile Applications (Tomorrow)

Each stage of this cycle has given the customer more and more control until, today, banks and the banking functionality is completely plug and play as components on a mobile phone.

This has created a big challenge for some banks, particularly highly technology automated mature banks, such as those in the U.S and Europe who have transitioned between each stage, and layered technologies on top of each other.

Back in the days of automating the drudge – when Visa and SWIFT were launched – the ability to deploy technology was prohibitively expensive. This is why banks spent a long time deliberating such deployments, as it would typically be a decision that would take five years or more to see a return on such investments. Today, technology is almost disposable. A mainframe of 1970 is a mobile telephone of 2010. The technology power you could buy in 1970 for a million dollars costs you less than a dollar today.

And this is the core issue Western banks face today. Most have paved their path to 2010 through layers of technology in the past. That technology is the foundation of the bank, and the foundations are too strong to break particularly as the foundations have walls, ceilings and floors of technologies layered

upon them through the 1970s, 1980s, 1990s and 2000s.

These layers have cemented over the foundations, making many mature banks' technology structures near unbreakable. But they need to be broken, because the technology structure is suffering from subsidence as the revolution of today's mobile Internet takes hold, and as the customer takes control.

In conclusion, for those banks who have not moved through these historical stages, such as many of the banks in emerging markets, today's component based bank developments offer a massive competitive advantage.

New banks and banks overhauling core systems will be able to offer components of functionality far in advance of those banks constrained by their past unbreakable technology structures. The new banks will be truly agile, flexible and capable of delivering banking everything everywhere, in real-time.

This will truly differentiate the leaders from the bleeders in the age of the mobile Internet ▪

Author

Chris Skinner
Chairman
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Also Read

Perfect Time to Transform - FinacleConnect Issue 17

Wanda Guttas, Executive Vice President, Union Bank talks about the transformation strategies that Union Bank is adopting to emerge unscathed and stronger in challenging times. She believes that as the economy and financial industries recovers and the consumer confidence is restored, they will be in a position to respond quickly to the changing environment... http://www.infosys.com/finacle/finacle-connect/Issue_17/default.asp



Online Banking: Innovation Required

Précis

Evolution of the Internet as a channel is pushing the change-averse banking sector to keep up with new technologies, business models and customer demands. At the same time, isolation of business unit silos and compliance requirements are pulling banks the other way, stifling creativity and innovation. But, the fact remains that banks must innovate to stay competitive as well as fight innovative non-conventional players who have entered financial market niches characterized by strong consumer interest or weak traditional competition.

Consumers, who are spending a lot more time online socializing, transacting or indulging in various activities, are demanding that their banks provide the same kind of rich user experience not unlike an Amazon, Yahoo or iGoogle. Unfortunately, a majority of online banking sites lag customer expectations on account of inadequate budgets, insufficient emphasis on innovation and poor agility. Banks must redress the inadequacy of online banking by participating in two areas reinventing the online space - Rich Internet Applications

(RIAs) and social media.

The early adopters of RIAs, including some non-bank consumer financial sites, are setting the standard for the rest of the world. Banks' online retail and wholesale banking solutions, which are adequate in functionality, have a long way to go when it comes to quality of experience and nurturing of customer relationships.

To date, many banks have studiously ignored the social media revolution, or made a token effort at participation by putting up a page on Facebook. What banks need is a social media strategy which spans multiple bank activities, is tied to business goals and has the backing of executive management. Social media activities must be part of day to day business and customer relationships. The focus must be on interactivity, experience and two-way information flow.

And finally, banks must believe that their investment in innovation of online offerings will earn a return through customer relationships.



The Internet is in a state of perpetual transition. The ever-evolving nature of this channel has banks careening in all directions to keep up with new technology, shifting business models, and customer demands and requirements. However, change is not something that comes easily to most financial institutions. Siloed business units, politics and heavy compliance requirements have stifled creativity and slowed innovation at many financial institutions. However, the market is too competitive to allow banks to rest on their innovation laurels, and customer demands are forcing banks to shift gears and refocus their priorities.

Interestingly, much of the innovation and competition is coming from non-banks that are active in the financial services sector. These companies have discovered opportunities in areas where banks have been slow to react or where they believe consumer interest is strong (for example Personal Financial Management). Consumer expectations are also being set based on online experiences outside of the financial services space. Consumers are flocking to trendy websites and interacting with rich Web 2.0 online tools and shopping sites. They are spending an increased amount of time socializing and conferring with friends, family, colleagues, organizations, corporations and strangers. There are hordes of examples - from reading product reviews on Amazon, to interacting in communities and blogs, to experiencing the rich experience provided by the iPhone.

Banks are starting to recognize that their online banking solutions are at a crossroads. The Web-based applications that they launched a few years back simply aren't cutting it, and they need to decide what direction to take them in. Generally speaking, banks' online offerings can't hold a candle to the innovation and online customer experience provided elsewhere. The problem is that customer expectations are rising - consumers, including but certainly not limited to Gen X and Y, expect a rich, interactive, and easy-to-use online experience. Why are banks lagging so far behind?

The overwhelming majority of banks are lagging for several reasons:

- **Banks don't have the budgets.** Sixty-four percent of IT budgets at North American banks are dedicated to maintaining a quagmire of legacy systems. Unfortunately, many banks have become caught up in this exercise and have not been able to successfully divert funding to new investments. The financial crisis has made it extremely difficult to get new projects funded.
- **Most banks don't place enough emphasis on innovation.** There are numerous exceptions to this. However, as technologically dependent as banks are, most don't necessarily have the right people or organizational focus.
- **Banks aren't agile enough.** The larger the bank, the slower it moves. Messy systems, politics, siloed units, and legal and compliance issues extend development times and innovation cycles. This is creating opportunities for smaller banks and credit unions to enter the picture. Some of their burdens are lighter and therefore allow for faster reactions and time to market.

Initiatives of smaller banks need to emphasize the online channel and focus on innovation solutions that are pertinent to their client base. There are two key areas that are reinventing the online space - Rich Internet Applications (RIAs) and social media.

Rich Internet Applications Are on the Horizon - Banks Are Slow to Catch On

The early adopters of Web 2.0 rich Internet applications (RIAs) are out there, and they are setting the bar for websites across all industries. For example, users of Hotmail and Yahoo Mail have already noticed significant improvements to the user experience as well as additional functionality (for example drag and drop, right-click menus, column resizing, among others). Certain consumer financial sites run by non banks are also displaying fresh looks that streamline navigation and transform the customer experience (for example, Mint.com). Banks have a lot of work to do when it comes to improving the online experience of their retail and wholesale

banking solutions. The core features and functionality are there; it's really a question of what banks need to do to improve the customer's interaction and experience with their products.

Banks may look at this type of enhancement with skepticism - the impact on the bottom line from this type of upgrade is difficult if not impossible to measure. However, banks need to consider these and other enhancements in order to:

- **Lead the market or follow the competition.** There will be leaders that set the bar with regards to RIAs. Once a couple of banks come out with new RIAs, others will follow. The challenge, however, is time to market and constrained IT budgets. Evaluating AJAX frameworks, developing and testing are time-consuming processes. Those that wait to jump into the game will be set back 12-18 months - a significant period of time to fall behind the competition and, even more importantly, behind customer expectations or requirements.
- **Anticipate customer requirements or be pressured into meeting them.** Users are experiencing Web 2.0 today. They see elements of it popping up on websites that they frequent and are hearing about it in the media. It is only a matter of time before users begin to compare the smooth look of Yahoo Mail, iGoogle, or Mint.com with their outdated online banking solution. Customers will begin to demand enhancements to the user interface in order to streamline and improve their experience.
- **Grow and nurture customer relationships or wait for other banks to step in.** The impact to the bottom line may be difficult to measure, but banks can improve customer retention, stickiness and relationships by focusing on the user experience. The ultimate goal of the bank should be to have satisfied users that can easily navigate within the system. The user should enjoy the online experience and be able to perform their job without getting frustrated. A positive experience can encourage users to try new features and will

in turn, over time, increase revenues for the bank.

Social Media is the Talk of the Town

The online world is constantly buzzing with new trends and activities. Among these are online communities, blogs, Facebook, Twitter and other flavors of the day. Making sense and interacting with the dizzying array of options is a challenge - one that many consumers embrace, but many banks struggle with. Social media is the talk of the town, and banks are just starting to get their arms wrapped around it.

Twitter and Facebook are growing in leaps and bounds - for individuals who want to stay in touch with friends, family and colleagues, not for those who want to keep in touch with their banks. In addition bank compliance departments limit what banks can do on Facebook. Many banks put up a page simply to say that they are on Facebook. This of course does not produce any fruitful interactions or tangible benefits. Banks shouldn't waste their time with Facebook because there are bigger and more lucrative fish to fry. The overwhelming majority of bank Facebook initiatives have performed miserably.

Twitter is presenting plenty of opportunities. Many banks are out in full force on Twitter. Celent believes that banks should take full advantage of the communication channel provided by Twitter and should consider using it for marketing and sales activities, building and solidifying relationships, solving customer service issues, and customer and product research. There are plenty of risks involved with social media, and Twitter is no exception. Banks are entering uncharted waters. Compliance and legal hurdles will also need to be cleared.

Social media also extends to blogs, online forums and communities, among many options. Blogs and communities should also be incorporating interactive content. The most relevant example is the incorporation of video. This is having an impact on online training and education as well as customer support. The concept of social banking is slowly emerging. It specifically pertains to Personal Financial Management (PFM), person-to-person lending



and collaborative banking.

Banks require a social media strategy. Many banks have taken the unfortunate step of placing social media in a silo and assigning a junior employee to deal with it. A social media strategy needs to span multiple bank activities, be tied to business goals, and have the buy-in of the executive team. A senior marketing executive should lead the charge and should seek task force representatives from various parts of the organization. Social media activities need to be blended into a bank's day-to-day activities and customer relationships.

Social media also needs to be integrated into online banking and a bank's website presence. The website should contain the bank's Twitter feed, and the bank's blog should be well positioned within the customer experience. Interactive help and training tools with video and commenting should be an integral component of online banking. Banks can even go the extra mile and build their own user communities and allow users to rank webpages, products and services. These seem like add-ons today, but are quickly becoming critical components of the Web. Banks need to emphasize online interactivity and the customer experience as they have a significant impact on relationships. The days of pushing data and information out to the consumer are over. It's now a two-way street, and banks should capitalize on the stream of data, information, and interactivity that is headed their way. Banks that choose to stifle or limit the two-way information flow (for example, deleting negative comments about the bank

posted to the blog) are simply missing the point and the learning experience.

Many banks are still choosing to ignore social media; others are dabbling at it; and a few are going full force. Whether banks like it or not, social media is part of the online world and must be addressed.

Banks Need to Emphasize Business Objectives and Customer Relationships

Banks need to work on solidifying customer relationships, particularly in these challenging times. Innovative products will increase the stickiness of relationships and provide competitive differentiation. In order to do this they should develop rich next generation online solutions and offerings that incorporate social media. As they pursue this journey they will be able to blend in new features including PFM, mobile banking and payments.

Banks must invest in innovation in order to see a return on the customer relationship side. Celent recommends that banks appoint an executive in charge of innovation. It is important for banks to understand where the industry is headed, formulate an innovation strategy and partner with firms that can help strengthen customer relationships and provide a competitive advantage •

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Also Read

1. Web 2.0: A Quantum Leap for Banking - FinacleConnect Issue 20

Banks continue to have difficulty harnessing Web 2.0 and the possibilities it represents. Analysts define Web 2.0 as the tipping point in the evolution of the Internet, where consumer behavior and activity, and its enabling technology emphasize the user experience and capabilities as engaging, interactive, and collaborative. Web 2.0 represents a departure from the aspects of much of the Internet's legacy roots of one-way communication and static, desegregated data. Absent the hype and technobabble, Web 2.0 might simply be characterized as "the dynamic Internet" or "the interactive Internet." http://www.infosys.com/finacle/finacle-connect/Issue_20/default.asp

2. Banking on Social Media - FinacleConnect Issue 19

Social media has the capability to fundamentally change the way businesses interact with their customers, employees and other stakeholders. Banks, which have largely stayed away, can no longer sit on the fence. Going forward, they must have a game-plan to leverage social technology or risk being left behind...

http://www.infosys.com/finacle/finacle-connect/Issue_19/default.asp

Delivering Business Value through Innovation

Focus on Customer and Channels



Précis

Return on Capital (ROC) is one of the acid tests of business. Ultimately all banks will judge and be judged by how well they use their capital resources. Since all other indicators like efficiency, productivity and customer retention flow back into ROC, this is the preeminent driver of business value, and the cynosure of any project investment.

But past economic travails and rising expectations from regulators and customers alike are making it harder for enterprises to meet their ROC and other targets. Innovation, important at the best of times, is now an imperative that can help banks improve agility, compliance, customer engagement and delight, on the way to differentiating themselves, and channel innovation in particular can contribute to business value by improving productivity, lowering costs and enhancing the efficiency of delivery infrastructure, provided it is leveraged correctly.

Channel innovation must ensure that channels balance ubiquity with respect for customer privacy; are equipped as per the context of

usage, paying attention to details such as location of the touch point and the profile and usage pattern of customers frequenting it. And notwithstanding their thrust towards self-service, channels must always give users the option to seek human assistance when required. It is also imperative that, when offering a selection of channels to customers, a comparable and consistent experience is delivered across all. Channel innovation must also be driven equally by technology and creative strategy. For example, harnessing the power of social networking by connecting banking channels directly to platforms frequented by customers. This enables banks to be a part of discussions that are about them and enables them to respond quickly and appropriately to their customers.

A note of caution: while deploying services across various channels banks must ensure the security of customers' funds, identity and information, especially those conducted online or via public channels such as in-store kiosks. At the same time, the firewalls must not make transacting a cumbersome activity.

Innovation and Return on Capital (ROC)

In a research report on the innovation strategy and practices of European banks, the European Financial Management Association defines innovation as “a new idea or method, which creates value for the customer or the company itself.” On another note, for a bank, ROC is arguably the most important measure of business value. Aside from being a key expectation of investors, a healthy ROC is usually a sign of efficiency, productivity and customer retention. ROC is indeed a proxy indicator of the value created by an innovation project.

How Meaningful Innovation Can Strengthen ROC

The realization of ROC and other secondary business drivers like efficiency and productivity, among others has become elusive on account of tough environmental conditions characterized by:

- Slow recovery from the global financial crisis for banks running in the 'normal' business mode
- Low customer confidence, resulting in lower retail business and investment
- Accelerated change and stringency in regulatory requirements
- Rapid escalation in the expectations of Gen-Next consumers

Innovation, which revolutionized the face of banking in the past, now has a very important role to play in the alleviation of these issues. By accelerating product and service delivery, improving customer engagement, enabling quick adaptation to changing compliance mandates and fulfilling higher customer expectations, innovation can help banks meet these challenges and differentiate themselves to get through a phase of intense consolidation within the industry.

It is not hard to see the salutary impact of innovation on ROC and drivers of business

value. For instance, customer experience innovation improves retention; product innovation improves cross-sales and process innovation improves the efficiency and productivity of the bank as well as its customers. Small wonder that banks are increasingly looking to invest in innovation to not only survive in the short run, but emerge as leaders over the long term.

Let's take a closer look at how innovation can positively impact two key drivers of banking ROC:

- Customer delight
- Channel experience

Innovation to Create Customer Delight

Customer delight – a primary contributor to ROC and business value – helps banks acquire and retain customers. On the flip side, a bank needs a base of loyal customers that it can proceed to delight and ultimately convert into advocates. This sets in motion a cycle of higher profitability, because it is well understood that it is much more profitable to service existing customers than chase new ones.

Innovation creates customer delight by improving product relevance and transparency, customer empowerment and choice, as well as banking reach, all of which make a great user experience. The following examples are amply illustrative:

- Innovations in GPS based technology and RFID enable banks to pinpoint the current location and activity of their customers and leverage that knowledge to deliver context-relevant messages.
- Innovation in analytics help banks understand their customers better and gain deeper insight into their needs. Armed with information about individual customers including their profile, preference, community and affiliation, banks propose targeted products and services to each customer. What's more, this deeper und

possible for individuals to learn more about products and services of interest, at a pace and time of their liking. If these tools, which are usually available online, can also be made available to customers at points of purchase, that could further improve customer convenience and the bank's cross-sell rate

- Agile and flexible systems support product innovation so that the right product, at the right price and in the right package can be offered to customers at the right time. Garanti Bank, Turkey offers Flexi Card which permits customers to determine 10 parameters including interest rate, reward rate, card fee, campaigns, redemption type, and card design is a good example of personalized product innovation

Thinking Out-of-Box with Channels

Few bankers will contest the fact that the emergence of new age channels has often been deemed an overt expression of 'definitive innovation' in banking. Channel innovation has created immeasurable business value by improving productivity, lowering costs and enhancing the efficiency of channel infrastructure. For instance, several banks in the Finacle-EFMA survey reported using ATMs and self-service kiosks to deliver a wider range of auxiliary services, from bill payments to loans, even to those without a card. Bankinter improved its customer satisfaction ratings and online product sales by providing a video-call facility to Internet banking customers using which they could resolve queries, complete transactions and even close deals.

Despite the success of banking channel innovation, there is much room for improvement in future initiatives. When channel innovation is deployed optimally, it can deliver scale, reach and business value at no additional cost.

1. Firstly, channels must be nonintrusive, yet within reach of customers when needed. Customer delight fades fast in the face of pushiness.

2. Secondly, different channels must be leveraged differently, in sync with the manner in which customers transact over each, and only relevant information or services must be delivered. For instance, banking services rendered over in-store display terminals must focus on providing basic account information and other communication that may be important within a shopping context; such terminals are not suitable for providing investment advice. Another example is that of the unbanked whose requirements are very different from those of the affluent; it is important that alternate channels factor in these differences if they are to deliver an optimal experience to either segment. Equally, channels must offer a fallback option to users to seek human assistance at any time during the transaction. Hence, a rural ATM kiosk must be able to render voice-based assistance in the local language and non-branch channels must offer the comfort of voice or video chat with a bank employee so that their less tech-savvy users can simply speak to someone when required.

Linked to the above point, banks must deploy channel intelligence to empower customers and thereby raise their financial decision making skills. Financial tools such as comparators and simulators can help customers understand the difference between competing products or the impact that a certain investment would have on their overall portfolio. This type of support is especially needed by older or less financially savvy users who might be acting independently for the first time.

Knowledge about the channel behavior of different customer segments must also be used to reward them by way of higher reward points for non-branch transactions or

higher interest rates for fixed deposits booked online.

3. Next, user experience on alternate channels must be multi-channel enabled, that is, it must not vary drastically from one channel to another, and the information acquired by one must be ported seamlessly to the rest. For example, navigation in the mobile banking site must be consistent with that on the Internet pages, and it should be possible to complete an interrupted ATM transaction through the contact centre without having to start at the beginning
4. Channel innovation cannot be purely technology driven; an innovative channel strategy is as necessary. Today, social media is a strong influence in any kind of decision making. People don't take company sponsored communication about a product at face value; they seek their peers' opinion instead. Since this applies to banking and financial services as well, banks can ill afford to ignore social media. By taking a creative approach to channel strategy, they can harness the power of this medium to their advantage. For that, they must enable their channel infrastructure to connect directly to various popular social platforms, so that customers can immediately follow up on an interesting new banking service that they've just come across by discussing it with in their communities. The facility to obtain timely advice from peer groups while an idea is still "hot" will enable customers to decide faster, and in all likelihood, improve the banks' chances of closing the deal.
5. Technological innovation must further improve channel automation and ensure that customers are confronted with the least amount of clutter. An application that immediately comes to mind is in the area of authentication. Innovative authentication measures such as voice recognition or finger printing can shorten the authentication process and eliminate the

need for user names and passwords, which are susceptible to theft. Hence, going forward, authentication of an Internet banking user should be possible with a swipe on a fingerprint reader attached to a laptop, and a mobile banking user must be recognized by voice. This also increases security of the authentication process.

6. Newer channels including mobile, TV, VOIP phones and kiosks can be further leveraged to create ubiquitous but unobtrusive reach.
7. Last but not least, channel innovation must also focus on making transactions absolutely secure through data encryption or the provision of multifactor and other sophisticated forms of authentication. Particular care must be taken to ensure that public channels such as in-store kiosks are not vulnerable to attack by fraudsters. The use of innovative biometric technology for customer identification is a further step in this direction.

Summary

Maximizing ROC is high on the agenda of banks. Several value-drivers such as efficiency, productivity and customer stickiness link back to ROC. Innovations that rejuvenate the channel experience and make for customer delight play a defining role in optimizing the drivers of business value. That said, to put in place a cohesive innovation strategy, is critical indeed. While laying down their vision for innovation, banks' senior management must ensure ground-level support by way of, employee training and a collaborative partner network in addition to robust technology infrastructure. This is the way to innovation success - the kind that strengthens ROC and builds a sustainable differentiator for the business ▪

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Also Read

1. Do the New: Why Banking Innovation is such a Great Idea - *FinacleConnect Issue 19*

Since banking is so relationship-driven, it must stay in step with customers in order to remain relevant. So, when a customer asks, "What's in it for me?" the bank had better be ready with an engaging answer.

Of course, this is not an altogether new idea. For years, banks, have tried to understand their customers' evolving needs and be the first to satisfy them. Early attempts were product focused, as banks tried to improve existing offerings and add new ones. However, this approach did not differentiate products based on the customers they were sold to or the channels they were delivered over... http://www.infosys.com/finacle/finacle-connect/Issue_19/default.asp

2. 8 Points to Ponder for Banks Seeking to Innovate - *FinacleConnect Issue 19*

Deborah L. Bianucci, President and Chief Executive Officer, BAI – Today, in the aftermath of one of the most significant economic upheavals, banks have a choice. They can insist that they will never put a dollar of capital into anything that does not come wrapped in an ironclad business case. Alternatively, they can opt to resourcefully explore the world of possibilities to capture their fair share of wealth in the new realm. Having made the latter choice, here are 8 thoughts to throw light on the way forward... http://www.infosys.com/finacle/finacle-connect/Issue_19/default.asp



Supply Chain Finance and the Role the Banking Partner Should Play

Précis

Global supply chain management is pressurizing companies to master new financing tools and revise working capital strategies. The dependence on global procurement means that companies accrue in-transit inventory overseas, which has big implications for their balance sheets. Hence, there is a need to find new ways to manage and accelerate the flow of funds through the supply chain.

The array of financial instruments and practices that help in the management of working capital is called Supply Chain Finance (SCF). Obviously, banks play an important role in SCF, starting from guiding the buyers' SCF design program, highlighting its own knowledge of legal requirements in major supplier regions, helping buyers identify the right suppliers and educating them about adding new ones on the SCF system following the supplier enablement process. But, banks' most important responsibility is to manage supply chain risk and create liquidity. For their own benefit as well as that of their clients, banks must take a process-centric approach which enables them to offer new capabilities to

SCF participants proactively.

Interestingly, studies reveal that corporate clients view their bank as the most reliable source of information regarding SCF products and services; however, very few banks actually educate their clients about this subject.

Clearly, banks must lay out a roadmap to:

- Educate relationship managers on the concepts of SCF and the way in which to communicate them
- Build a business case with estimates of costs versus benefits of SCF implementation, to present to clients
- Decide how to deliver the SCF portfolio
In addition, banks must find ways, including the use of business rules, to adapt to changing regulations faster.

Since SCF products must be tailored to customer needs, banks' technical capabilities and the features of their products could be important differentiators. Also, going forward, banks should focus on portfolio and risk management.

Corporate Finance and the Need for SCF Programs

As companies increasingly operate their supply chains on a global basis to remain competitive, they also feel pressure to master unfamiliar financing tools and to revise their strategies for managing working capital. The trend of rapidly increasing planned direct imports and global procurement strategies has major implications for companies' balance sheets because they accrue in-transit inventory at some point overseas.

There is, therefore, a need to look at new ways of managing the flow of funds through the supply chain. Many analysts and researchers have observed that, although the flow of information through the supply chain has accelerated, with electronic ordering now possible in seconds, and the flow of goods is faster, with many deliveries possible on the next day, the flow of funds has not kept pace. It can still take weeks for money to be moved along the supply chain.

While the physical supply chain represents the management of materials and information to deliver goods, the financial supply chain represents the management of cash and capital to deliver the same goods (source: JPMorgan). When corporate finance managers (i.e., CFO and treasurer) understand the financial dynamics of the supply chain, they can employ a vast array of financial instruments and practices – factoring, letter of credit, pre-shipment financing, maturity, forfeiting and reverse factoring - to help the company meet its working capital objectives. These instruments and practices are called Supply Chain Finance (SCF).

Typical steps of a SCF program

Like any change management program, a SCF program has a number of steps in sequence.

1. Structure the Proposal for Discussion

2. Review of the Proposal

3. Mandate from Corporate Buyer and Implementation

4. Financing

What Role Should the Banking Partner Play?

The positive outcome of the program is subject to a number of elements that must be factored before, and during, its execution. It would be impractical to display an exhaustive list of considerations, but it is advisable for the bank to keep the following items in mind:

- Ensure accurate information between parties (i.e., buyer, supplier) and make it always available
- Expect realistic timelines, with clear milestones and deadlines
- Secure commitment from buyer's executive management
- Ensure the buyer appoints a project leader

The SCF banking partner must guide the buyer in the proper design of their SCF program. When the buyer is targeting a significant number of suppliers in a particular region, the bank will highlight its competitive advantage of being comfortable with the legal requirements of operating in that region.

The bank will also help buyers target the suppliers according to criteria (for example, geography; currency; payment term tenor; credit risk profile) that will increase the success opportunities of the program when the bank will buy their receivables. The bank will also educate the buyer to plan the introduction of new suppliers on the SCF system following the supplier enablement process.

This activity is best executed when the bank has taken a much more holistic picture of their clients' risks by analyzing the process

elements that build up their physical and financial chains.

The real value that a bank sells is tied to its ability to manage risk, and turn it into liquidity. There are many elements of risk in the physical supply chain. The corporate buyer expects the bank to take the risk of financing the supplier, once the buyer has confirmed the supplier's reliability, responsiveness, flexibility, quality of delivery, and service levels. These are all supply chain-related performance criteria, which the bank must be able to translate into risk ratings.

A bank breaks the chain into its components to establish a risk profile for each one. The more granular the segmentation of the chain, the closer the risk profile to the real risk curve.

The attention to business processes allows the bank to increase customer stickiness and dependence by offering integrated supply chain management and finance products, which can attract new clients. A process-centric approach enables banks to offer new capabilities to financial supply chain participants proactively rather than wait for a product request or merely provide information on products.

The impact on operations and organization SCF falls under a bank's transaction services unit. In order to gain its role as SCF program partner the bank must look under a new perspective the organization of its units. The business rationale behind the necessity of an organizational review sits on two major elements: income generation and cost reduction.

The objective of boosting revenue is a driver to develop a holistic and integrated offering, forming cross-sales plans for existing clients to push the entire product portfolio and increase share of wallet. In order to accomplish such results, the bank's organization and governance must be aligned with the client's business objectives.

To reduce costs, it is imperative to leverage organizational synergies. The bank must accomplish several objectives by reviewing its organizational structure. Typically, the transaction services unit at a bank has several products targeting corporations in the working capital area, namely cash management, trade finance, and foreign exchange. Today, these products belong to different business units and there are difficulties in integrating the full product offering. Often times, it is the governance set up to inhibit cross-sales. As a result, there are discussions in transaction services groups about reorganizing the sales organization, with the aims of coordinating sales activities based on the clients' needs, developing a holistic product offering, reducing cost associated with the current organization, and ensuring global coverage with local support.

Banks must realize that a successful approach to serve corporate client needs starts from covering all payables/ receivables "ledgers." Utilizing the operational financial transaction flow of the client (i.e., database with information) increases the chances of up-selling from pure transactions to different working capital financing solutions.

The impact on a bank's business model in terms of internal organization resides in its ability to arrange the offered products with the market approach of an investment bank. An internal redistribution of resources is necessary to reinforce the investment banking skills and capabilities, notably by reallocating teams from the syndication loans units. A loan is, per se, rather simple to manage. The complexity arises in the structuring phase when the bank must win the corporate mandate, which is the result of a thorough examination process where the bank must show its entrepreneurial skills.

Indeed, one of the most significant traces left by the rearrangement of bank relationship policies among corporate treasurers is their demand for banks with a more entrepreneurial behavior and their willingness to support

supply chain lending policies.

Banks should consider research as a brand-building function, enabling the rebuild of their engagement with potential clients, both corporate and fund managers.

For instance, ING launched a campaign to support their clients in an exercise of balance sheet optimization. In preparation of the service the Dutch bank trained its sales teams to analyze the balance sheet of corporate clients. Royal Bank of Scotland plans to hire around 15 research analysts in 2010, having already hired 15 analysts since September 2009. Other banks, including Citigroup, Credit Suisse, Deutsche Bank and Morgan Stanley, are looking to increase headcount or hire selectively. (source: Financial News).

Market sector studies report that the bank relationship manager and the bank as an institution are, in the eyes of the corporate client, the most reliable sources of information for banking SCF products and services.

A survey among corporate executives revealed almost one-third of respondents with absolutely no opinion of what supply chain finance is, for the simple reason that nobody ever explained it to them. In fact, when asked whether any bank had approached them to explain the concept, an overwhelming majority of practitioners said no.

This demands a clear and stringent, roadmap for banks if they want to emerge:

- Educate the relationship managers teams to the concepts of SCF
- Educate them, also, on what are the messages to convey when approaching a non-finance corporate counterparty. That is, “speak the language of operations and supply chain management.”
- Build an evaluation model to support the prospective client through the preparation of a business case, to estimate the cost/benefit ratios when implementing an SCF solution

- Decide how to deliver a SCF portfolio

Banks must also think at solutions that support a vast number of standard government and corporate securities that are pounding the global capital markets. They must determine how they can adjust faster to new financial regulations through business rules that equate to real time changes.

The bank SCF products must be tailored to meet the needs of the customer, which often can be very specific. Product features and the bank's technical capabilities become critical to winning the business and can be a differentiator between potential bank suppliers.

The main areas for banks for the next 2 to 3 years will be portfolio mgmt and risk. Given the continuous pressure of regulators (for example, IBM Institute for Business Value has counted 4,000 brand new regulatory interventions in 190 countries since the financial crisis began) financial institutions may be required to value their portfolios in a number of ways. Banks need to manage multiple portfolios and deal with different views of the same portfolio, by merging together data from multiple asset classes within many different systems, and consolidate this information onto a single comprehensive portfolio management tool.

The added value will be to provide an automatic tracking of activities and exceptions to regulatory standards.

Are there any implementation pitfalls to avoid? The bank partner's role is again fundamental. The experience acquired in the course of past SCF program implementations provides an invaluable service to the corporate buyer. The bank's implementation team will show the most common mistakes a buyer should avoid to reap the benefits of a successful SCF program:

- Lack of program design
- Not including the procurement function in the SCF decision process. Procurement must work with suppliers to achieve the program objectives

- Not understanding the documentation the bank requires from the suppliers
- Lack of appropriate incentives. Both procurement and suppliers must be motivated to avoid the risk of chasing the wrong objectives, such as giving shorter payment terms in return for small price reductions. The benefit of the price reduction can be offset by the liquidity deficit due to the advanced payment.
- Failure to train / educate procurement on how to use SCF in their supplier negotiations. The most successful approach is to determine the term extension request based either on a business reason (for example, via payment terms benchmarking) or economic reason (for example, supplier financial condition) and then negotiate on the basis of a business reason

Conclusions

If implementation steps are scrupulously followed and properly managed, supply chain finance programs promise to deliver significant results to all participants: the buyer, the supplier, the bank.

Quantitative benefits can be measured in reduced DSO for the supplier, extended DPO for the buyer, and increased market share and new delivery channels for the bank.

More qualitative benefits must also be accrued to evaluate the overall ROI of the SCF program. It is important, for the bank, to highlight these intangible advantages to the

parties involved in the SCF program, who strongly rely on the bank's ability to guide them through activities and processes most unfamiliar to them.

Benefits to indicate to the buyer:

- Possibility of indirect supplier financing
- Automatic payments on agreed dates – easy settlement of payments
- Improved negotiation position towards suppliers (e.g., buying conditions)
- Possibility of expanding terms of payment

Benefits to indicate to the supplier:

- Converting short-term receivables into liquidity
- Earlier availability of liquidity
- Improvement in cash flow
- Financing of the delivery period
- Alternative form of financing
- Own credit lines are spared
- More favorable financing/ interest rates
- Possibility of offering extended terms of payment
- Reduction of transaction costs (for example, debt insurance, documentation)*

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Building an Effective Compliance Program for Banks

Précis

The financial crisis catapulted regulation, supervision and risk mitigation into the limelight and underscored the need for a sound compliance program running on a continuous cycle of design and implementation, checking and correction and, reporting and reaction.

The design and implementation phase begins with a bank setting up its compliance plan in alignment with the broader strategic plan. It's important to do so to prevent both from pulling in different directions in future. Next, the compliance strategy needs a structure to take it forward, and while that depends upon the individual context of the organization, what doesn't change is that the executive management is always responsible for the program's success or failure, while the business units are responsible for hands-on execution.

Checking and correction of a compliance program is done through extensive testing. Different parts of an organization follow different testing and quality control processes; it is important to test each to understand the

extent to which it tolerates error or enforces compliance. Of course, the next step is to identify the root causes of error and propose remedial measures in the form of an actionable plan.

Analysis of data and communication of findings lead the reporting and reacting phase. Analysis seeks to uncover the Key Risk/Performance Indicators, which point to any event that may impact the compliance performance of the organization or suggest that the management's risk tolerance threshold has been violated respectively. These findings must be collated and the reports circulated to the appropriate layers within the organization, with serious violations brought to the attention of the highest executive authority.

Since compliance is not a one-time event but an ongoing effort, the entire cycle must be revisited periodically to determine whether there's a need for adjustment in compliance strategy, structure, assessment and testing or the assumptions underlying the program.

In the highly regulated environment of financial services, it is absolutely necessary for a bank to have a sound compliance strategy, structure and process. Otherwise the bank's business plan could be in jeopardy regardless of how sound it might otherwise be.

An effective compliance program runs as a continuous cycle of the following processes:

- Designing and implementing
- Checking and correcting
- Reporting and reacting

Designing and Implementing

The design and implementation phase comprises three main activities:

1. Setting strategy and structure

Broadly speaking, a bank's strategic plan determines where it is headed and how it will get there. Obviously, the compliance program must be synchronized with this plan. For instance, if the bank is pursuing a high growth strategy, its compliance program must be flexible enough to allow minor control deviations to enhance competitiveness, yet, not permit any significant violation. On the other hand, if the management has a conservative outlook of the business and little appetite for risk, the compliance control strategy can brook no lenience.

In addition, the central compliance unit must ensure that the central program is aligned with the goals of various business compliance units, and that there is clear delineation of roles and responsibilities since those business units are the ones with direct responsibility for day to day compliance.

With a compliance strategy in place, the bank needs to establish a structure to carry it forward. The type of structure will depend upon the individual situation of the bank – its size and nature, products and services and

regulatory environment, to name a few. One of the primary objectives at this stage is to set up roles and responsibilities for different layers of the organization. Hence, while executive management sets the tone and initiates the program, hands-on compliance is the responsibility of the business units. However, the onus of failure or violation finally rests with the senior-most executives, that is, the Board of Directors.

2. Assessing compliance risk

The first step is to identify those risks that might prevent the bank from achieving its business objectives. At this stage, it is important to understand the type of products and services the bank offers, the extent with respect to systems and process automation and a clear understanding of the regulatory environment.

The second step involves classifying the risks into *inherent* and *residual* risk types. As the name implies, inherent risk is the measure of risk before controls, whereas residual risk is the measure of risk after controls have been applied. The effectiveness of the controls is reflected in how well they succeed in mitigating risk. This is most important because high inherent risk can be mitigated into low residual risk through strong controls.

3. Ranking risk

Next, risks must be ranked according to exposure, which is the extent of potential damage and likelihood or the probability of that occurring. From a compliance perspective, a high risk ranking exposure caused by significant violations could invite severe regulatory criticism and result in large economic and reputation damage to the bank. On the other hand, a moderate risk ranking exposure, brought about by some violations would have a milder impact. The combination of exposure (high, medium, low) and likelihood (high, medium, low) yields the overall risk ranking. While assigning a ranking

it may be possible to categorize and measure inherent risk in key aspects such as financial, litigation, transaction or reputation risk.

Finally, the effectiveness of controls must be established. Controls are of two types - *preventive*, which stop the violation from happening, and *detective*, which come into play post-facto. Preventive controls are generally applied at points in a process where errors could occur. Examples include automation, systems processing controls, written procedures and independent checks. Detective controls find compliance errors after they have occurred. Exception, reconciliation and other reports or asset control activities such as counts, physical verification and discrepancy investigation are all various types of detective controls.

Like risks, the effectiveness of controls too can be ranked in three main categories as *strong*, *adequate* or *deficient*. By mapping controls effectiveness rating against inherent risk rating, it is possible to establish an algorithm deriving the residual risk rating.

The compliance unit must distill this collective knowledge into a controls inventory that documents where controls are, where they should be and where the gaps exist. Likewise, the risks must be classified into a database, maintained dynamically on an ongoing basis. It is important that the compliance unit reviews controls assessment regularly, perhaps every quarter, to ensure that the controls are still adequate.

Checking and Correcting

1. The first step is compliance testing, which is the process of reviewing transactions to determine the error rate or level of compliance. Different parts of the organization follow different plans and methods of testing and quality control. The compliance unit monitors business units' analysis, systems, reports, complaint trends, among others to determine how strong their testing programs are. At times,

the compliance unit might also run separate tests on various transactions. The ultimate goal is to refine the scope of testing to increase focus on high risk areas and render it capable of detecting potential violations. The role of the compliance unit differs from an audit in that the former works along with the business units as part of the process, whereas the latter is independent.

2. Next, evaluate the results of testing and determine what the control effectiveness ratings mean within the specific context of each bank and its regulatory environment. This is because there is no standard, universally accepted definition for strong, adequate or deficient control effectiveness within banking. Therefore, each institution must assign a threshold that it deems appropriate.

3. Obviously, the ultimate goal of the checking and correcting phase is to propose remedial action. Once errors are detected, it is important to determine their root cause before prescribing corrective action. Finally, the corrective plan must be handed over to responsible people within the organization, for implementation within a specified time frame.

Reporting and Reacting

The key activities in the reporting and reacting phase of the compliance program cycle are analysis of data, communication of results followed by reaction or modification as required. The goal of analysis must be to highlight Key Risk Indicators (KRI's) and Key Performance Indicators (KPI). A key risk indicator is an external or internal event or activity that may have an impact on the compliance performance of the organization, for example, an increase in customer complaints or closer regulatory supervision. A key performance indicator is a detectable and measurable event or activity which indicates that the management's established risk tolerance threshold has been crossed - for example, test results with a high error incidence.

The results of these analysis must be compiled into reports and reached to the right people within the organization; more serious violations must be escalated to senior executives and ultimately to the Board of Directors, if necessary.

Finally, the organization must revisit the entire cycle in order to determine the right course of action. This means asking whether:

- There is a need to adjust implementation strategy, structure or goals
- The assessment process is faulty
- The testing program is inadequate because it is unable to discover risks that show up during audit
- The risk tolerance has changed, and therefore necessitates other adjustments

In other words, an effective compliance program is one that follows this cycle on a

continuing basis, and understands how each cycle relates to the others. These programs not only see the benefit of the direct results (“What does this specific test tell me about the control being measured?”) but also the broader results of what all of your testing is telling you about “state of compliance” of the entire bank, or possibly even a new direction that your compliance strategy needs to address, but regardless always responds to the never-ending cycle of an effective compliance management program*

Author

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Tech Watch

Revisiting Model Driven Architecture

Précis

Banks today are facing challenges on multiple fronts - customers continue to demand convenience, ease of use and richer functionality; competition from new entrants and tighter regulatory requirements are adding to cost and margin pressure; and banking products are quickly becoming more and more commoditized.

The need to continually evolve new products, channels and services to remain competitive can no longer be ignored and innovation and agility will make the difference while launching new products, improving customer experience, optimizing processes and raising operational efficiencies. When IT ecosystems become the key ingredients of innovation and differentiation, the risk, cost and complexity of application development increases.

Over the last decade, various software development methodologies have been

introduced to support agile development of applications while minimizing the associated costs and risks. This article revisits Model Driven Development, a methodology which provides a visual model-based approach for application development and helps in building well-architected systems quickly and efficiently. The MDA approach comprises of various models which describe the business process, independently of the implementation technology and, describe the system deployed in implementation technology.

The article also highlights the key trends that are being seen in the development of SOA applications and the banking environment. MDA clearly has the potential to enable enterprises and application vendors to quickly scale up their development teams without compromising on standardization of development, quality of code and usage of common reusable components.

Model Driven Architecture

Model Driven Development (MDD) focuses on the use of models in software development. It attempts to insulate the business and application logic from the implementation platform and technology and aims to enhance productivity, promote reuse and support portability by separating abstract architecture from the implementation architecture, model transformation and code generation.

Model Driven Architecture (MDA) is a framework created by Object Management Group (OMG) for promoting MDD. OMG has defined open standards and terminologies to promote system interoperability via modeling standards – Unified Modeling Language (UML), Meta-Object Facility (MOF), XML Metadata Interchange (XMI) and Common Warehouse Meta-model (CWM). The MDA approach follows the following models:

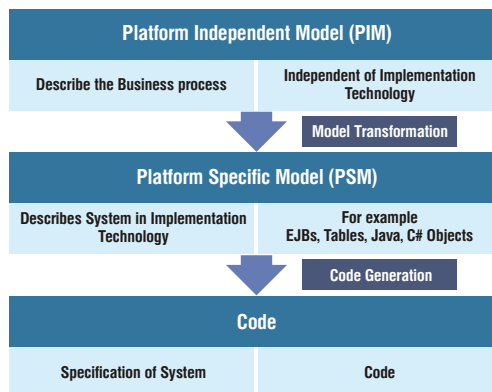


Figure : MDA Models

Platform Independent Model (PIM)

The platform independent model defines the business functionality of the system at a high level of abstraction. It is independent of the implementation technology. This allows both business and technical aspects of the application to evolve independently of each other in response to technical innovations or business requirements.

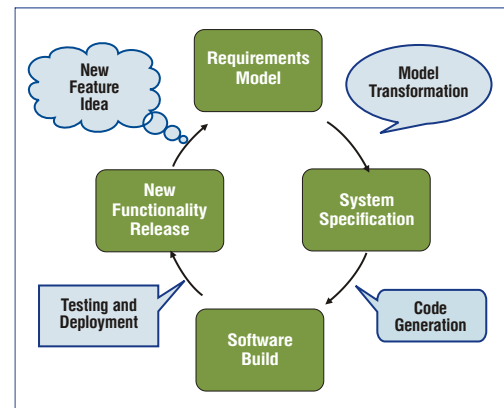
Platform Specific Model (PSM)

The platform specific model describes the system from a platform-specific perspective. It is a representation of PIM with

implementation-specific details. It is specific to the technology platform. A PIM can be transformed to multiple PSMs. For example, a PIM in Database PSM would mean tables, columns, relationships and constraints while a PIM in Java/ C# PSM would mean classes, attributes, methods, among others. Model transformation tools are used to generate PSM from PIM.

MDA modeling becomes the foundation of application development. Hence, there is no need to repeat the modeling each time the technology or platform changes. Using automated code generators, the enterprise architecture patterns and practices can be enforced and traceability between the models maintained.

Application Development Lifecycle Using MDA



Requirements Specification

The application development lifecycle starts with a business analyst specifying the requirements using a modeling notation. Requirement modeling provides a view of how the system would support business functionality by providing business data, business rules, services and processes independent of the implementation details such as technologies and platforms. It helps align business and IT teams by providing a better understanding of the requirements, characteristics and constraints. The business users specify the requirements in sufficient detail to allow transformation of technical specifications and software development.

Requirements are typically modeled visually using Unified Modeling Language (UML), Business Process Modeling Notation (BPMN) or Domain Specific Languages (DSL) and modeling tools such as Visio and Rational

System Specification

System specification describes the requirements in terms of the chosen implementation technology. Enterprise architects and designers transform the requirements model into one or more platform-specific implementation models. These transformations can be automated by transformation tools based on the chosen implementation. This transformation capability enables abstraction of application development and allows implementation and portability across target platforms. Requirement models are transformed to multiple platform-specific models based on the implementation technology used. For example: JSP, ASPX, Database, Java, EJB and C#. OMG reports that currently available transformation tools automate 50-70 percent of PIM to PSM conversion.

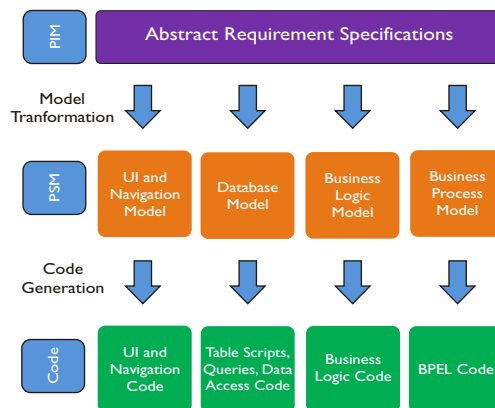


Figure : MDA Transformations

Code

Code refers to specification of the system in source code. MDA offers a range of tools to transform the system specification into code. The algorithms, mappings and transformation from PSM to code are intended to be configured by enterprise architects and designers. This allows architects to enforce enterprise architecture principles and patterns and usage of reusable components. The range

of tools available for code generation varies from manual transformation to completely automated transformation.

Using abstract specification and completely automated code transformations may sometimes lead to a trade-off with application performance. Application architects would need to watch out for this and carefully choose a hybrid approach for developing an application.

Vendors of both development tools and business applications are adopting the model-driven approach with respect to their development tools. Vendors are following various strategies to support MDA. While vendors such as IBM, Borland and SAP support OMG MDA standards and framework, Microsoft focuses on Domain Specific Languages (DSL) and software factories. The major tools available are IBM Rational Suite, Borland Eclipse 2, Microsoft Visual Studio, Microsoft Visio, Compuware Optimal J and Pegasystems.

Benefits of Model Driven Development

Communication

Modeling techniques help teams understand and communicate ideas. Standard definitions and reference models facilitate discussions between business and IT stakeholders from various backgrounds as well as among disparate teams and reduce the confusion over the requirements and constraints under which the system should work.

Architecture compliance

MDA defines a framework for specifying transformation rules. This helps in enforcing enterprise architecture principles and patterns consistently across solutions when developers convert the design model into code. It also allows for architecture refinements to be applied to the systems.

Reduce project cost and time to market

Model transformation and code generation



allow for patterns and processes to be reused over a period of time leading to reduced project cost and time to market. Models also allow simulation of various architecture and design alternatives resulting in early identification and resolution of critical issues. By maintaining consistency between application models and generated code, maintainability of the application is greatly improved.

Recent Trends

Architected Model Driven (AMD) development is an emerging trend in the development of SOA applications. AMD is a set of processes and technologies for visual modeling, analysis of business requirements and automation of their design and delivery. These new tools aim to automate 100 percent of code generation or until execution of the model itself. The tools also support bi-directional transformation and a model-code elaboration approach. A practical example of this would be the orchestration of a process based on calling of services in a certain sequence. Most process designers allow the user to create a process visually by selecting appropriate services and other elements to be glued to each other. The designer tool can generate either meta-data or code which can be executed by a runtime engine. Usage of AMD requires sophisticated skills and efforts for business process analysis and design. Hence, analysts recommend AMD for complex projects that require a high reuse of business services. Analysts also note that these tools are evolving and will take 2-5 years to mature.

Architected Rapid Application Development (ARAD) is a set of processes and tools for developing applications. An analyst firm has positioned ARAD as “an emerging approach that charts a middle ground between the Rapid Application Development (RAD) approach used for small, short-lived projects and the architected approach used in large, heavily designed and systematic development efforts”. With ARAD, architectural patterns are used to ensure performance and quality of application code. A practical example of this would be writing specifications to generate a database

maintenance use case in Java using JDBC or C++ (using say embedded SQL). Analysts recommend usage of ARAD tools to reduce the learning curve and boost the productivity of developers. For agile development and to optimize the development process, a mix of AMD and ARAD-based development is being recommended.

With the increasing acceptance of community-based development, a trend observed within enterprises and application vendors is the increasing involvement of partners in new business functionality development in order to reduce time to market. The key issues seen in partner-based functionality development are architecture compliance, design conformity and software quality. Enterprises are prescribing using model-based transformations, ARAD tools and exposing Platform APIs to address these issues. One example worth citing in the end user applications space is that of the huge success of Apple in expanding its applications portfolio on its iPhone through published iPhone SDK. iPhone applications need to pass through Apple’s stringent standards before they are accepted for publishing.

Trends in the Banking Industry

Industry-focused models that represent the best practices in the domain are currently being developed. These models enable the definition of the target enterprise architecture and set the direction for alignment of its IT ecosystem. These models provide standard definitions for processes and services which serve as a reference for re-engineering systems and processes and are aligned to regulatory risk and compliance requirements.

IBM has developed an Industry Framework (IFW) for banking to provide information models, processes models and services models. These framework models support most banking requirements and leverage best practices while enabling banks to focus on competitive differentiation. These models act as an accelerator for building new applications and aligning legacy applications with

enterprise architecture.

OMG Financial Domain Task Force (FDTF) has defined a UML profile – Model-Driven Message Interoperability (MDMI) for mapping financial messages based on ISO 200022 format. This specification, built to UML standards helps in defining messages and mapping financial messages from legacy applications to ISO 20022 formats, providing interoperability between disparate systems. The task force is also working with Financial Services Technology Consortium on creating standard process models for processes such as account opening and funds transfers.

Banking Industry Architecture Network (BIAN) is a new standards group in the financial services industry created to facilitate banks' efforts to integrate software components obtained from different sources and provide interoperability between in-house developed components and those supplied by vendors. BIAN focuses on building business content semantics and Application to Application (A2A) interoperability. BIAN is currently making incremental extensions to UML profiles and ISO 20022 repository to support service orientation.

In all the cases above, the models describe either process or service specifications. They do not specify technologies used to achieve the same and hence are platform independent models.

Conclusion

Banks have a pressing need today to innovate and offer differentiated solutions to survive in today's market conditions. MDA holds promise in implementing new business functionality in IT systems with agility. This has the potential to enable enterprises and application vendors to quickly scale up their development teams without compromising on standardization of development, quality of code and usage of

common reusable components.

MDA concepts have enormous potential but are still in the stage of early adoption. Best practices in business process modeling, component-based development and UML methodologies are in the evolution phase. Analysts are forecasting a renewed focus on enterprise architecture and business processing which would accelerate the adoption of model-driven development.

Let us hope to see the day when business functionality could be modeled using modeler tools and directly executed by the runtime engine without the need for intermediate code generation*

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Banking in Canada

The Rising Tide



Précis

Canada's sedate banking industry has been roused by the arrival of new age non-traditional players like virtual and Internet-only banks. When customers gave them the thumbs up, it forced the big boys to sit up, take notice and launch similar initiatives. Thanks to these innovations, the industry has managed to come out of the trough it found itself in during the crisis.

Five players dominate the sector, which is consolidating further to acquire related services offered by smaller intermediaries like mutual funds and investment trusts, positioning banks as universal financial service providers and important drivers of economic growth. Besides merger activity, the other trends in this market include internationalization, competition, supervision and investment in channel infrastructure.

Canadian banking is also undergoing a change of product and service profile. With infusion of

young blood into the population, the market is changing to suit new tastes for banking self-service and electronic channels. That being said, this is one market where there is equal emphasis on strengthening branch infrastructure; between 2007 and 2009, the number of branches grew 28 percent. Even today, branches are being viewed as an influential channel for the delivery of high quality customer experience.

Alternative channels including online and mobile banking, data management and business intelligence are the targets of most technology investment. The financial gloom of the crisis has slowed down IT spending; however, it is important for Canadian banks to realize that in a stable and slowly growing market, technology, as a driver of operating efficiency is one of the key contributors to profitability. Hence, they cannot afford to take their foot off the gas pedal for too long.

Any banker in Canada would be happy with the way the banking system has turned around in that country. The once staid and sedate business is now abuzz with activity, thanks to the efforts of aggressive new age entrants such as the virtual or Internet banks which have challenged many fundamental banking tenets. These upstarts introduced unconventional and innovative methods of banking which have been widely accepted by Canadian customers. Consequently, conventional banks have also taken cognizance of new opportunities, entering the fray with a standalone Internet bank or a closely integrated Internet banking system to change the market landscape altogether. These and other innovations in products and services have driven strong growth after the market slump engendered by the financial crisis.

The Banking Ecosystem

Canada has one of the most stable banking systems in the world, dating back to the 18th century, and strongly influenced by the more established systems of that time which existed in the U.S and U.K. That being said, the Canadian banking system has evolved its own identity over time, and is now a distinct industry with its own set of practices and conventions, having shrugged off the legacy of the U.S and U.K banking systems on which it was modeled. Canada's banking industry comprises five large domestic banks which are referred to as the 'Big Five', 14 domestic banks, 24 foreign bank subsidiaries, 26 branches of foreign banks most of which offer full services and a wide range of financial institutions in the form of trust companies, life insurance companies, credit unions, mutual funds and fund managers.

The Big Five domestic banks - Royal Bank of Canada (RBC), TD Canada Trust, Bank of Nova Scotia (BNS), Bank of Montreal (BMO) and Canadian Imperial Bank of Commerce (CIBC) control assets to the tune of 2.5 trillion Canadian dollars. The sixth addition to this group is the National Bank of Canada; together

with the others, it forms the 'Big Six'.

The industry is witnessing a consolidation phase wherein banks are absorbing most of the ancillary and allied services provided by firms such as trust companies, investment dealers, financial planners, brokers, leasing firms and mutual funds and are on their way to becoming universal banks offering a wider range of services beyond traditional banking. This has significantly increased the relevance of the banking institutions in this country which are being increasingly seen as an avenue for delivery of all types of financial services.

A few of the trends dominating the industry are:

Internationalization

Increasingly, Canadian banks are opening branches in foreign locations - U.S, U.K and Latin America to name a few - in pursuit of business expansion, since the mature and stable domestic market does not hold out significant growth opportunities. Industry consolidation has also led to the internationalization of Canadian banks.

Mergers and acquisitions

Ever since two big proposed mergers (RBC-BMO and CIBC-TD) were shot down, mergers within the industry have been on a slow track. However, Canadian banks have been eagerly lapping up acquisitions outside the border, buying banks mainly concentrated in the U.S – about 95 percent of the acquisitions have been U.S-based small and medium institutions. The reasons for this are open U.S regulations, geographic proximity, similar banking practices, and a high level of integration between the two economies. The rate of acquisition has slowed down of late mainly due to recessionary conditions.

Competition

For a long time, the banking industry was highly concentrated with the Big Five

commanding 80 percent of its total assets. Their share of the mortgage market is about 70 percent and they hold similar shares in the credit cards and retail deposits business. While operating as universal banks, they also dominate the wholesale business to a large extent. However, in recent years several regional players, non-bank institutions and virtual banks have slowly broken this barrier and become more prominent. Many foreign banks play a role. Notable among these are HSBC, ING, BNP Paribas, Citigroup and ICICI. That being said, some of these are late entrants offering limited products and services.

Stability

The Canadian banking sector has displayed remarkable resilience and stability in the face of a tough crisis which affected its neighboring countries the most. In fact, a recent World Economic Forum report ranked it the soundest in the world. The credit for this goes to Office of the Superintendent of Financial Institutions (OSFI), responsible for supervising federally regulated financial institutions, including banks, insurance companies and trust and loan companies, to ensure their financial soundness and compliance with law. This office has been on a continually evolving path of supervision, guiding banks as they conduct their business and ensuring a strong, stable industry.

Products and services

For a long time, Canadian banks offered standard, staple products and services, steering clear of innovation. Now, when both domestic and global competition is becoming tough and customers more fastidious, they are slowly picking up the pace. With the 40-45 and 20-25 year olds dominating the population, demographics is another factor in the expansion of the products and services basket. While the former group tends to go in for products such as Registered Retired Savings Accounts (RRSPs) and other

registered pension products, the latter prefers self-service avenues of banking via mobile, ATM and Internet.

Channel usage

While the branch remains the most prominent avenue of distribution for services, there has been an exponential rise in the number of banks offering other channels including the Internet, kiosk and mobile. Some virtual and semi-virtual banks have sprung up, but they still have a long way to go before they can make inroads into the market. The well-entrenched banks have however realized the power of the branch channel and their focus is now on maximizing value from it by making branch-banking a powerful experience for the customer and optimizing operating costs incurred in running the set-up. This is evident in the 28 percent increase in the number of branches in the country between 2007 and 2009. The banking industry has also been innovative to create the 'Limited Branch' – a sales focused mini-branch popularly called a 'Pavilion'. This is an excellent avenue for sales and also caters to a limited number of servicing requests.

Technology usage

Royal Bank of Canada, the industry leader, is pioneering the adoption of latest technology and assimilating the same as an integral component of banking. Other banks have followed the leader and increased automation to a large extent. Investments are mainly in the areas of online banking, alternative channels, bill payments, mobile banking and to a lesser extent in Business Intelligence and data management. The growth rate in spending has not been significantly high in recent years which can be attributed to the inherently cautious nature of these banks made even more so by external factors. The mature banking market does not hold too many growth opportunities and banks must continuously innovate in order to survive and thrive. They must realize that technology is the main driver

of productivity and cost efficiency. Banks also have to face several challenges while optimizing operational efficiencies and improving other capabilities; these may be overcome by making fundamental changes, replacing legacy systems and using emerging technologies to support growth.

Conclusion

The Canadian banking sector is striving for increased efficiencies and organic growth while defending its turf against new market entrants. Technology has long been a key enabler within an increasingly complex industry, and going forward, Canadian banks will have to continue to invest in IT to facilitate both near-term operational tactics and long-

term transformational initiatives that are required to achieve their goals*

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Also Read

1. How Canadian Banks can Retain, Sustain and Grow Customers - *Whitepaper*

Banking is a tough business. More so in countries like Canada, where a small market size offers limited potential for growth. The Canadian banking industry is highly advanced. As per a report made by the World Economic Forum, Canada's banking system was rated the soundest in the world, and was among those with the highest usage of phone and online banking, ATMs and credit cards.

While all of this is good news, it creates a huge challenge for banks seeking to strengthen their position in that market. Banks will need a more thought-out, long term game plan for growing their business in the future, based on strategies to retain, sustain and extend their customers... <http://www.infosys.com/finacle/solutions/thoughtpapers.asp>

2. Success Follows Canadian Banks that Follow Their Customers - *Whitepaper*

Migration is one of Canada's most distinguishing characteristics. The onset of winter sees the migration of "snowbirds" - Canadians escaping the cold – to the milder climes of United States and Mexico among other destinations. Then there is Canada's demography, largely composed of immigrants, who regularly travel to and from their native countries. The high mobility of the Canadian people has certain implications for businesses, which must find ways to stay connected with their customers as they travel back and forth. The banking industry is no exception... <http://www.infosys.com/finacle/solutions/thoughtpapers.asp>

Cooperating and Competing: Looking Beyond Short-term Wins

Gökhan Mendi
Retail CEO and Executive Board Member
Fortis Bank, Turkey



In 2005, Fortis made a strong entrance to the Turkish finance market by acquiring Dişbank. In 2008, BNP Paribas became the main shareholder of Fortis Bank Belgium, which is the majority shareholder of Fortis Bank Turkey owning 94.11 percent of its shares. Fortis Bank Turkey with an even stronger capital structure continues its strong growth with high quality services, financial expertise, innovative and affordable products. Fortis Bank Turkey is active in Retail, Corporate and Merchant Banking and Asset Management.

We spoke with Gökhan Mendi, Retail CEO and Executive Board Member at the Fortis Bank Turkey about the various steps banks can take in the face of rising competition. He also shared his thoughts on how cooperating with the competition might just be the way to restore customer confidence and arrest falling margins.

Q How can I reasonably improve my bank's ability to launch products faster than competition?

A In my view, one needs two things above all – a commitment to project realization and a flexible IT platform. Responsibility for the former lies with senior management, which must ensure that a pro-innovation climate prevails within the organization. They must guide the product development program and assign priorities within it so that there is a reasonable flow of new products through the funnel at any given time. Since banking products are so commoditized, being the first off the blocks does offer some advantage including differentiation, at least till the time the others catch up. Often, worthwhile ideas fall by the wayside, either due to inattention from the organization or difficulty in execution, allowing competition to step in; top management must be watchful not to let this happen.

The good news is that most barriers to execution can be overcome by an agile and flexible IT platform. In the case of legacy systems, it was hard work to make even small changes, not to mention expensive as well. Now, with the availability of parameterized and configurable applications, making changes is quick and painless - new product set-up is

achieved by modifying existing parameters and defining the necessary business rules, scripts and processes. And because modern IT platforms are Web-enabled, everything is much simpler.

Q How can I offer my consumer community a value-proposition more attractive than that of competition?

A In our experience, this is quite market-condition dependent. For instance, in the aftermath of the crisis, there was a greater demand for basic products, those that seemed safe and transparent. That wasn't the time to introduce complex or fancy offerings. Having said that, I will add that price is the most important value proposition for any customer, because one bank's products are so similar to the other. Hence, you have to price your products competitively to stay in the game. Obviously, internal cost efficiency becomes the key to sustainability of low prices and banks must consider all options to optimize costs - from improved productivity to outsourcing to right-sizing. Because banking operations are so vast and complex, they offer many opportunities for improvement. For instance, employee productivity can be enhanced through redeployment and cross-functional training of personnel, or supply chain efficiency can be raised by centralizing the procurement function to order economical quantities at the best rates.

Outsourcing of non-core functions can do away with the need for large investments that would be required to set up the infrastructure necessary to conduct the same functions in-house. IT in particular offers several outsourcing opportunities, in operations, maintenance and development. Outsourcing and automation also raise productivity of employees by freeing them of routine tasks, and thereby enabling them to focus on core activities.

But, at the end of the day, lower pricing is only a short term value proposition. Sooner or later, the competition will catch up, and if a bank wants to avoid being sucked into a price war, it

must have something more solid to differentiate itself by. This is why service and branding are both so crucial – being harder to copy, they sustain competitive advantage for much longer than price alone.

High quality service shapes great customer experience, deepens the relationship and improves customer stickiness. Similarly, when customers feel pride in their bank and all that it stands for, they are unlikely to be swayed by price cuts and small-time promotions put out by rival institutions.

Q How can the journey of expanding global reach be eased?

A When a bank tries to enter a new market, it faces a host of challenges - local regulations, banking practices, cultural differences and existing competition, to name a few. On top of that, it must also grapple with operational issues such as setting up the IT infrastructure, acquiring market knowledge, complying with the law, among others.

Hence, global expansion is possible only when a bank has adequate resources and technology at its disposal. Big banks are at an advantage because apart from having the physical resources, they can use their previous experience and accumulated knowledge to cut down the time and effort of every subsequent implementation. My personal experience of global expansion, acquired in different companies, says that it is important to take a strong foothold in the home country before venturing overseas. Once there's a solid platform in place at home, in terms of physical infrastructure, technology and expertise, the same can be used as a hub to serve foreign operations. It's also possible to reuse software and databases to a large extent, provided they can be suitably altered to cater to the specific needs of the local market.

We have done this several times – using our experience in Turkey to enter Russia or Romania, for example. The transformation we undertook in Turkey is supporting many of our operations all over Europe. In every case, we

deployed trained personnel from home to establish the organization in the new country, and followed that up by training the local hires. This approach has been very successful so far.

That being said, technology has advanced so much that it is now possible to have a presence in a foreign market without taking on a large infrastructure burden upfront. So many institutions are going the direct banking route to test the waters and even achieve a few quick wins. Cloud technology offers the chance, especially to lesser banks, to acquire modern scalable systems quickly, at relatively low cost. All these developments are making it easier for banks to have a global footprint.

Q How can I cooperate fruitfully instead of just competing with competition?

A Cooperating with competition is possible and especially advisable during trying times. At present, restoring customer confidence, arresting falling margins and surviving tough market conditions are the bigger priorities, and it's a good thing if competing banks can come together for mutual benefit.

We are also taking this approach in Turkey. We are sharing credit card systems, POS, ATM services and cash transportation with other banks in order to cut down costs. Our aim is to focus on and compete for core business; we are happy to cooperate in other areas.

When we come together as a group of banks, we gain strength in vendor negotiations and that helps us realize higher cost savings which can be passed on to our customers. Also, being able to concentrate on the core business allows us to serve our customers better.

I would like to add that it is important to be smart while entering into an agreement with your competitors. The deal will work so long as it's a win-win for all parties. Therefore, synergistic arrangements, in which the cooperating entities bring complementary strengths to the table, are best. For instance, a national player could tie up with a regional bank to improve distribution at a local level, or a small bank could ally with a big one to gain access to its sophisticated technology, processes and products. Another factor in favor of such deals is that the cooperating parties are unlikely to cannibalize each other's business ▪

What Constitutes Innovation in Banking

Anthony Thomson
Chairman
Metro Bank



Metro Bank is about to open its doors this summer as the first brand new retail bank that Britain has seen in centuries. The origins of Metro Bank lie with Vernon Hill, the Bank's Vice-Chairman and an American entrepreneur who created Commerce Bank in the 1970s. Commerce Bank started with one branch, nine employees and \$1.5 million in capital and was sold in 2008 for \$8.5 billion to Canada's TD (Toronto-Dominion) Bank, having blossomed into a 470 branch powerhouse. Vernon was approached by Anthony Thomson, a serial entrepreneur in financial marketing based in the U.K, to repeat Commerce Bank's success in Britain. That vision is being realized this year.

Anthony co-founded City Financial Marketing in 1987, which became Europe's largest financial marketing consulting and communications group before being sold to Publicis in 1997. After this, he created the highly successful Financial Services Forum, possibly the largest membership group that is dedicated to the financial services marketing community.

Chris Skinner, Chairman of the Financial Services Club, met up with Anthony Thomson, Chairman of Metro Bank, to discuss what constitutes innovation in banking and its future.

Q Anthony, your bank is the first new retail bank to be seen in Britain in most people's memories. In order to succeed you must do something different and so, to be begin with, maybe we can focus upon what you see as innovation in banking today?

A Without looking at the dictionary definition it is about introducing things that are new that are really different to the past to a lesser or greater degree. In terms of banking, I'll talk about retail banking as I'm not qualified to talk about investment banking.

In retail banking innovation has been all about cutting costs. The dialogue is all about cutting the expense ratio and dealing with customers more efficiently. It is not only about how can we give our customers a better experience and meet their needs better.

I also see a lot of innovative articles come across my desk about mobile banking,

payments, among others and so a lot of it is about solutions seeking a problem. IT companies are particularly good at coming up with solutions to problems that we don't realize we have yet.

Q What are the innovations Metro Bank will bring to U.K retail banking?

A For us, everything starts with the customer. It's about putting the customer at the centre of everything we do. So innovations for us are around how we can better serve our customer. We do that by having a single customer view, which is a major point of differentiation for us. In fact, you could argue that being able to have a single customer view is a real innovation in U.K retail banking as that allows us to do a number of things that are innovative, such as opening an account within fifteen minutes. We can print debit and credit cards, and issue them instantly. We are the first to do this in the U.K and we believe, in Europe. We can issue you cards instantly in store, and can immediately replace them for you at any store if you lose them. The technology exists to do this and the machines to do this are well established, but it is the ability to plumb those machines into your core banking engine that has proven to be so difficult for everyone else. We can do that because we have a single customer view and we are able to implement a number of innovations thanks to that single customer view.

Q Is innovation all about technology?

A Absolutely not. Innovations are not just about technology. Would you view it as innovative that we don't pay our staff for sales of products, but for giving great customer satisfaction? Would you view it as innovative that we have been introducing customer toilets in our stores? The press has picked up on this as much as the fact that we encourage our customers to bring their pets in store, or encourage parents to bring their children to use our coin-counting machines.

Q But are these innovations or just gimmicks?

A One man's gimmick is another man's iPhone. People can accuse us of being gimmicky, but what they cannot say is that we do not put our customers at the centre of everything we do. That's our focus and that is the strategy we have built our business around and that is what drives these innovations.

A key point here is that we want people to come in and use our stores, whilst all of the other banks are trying to migrate their customers to telephony or online. We want our customers to physically come into our stores to meet with us, so that we can create a good service experience for them. We think we create that experience of service best viscerally in a store. Sure, they can go online with us or on the telephone with us, but we want to see them.

This means that the choice of channels needs to be there, but the channel choice should not be driven by the bank's operational costs. The whole concept is to put the customer first. You could argue that it is old fashioned and not innovative, but that is our core focus: to put the customer first.

Q Is it that important to have customers in store? Everyone deals remotely today?

A Banks may prefer to deal with customers remotely but that's not what customers want. There are lots and lots of data that shows they would rather deal with people in a branch. For example a YouGov survey produced in February for Deloitte said that 65 percent of people would only have a current account at a bank with branches they could visit; and 53 percent would only place their savings with a bank that they could visit. So there is a strong argument for physicality. A Switch survey that came out in May states that 51 percent think that new banks offer a 'fresh start', whilst 37 percent think they will be 'innovative' and 'change banking for the better'.

Q The other banks would claim they cannot be as responsive or agile as you because they have so much heritage and legacy to deal with.

A There's some truth to that but also there's the reality that, in the U.K market, the banks see the current account market as extraordinarily mature and a zero sum game. They gain one place and lose somewhere else. We see it as an absolute growth market. It depends therefore upon your point of view.

Q And what about the other new competitors, such as Tesco and Virgin; how will they change things?

A Our view is that we have two tasks ahead of us: first, we have to get customers to think about switching and second, to switch to us. So any new competition is good news for us, as they will make people think of switching banks.

Q What are the things that will attract them to you?

A We have said that it really comes down to the current account. The current account is the core of the relationship. People want to open their current accounts in a branch bank. We know that from the OFT survey of 2009, which found that 94 percent of people open their current account in a branch or, in our case, a store. Bear in mind Chris that we started on this three years ago, as you know, and the world looked very different. Everyone was saying only five percent of customers switched and that you were more likely to get divorced than switch bank accounts.

In fact, there were three fallacies back then that everyone thought was true of banking. First, that customers are driven by interest rates. Second, that customers don't switch banks. Third, that the only way to make profit out of retail banking is by driving down your cost-income ratio, which is generally to the detriment of customer service.

We are seeing these fallacies exposed now.

We know from last year's OFT report that 93 percent of customers don't see rates as the most important thing, they see service and convenience as the most important thing.

We know that, in the last three years, the number of people who have switched banks has increased from five percent to nine percent, and the number who would consider moving their main account to brand new banks has risen from 16 percent in 2007 to 38 percent this year. So we know that fallacy is a lie.

And if profits were purely delivered by driving down the cost-income ratio, then look what's happened to the U.K banks. Vernon Hill spent 34 years building the 18th biggest bank in America with one of the highest cost-income ratios.

Q With Vernon's approach however, the view is that he invested in things that had no cost justification. Why would you do that?

A It's no single thing that supports doing this, but it is part of a host of things that put the customer first. For example, Vernon's last bank gave away 23 million pens in his final year there. There's no cost justification for doing that. You can't say: "our return on giving away this many pens was X, Y or Z". Similarly, the coin counting machines. Nobody can cost justify why you would put a coin counting machine, that costs £30,000, into a store with no tangible return or even putting two into big stores. It's easy for people to criticize these things, but it's not easy to criticize the results. Commerce Bank grew 23 percent CAGR for its entire 34 years. It sold on a multiple of 25. The facts speak for themselves. But people pick on the fact that we give away the pens; they pick on the fact that we offer the coin counters; they pick on the fact that we give away free lollipops; that we encourage dogs in stores with dog bowls; they pick on the fact that we pay staff for satisfaction rather than selling things; they pick on the fact that we have no security screens; the fact we take the best site locations at the highest cost and spend more on fitting out; and so on. But

it's no one single thing that makes the customer experience better with us, it's the combination of all of these things. The amalgam of a hundred or a thousand things, just done one percent better.

Q So innovation is more about the complete culture than just doing one thing differently.

A You innovate in a hundred different little ways. Is it innovative to interview 3,500 people for 60 jobs? Possibly not. Is it innovation to encourage customers to bring their dogs into stores? Possibly not. Is it innovating to encourage customers to count coins in store for free? Possibly not.

They are all innovations around culture, around service, around delivery, around technology.

We particularly innovate in our culture however. For example, as you know, we have this saying "one for yes, two for no". This means that I can say yes to any request you make of me, but I cannot say no without another person from the bank agreeing with me that the answer is no. What sort of innovation is that? It's not a huge change, but it's incredibly valuable in terms of improvements for the customer's experience.

Q So looking into the future, what is going to change traditional banking?

A It's interesting because I've used this analogy a few times now. I think it's possible for us to change retail banking in the U.K with just one

branch, or store as we call them. If you go back twenty five years to the launch of Virgin Atlantic you will recall they launched into a market that had two carriers with hundreds of planes, and were accepted as the de facto standard for transatlantic flying. Virgin came in flying to and from the same airport with the same airplanes. There was no difference except that they focused upon making it a completely customer focused process, and changed it from travel to an experience. Now Virgin is a major player and the Virgin Atlantic service is regularly voted the best in the market. I think the same opportunity is there for us in the market to be a game changer.

Q Finally, what do you think will be the top tips for being innovative in banking in the future?

A The role of management is not to set out and seek innovation, but to set a clear strategy. Not just a strategy you pay lip service to - we have all seen how mission statements can appear to be the same thing - but to make clear what it is that you stand for. So you don't set out to be innovative, but you set about to do something that you are passionate about and want to do really well and then you set out to innovate around that core focus. So my top tip would be that you have to stand for something and set a clear strategy of how you are going to achieve it •

For more on Metro Bank, read this article:
<http://thefinanser.co.uk/fsclub/2010/04/metro-bank-the-first-new-bank-for-a-while.html>



Looking Beyond the Branch to Find and Keep Customers

Finding and keeping customers is a top priority of all banks. However, the overload and high infrastructure costs of branches make them an unviable channel for acquisition and retention. The solution lies in getting an integrated multi-channel network to do the job, led by online modes including the Internet and mobile.

Besides scalability and economy, alternative channels bring several benefits, which can go a long way in building new relationships and fortifying existing ones.

- Convenience of banking anytime, anywhere
- Rich, unified and seamless user experience with several personalization options
- Empowerment through online tools and information dissemination on a scale that can never be matched by branches
- Agile framework which enables banks to amend and deploy products quickly, in response to market needs. The direct banking model represents a quick market entry strategy minus

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- heavy infrastructure costs for banks
- Significant cost reductions - anywhere between 10 and 25 percent of banks' IT costs - and higher cost efficiencies through improved delivery of products and services, optimized processes, higher cross-sell opportunities and reduced staffing needs
- Highly scalable models allowing sharing of channel infrastructure with other institutions, as well as reduce upfront investment through third party hosting arrangements
- Channels like mobiles are enabling banks to extend services to the unbanked, thereby building the case for financial inclusion
- Customer insight through integrated channels enables capturing unstructured and tacit information which may be used by banks for various purposes, especially to refine their segmentation strategies
- Banks can smartly exploit their electronic channels to not only reap the abovementioned benefits but also differentiate themselves from the rest of the competition. And that will be their hook to attract new customers and hold on to old ones

For a bank, or indeed any other enterprise, few things are more important than finding and retaining customers. But in reality, there are several obstacles in the path of business growth, such as:

- The need to comply with various regulations and mitigate risk
- Erosion of consumer trust and confidence in the financial system
- The focus on conserving resources and improving efficiency
- The threat of competition

While there may be no room to maneuver around compliance requirements, it is possible to surmount the other challenges through a multi-pronged approach, of which channel strategy is an integral part. Specifically, electronic channels must take the lead role in attracting new customers and encouraging them to engage more deeply with their bank, since branches, straining under the pressures of high cost and workload no longer have the bandwidth to do so. Moreover, the expectations of a generation of literate and technology savvy customers cannot be fulfilled through age-old branch banking techniques. The need of the hour is an integrated multi-channel platform capable of providing an array of benefits including convenience, high quality experience and empowerment to customers as well as agility, cost efficiency, scalability, reach, customer insight and differentiation to banks. Each of these benefits fortifies a bank's ability to acquire and retain customers:

Convenience: Although customers still feel the need to visit the branch occasionally, they have unreservedly embraced the convenience of alternative channels, which are available to them everywhere and at all times. It is also not unusual to find an individual using multiple channels at times even during a single transaction. By and large, since customers are

transacting more frequently at multiple touch points, banks are presented with more opportunities to deliver products and services, resolve issues, provide information and propagate their marketing messages.

High quality experience: An implication of multi-channel usage is that banks must provide a unified, consistent and high quality experience to customers across all modes. Since a customer may choose to initiate a certain transaction on one channel but close it on another, it is important that the same information or status be reflected instantaneously in both. As far as possible, the processes/ look/ feel on various channels must be congruent so that the user has minimum difficulty switching from one step to another. The ability to personalize the banking experience - by specifying landing page, favorites and alert options, for example - is another big draw with customers. In short, quality of experience is an important determinant of satisfaction and may well decide whether a customer stays with the bank or not.

Empowerment: Customer confidence, which took a beating during the financial crisis, can be gradually restored through education and empowerment. Customers must be provided complete and correct information on various aspects that concern them, including but not limited to, key product features and risks, service level commitments, charges and fees, among others. Self-service channels are ideally suited to this purpose, easily bridging the distance to customers on a scale that is impossible for branches to match. Besides disseminating product and service related information, banks can make simple financial tools available on their Internet banking portal or kiosk network using which customers can build portfolios, plan budgets, compare investment options, calculate EMIs and simulate returns.

Agility: Banks need to be agile to stay relevant and competitive in a dynamic market environment. Online channels allow them to quickly and simultaneously disseminate new offerings to all their customers, irrespective of physical location. That apart, a channel like direct banking enables banks to enter new markets easily, without spending much money or time on setting up physical infrastructure, while making it equally simple for customers to open an account wholly online.

Cost efficiency: As opposed to the resource draining branch, electronic channels provide many opportunities for cost optimization. While direct banking saves sizeable infrastructure investment, other channels also contribute to cost efficiency by optimizing the delivery of products and services and improving the working of internal processes through higher automation. By enabling customers to transact or even resolve complex queries online using interactive help services, self-service channels reduce the need for human intervention in routine operations, leaving bank staff with more time to deal with higher end advisory and wealth management activities.

A bank with an integrated channel platform need make only a one-time change to its back-end to roll out new products and services simultaneously across all modes of delivery. Multi-channel integration also improves cross-sales effectiveness by ensuring that front-office staff has access to up-to-the-minute customer information on all channels. It is believed that multi-channel integration could save a bank between 10 and 25 percent of IT and operational costs.

Even the management of electronic channels opens up cost reduction possibilities when outsourced to specialized third party vendors, relieving banks of channel overheads. On the other hand, mega institutions that prefer to

retain control over channel management could improve efficiency and the utilization of infrastructure by sharing this service across subsidiaries leveraging a single back-end.

Scalability: While it has always been faster and cheaper to ramp up non-branch distribution infrastructure, achieving scalability has become even simpler thanks to the development of new alternatives led by SaaS, cloud-based hosting and ASP-based outsourcing, which enable a bank to share its channel infrastructure (and consequently the cost) with other institutions over a “cloud” or cut back on upfront channel investment by entering into third party hosting arrangements. These non-traditional arrangements allow banks the luxury of “pay per use” scalability.

Reach: If the ATM, call centre and Internet succeeded in expanding the delivery of banking services to existing customers, the mobile phone has gone one step further to enable basic financial transactions among the unbanked. Since even the less literate are able to conduct basic operations over a handset, banks and telecom firms have leveraged the mobile phone as a means to financial inclusivity. The success of m-payments in Africa and other parts of the world is testimony to the effectiveness of the mobile channel as an avenue of customer acquisition.

Customer insight: Increasingly sophisticated customers have higher, more nuanced expectations from their banking relationship including products and services that fulfill their individual needs. Since a customer is no longer satisfied being part of the crowd, banks have to respond by treating each as a “segment of one”. This calls for a total relook at existing segmentation strategies which typically use broad brushstrokes of income or bank balance to group large numbers of people together; rather, customer segments must reflect finer points of demography, ethnicity, habit and

preference all of which can have a strong bearing on a customer's financial behavior.

Integrated channels can play a big supporting role by providing exhaustive customer/transaction data across all touch points for analysis and generation of insight. Analytics tools can work with such data to create better understanding of historical customer activity and predict future trends. What's more, the more sophisticated tools also have the "intelligence" to process unstructured data gathered over telephone conversations, emails, websites and social networking platforms to generate valuable insight into qualitative customer aspects. Banks can leverage this insight to create offerings that are in tune with customer expectations and thereby improve prospects of retention, cross-sales and profitability.

Differentiation: By exploiting various channels to create value for customers and the organization as detailed above, a bank can successfully differentiate itself from competition and acquire a favorable image among the target audience.

While all of this is good news, in the current context, electronic channels are most valuable as a means to regain trust and advocacy. What customers really want is for their banks to empathize with their troubles and simplify things that matter to them - by providing clear product explanations and speedy problem resolution, for example. While websites provide the wherewithal to disseminate and disclose information on a wide scale, social technology platforms enable banks to forge an open and intimate bond with their audience. By interacting with customers in a frank and transparent manner, seeking their feedback and demonstrating commitment to resolving their grievances, banks can undo some of the damage inflicted by the financial crisis, and

from that position, weave a closer partnership with customers, vendors and other stakeholders. If they succeed in generating a favorable buzz in social media, banks can look forward to their customers turning into loyal champions, similar to those of retail giant Amazon who spread the word around through book reviews and peer to peer advocacy.

Given the umpteen benefits, banks must do all they can to encourage adoption of non-branch channels. One way is to reward "good channel behavior". Until now, most have taken the stick approach, usually by imposing a fee on in-branch transactions, to drive usage of self-service channels. However, a couple of forward thinking institutions have bucked the trend to reward users of alternate channels with greater loyalty points, preferential rates or other means of recognition. This seems to be a more likely way of improving customer stickiness.

What lies ahead? Although the physical branch will sustain, it will morph into new formats such as supermarket branches, investment centres and "full service" ATMs. Online channels will continue to grow and dominate, and therefore, influence banks' ability to onboard and hold on to customers more than ever before.

Summary

Overload, particularly in urban centres and high infrastructure costs make it unviable for banking institutions to use their branches to conduct routine business including bringing in new clients and servicing existing customers. On the other hand, low cost electronic channels including the ATM, Internet and mobile are ideally suited to customer acquisition and retention, providing unmatched convenience and usage experience to customers and widespread reach to banks. What's more, the

use of self-assisted channels does not mean that relationships become impersonal – indeed, ATM's and Internet banking are very effective in customer education and empowerment, and online social forums enable banks to come much closer to their audience. In this way, these channels facilitate the cycle of customer acquisition, retention and advocacy ▪

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Also Read

1. Delivering Customer Experience that Delights - *FinacleConnect Issue 18*

Olga Botero, Chief Information Officer, Grupo Bancolombia, S.A – “I must admit that we are making great efforts to improve customer service at our bank. However, in general, the international financial crisis has contributed to undermine the confidence of customers of financial institutions. It has stressed the traditionally difficult relationship among customers and banks. And this lack of confidence makes customers feel stronger and have higher expectations from the service we have to offer them. While this may be an easy subject in other industries, defining good customer experience and going on further to deliver it, consistently, is barely something to be made light of in the financial industry.” http://www.infosys.com/finacle/finacle-connect/Issue_18/default.asp

2. Online Customer Experience: What Works - *Whitepaper*

About 75 percent of American banking customers surveyed during an October 2008 study reported using online banking to keep track of their expenses. Not surprisingly, a similar number confirmed that they were watching their finances more closely during the current economic downturn. Online banking reported the strongest growth among all channels – customers wanted to watch their finances more closely, at least cost, and online banking served both ends... <http://www.infosys.com/finacle/solutions/thoughtpapers.asp>

Setting the House in Order



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The U.S' theme of tighter regulation is being echoed in other economies that were also hit by the crisis. Even as banks everywhere learn to deal with greater control and regulatory conservatism, they will have to take some more steps to put their house in order.

Banking is heading away from the abnormal growth of yesteryears towards a more grounded 'new normal'. Sharp manufacturing and asset growth, unnatural bonuses, stock-market surges will all be scrutinized carefully to avoid repetition of earlier misdemeanors.

If the crisis was precipitated by the greed of a few, recovery has been led by the generosity of many as corporate and banking institutions try to give back to customers in monetary and other ways. They will seek value over volume by taking a more discerning approach towards their products, services, processes, customers and partners. The mindset will change to one of inclusivity and togetherness as the previous approach of devolving tricky issues upon others including customers, investors and partners will be erased by a new collaborative attitude of working along with stakeholders.

Banks will go back to basics, making products and services simpler, fairer and more transparent and, will have to innovate harder to create 'real' change, as the benefits of simple 'tweaking' innovation dry up. They will also look up to other industries such as telecom and consumer electronics that have leveraged innovation to make products progressively smarter, faster, simpler and cheaper. There will also be a redoubling of customer focus, as banks pay heed to individual needs and identities. Consequently, individual identity will replace identical individuality as the building blocks of banking segmentation. The age of right-selling is upon us.

Optional banking regulation will no longer stay that way. Besides having to comply with the dictates of Central Banks, the industry will also come under the scrutiny of entities such as the G8, G20, WTO, WEF and various accounting bodies.

These moves will lead the industry towards a more progressive outlook which respects security, compliance and openness, and values long term survival over short term gain.

These days, global financial news is dominated by regulatory developments. Earlier this year, lawmakers in the U.S came to an agreement over a landmark bill that seeks to tear down failing Wall Street firms, prevent bailouts, toughen capital norms and improve disclosure. And although the U.S administration says that it has no intent to shackle business, financial reform is very much a top priority.

This theme is echoed in other economies that were also badly hit by the crisis. Globally, banks and financial organizations are learning to deal with greater control, regulatory oversight and conservatism. A case in point is Europe's U.S \$1 trillion "shock and awe" package, which will put further constraints on the recipient economies and their financial sectors. Since setting the house in order is an important part of this process, in my view, this is where the banking business is headed:

From abnormal to the new normal: The abnormal growth in business and economic indicators of yesteryear will reset to a "new normal". Accretion in retail and manufacturing activity, bonuses and profitability, banking and stock market growth have all hit ground reality and henceforth, will come under more stringent regulatory scrutiny. The banking regime has and will continue to shift from easy credit and low interest rates to an opposite scenario. With liquidity being so tight, any abnormal growth of banking credit and balance sheets will be scrutinized carefully by the regulatory watchdogs. Across the board, institutions will have to practice greater transparency. Organizations, customers, investors and other agencies will have to accept this new reality.

From leadership to survivorship: Banks that grew abnormally to a size which was considered too big to fail have slipped from a leadership position to one of ensuring survival. Although they may support themselves in the

short term on the crutches of government assistance, that is hardly a viable long term strategy. They will have to think of ways to wean themselves off this largesse and still survive in the longer term.

From nicety to necessity: With the tempering of growth and size, the erstwhile condition of "nice" prices, profits, rates and returns has dwindled to a situation in which all are fighting for basic necessities. In the banking context, for instance, banks and customers alike are striving for liquidity which is no longer available in abundance.

From greed to generosity: A positive outcome of the upheaval of the past months is the emergence of "Generation Generous". If the crisis was sparked by the unmitigated greed of a select few – financial institutions that garnered huge profits by offering risky, opaque products and rating agencies that ratified them without heed of consequences – the recovery is being driven by the generosity of a larger majority. Companies are giving more for less by way of preferential prices and freebies. Similarly, some banks are adopting a sympathetic stance, generously supporting problematic customers instead of throwing the rule book at them.

It is clear to see that where greed brought about the downfall of customers, partners, investors, economies even, generosity will pay back by way of higher loyalty. London's newly launched Metro Bank is a firm believer in this philosophy, going so far as installing expensive coin changing and card vending machines within their branches, promising personal "human" attention to every call, working extended hours and doing away with fussy "no pets" rules to improve customer convenience.

From complexity to simplicity: The world has paid a heavy price for the unthinking

actions of retail, investment and corporate banking businesses which outdid each other in peddling complex products that no one understood in full, playing upon investors' desire to make quick, high returns that could never be matched by traditional instruments. By rubber stamping products, including hedge funds and CDOs, rating agencies made things worse. Since the same real estate assets underlay all these complex products, when the bubble burst, it brought down the whole pack of cards. While few players in the game had already made their money, investors and real estate owners lost out.

But now, I see banks going back to basics, spurning complexity for simplicity in their products, services, documentation and communication. Even as they cut back on resources, organizations will become more efficient in order to support business growth. I also believe that they might take a leaf out of the telecom book which has progressively become cheaper, faster, smarter and simpler and offers so much additional value that voice calls have become incidental to the business.

From volume to value: As an extension of the preceding comments, one can anticipate that organizations will turn towards quality instead of chasing quantity in the value derived from customers, products, services, lines of business and partner relationships.

From identical to individual: In future, the focus will be fulfilling individual needs. In the past, financial institutions pushed identical packaged products to customers regardless of their financial goals, credit worthiness and risk appetite, and the results are plain to see. Not so any longer; in future, each individual will be rated on the basis of financial health, risk tolerance and earning potential and offered products best suited to that context. There's a lesson to be learned from the likes of

Amazon.com and Netflix.com, where every customer action is used to enrich the profile. Both leverage this deep insight into individual preferences to make intelligent product suggestions to their users. It is logical that customers will expect the same from their banks with whom they interact much more intensively.

From more to less: Linked to the earlier discussion on the moderation of market demand, profitability and liquidity leading to the creation of individual risk tolerance and need-based offerings, customers will move from multiple, generic to select, specific products. This will keep banks on their toes, questioning the status quo every time to find a better way of doing things. The drive to do more with less will lead to a win-win condition of improved efficiency and customer experience. To support this endeavor, banks will need more tools and automation to sharpen their understanding of customer behavior, which they can apply going forward. This will propel a shift from earning towards learning, subordinating the pure profit motive to a desire to learn about the needs of the market, customers and partners as well as the demands of regulation.

From simple innovation to disruptive: The runaway success of products in the past prompted banks to tweak them through simple innovation, with the expectation of further gains. Since simple innovation has come a cropper, I expect that banks will fall back on disruptive innovation, and ensure that this time around, it is packed with the right attributes of disclosure, simplicity, transparency, relevance and compliance. I can't help but cite the example of Apple, which has continuously disrupted the status quo with its ground breaking designs, and chosen long term sustainability over a quick buck. Apple teaches us that it is more important to look at 'how far'

than 'how fast' when offering products and services. Hence, banks too must do some soul searching to arrive at what is right for them.

Interestingly, economic hardship is fertile ground for disruptive innovation. Throughout history, recession has spawned upstart companies and breakthrough innovations which have gone on to stand the test of time, whether it is IBM and Coke during the 1920s or Google, Amazon and EBay 80 years later. Through a combination of resilience and foresight, these companies turned adversity into opportunity and wrested market leadership, lasting to this day. What applies to other businesses holds for banking as well; although the last crisis hit the financial industry the hardest, wiping out hallowed institutions, the survivors have an opportunity to seize the initiative and lead growth in this new decade.

From aggressive to progressive: I believe that as a result of these shifts – from complexity to simplicity, from volume to value, from more to less – we will witness the metamorphosis of an aggressive financial services industry into a progressive one, which lays greater emphasis on creating a secure, compliant and value-packed business environment and surviving in the long term.

From G8 to E8 (or 10 or 20): Since growth will come not from the G8 countries, but a bloc of emerging nations variously drawn from Asia, Africa and East Europe, banks will have to adapt their business strategy to the needs of these markets.

From yours to ours: The mindset will change to one of inclusivity and togetherness. Banks' previous approach of devolving tricky issues upon others including customers, investors and partners will be erased by a new collaborative attitude whereby they will work collectively with these stakeholders.

From option to compulsion in regulation:

We have clearly entered a phase of strong and binding regulation where compliance is no longer optional. But, on top of regulatory oversight, one can also expect banks to come under the scrutiny of entities such as the G8, G20, WTO, WEF and various accounting bodies. Since financial institutions will have to set aside greater amounts of capital to insulate themselves from a downturn, the move will suck further liquidity from the system, push up rates of interest and inflation and spark a chain reaction that could potentially depress global economic growth anywhere between 100 to 300 bps.

Towards greater urbanization: In about 100 years, the proportion of the world's urban population has risen tenfold, from 5 to 50 percent. In Canada, majority of the population already lives within 200 km of the U.S border or major cities; Indian cities will receive 140 million immigrants by 2020 and 700 million by 2050! Undoubtedly, this will create opportunity, but also stress civic issues of logistics, transportation, infrastructure, among others besides challenging the financial system's ability to serve a vast unbanked population which has relocated from the hinterland to the cities. The urban unbanked will differ from their rural counterparts in that they will be better educated, conversant with technology and generally more demanding. Hence, banks will need to change their mindset and adopt a new approach to take up this opportunity and its associated challenges.

Conclusion

The past has taught us many lessons which have given us a roadmap for the future. As important actors on the world stage, banks have a responsibility to add value by creating simpler, more relevant and affordable products, efficient and effective processes, and

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richer user experience. The dynamics wrought by the “new normal” demand that banks take a fresh approach to everything, forsaking greed for generosity, complexity for simplicity, self-interest for collaboration on the road to survival ▪

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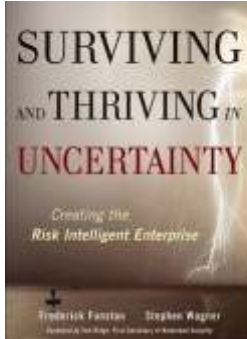
Also Read

10 Innovative Ways to Achieve Greater Agility in 2010 - *FinacleConnect Issue 20*

It is the end of another eventful year and it's time to make our new year resolutions. For most banks 2010 will be about innovating more and better to create sustainable advantage. Given challenges like increasing competition and demanding customers, agility should also be added to that wish list. The word agility usually evokes images of quick-fire action; a race in which getting off the starting block is everything. A scan of the various definitions of this word showed that it means different things to different people, from nimbleness to the ability to avoid damage. But the one that catches attention says that agility is a “perpetual state of innovation, moving quickly yet thoroughly through product and process development that creates competitive advantage and increases stakeholder value.”
http://www.infosys.com/finacle/finacle-connect/Issue_20/default.asp



Surviving and Thriving in Uncertainty: Creating the Risk Intelligent Enterprise



**Frederick Funston
and Stephen Wagner**

An enterprise structure or culture that is not in-built with a certain measure of risk assessment and management practices is unimaginative, according to The Honorable Tom Ridge, first Secretary of the U.S. Department of Homeland Security and former Governor of the Commonwealth of Pennsylvania, who has written the foreword to the book titled *Surviving and Thriving in Uncertainty: Creating the Risk Intelligent Enterprise*. But, the multi-million dollar spending on risk management solutions each year is hard evidence of the fact that enterprises have always been aware of the need to manage risks. So why are their defenses breached time and again? Has the last financial crisis proved that risk is in fact ungovernable? The best way to overcome business uncertainty is through more regulation, or is it? These are some of the questions that company boards are asking.

In their informative and thought provoking book authors, Frederick Funston and Stephen Wagner, assert that it is indeed possible to keep enterprise risk under control even in turbulent circumstances. However, the conventional approach is fatally flawed and ineffective in realizing the true goal of risk management, which is to drive value creation. Since risk is inextricably linked to value, risk management must focus on preserving and creating value in addition to its current priority of asset protection. What's more, the right type of risk taking is necessary to foster innovation within organizations and help them build competitive advantage. In the authors' opinion, "risk intelligent" companies – which think out of the box and take calculated risks – will live to tell the tale. Drawing extensively upon their years of practical and advisory experience, Funston and Wagner propose adoption of several measures to make organizations more risk intelligent, including questioning basic business assumptions, being ever vigilant,

defining risk tolerance and appetite, factoring velocity and momentum, anticipating possibilities of failure, conducting due diligence on information, keeping a margin of safety and taking the right amount of right risk.

The book, packed with insights from a number of risk facers and takers both from the corporate world and outside, starts by talking about the challenges of risk management confronted by executive boards. The next section describes the 10 fatal flaws of conventional risk management and in answer, the appropriate skills required to counter each. This is followed with a framework for creating the risk intelligent enterprise and practicing risk intelligent governance.

Surviving and Thriving in Uncertainty helps business leaders and senior professionals get smart about risk management, which involves both monitoring risks and taking them in the right measure. Often bold and unconventional, the book challenges practitioners to expand their risk horizons and exercise better decision making even during times of great uncertainty and stress. The discussion on leadership challenges and responsibilities is food for thought for executive boards and top management.

A rather 'loaded' book, in the conventional sense; but for bankers who bear the onus of some of the weightiest decisions made in the business world, this book may actually fit neatly as the perfect after-hour read, on a long haul flight or a quiet evening even ▪

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