Jul. - Dec. 2010/ Vol 06/ Issue 22

FINACLE CONNECT

Connecting The Banking World

Contents

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FinacleConnect is a journal on banking technology published by Infosys Technologies Limited. For more information contact: Namrata Kapur, Infosys Technologies Limited, # 44 Electronics City, Hosur Road, Bangalore 560100, India. Tel: +91–80–41057541 or write to us at: finacleweb@infosys.com

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New Year and Newer Resolutions!

So what is it that banks are looking to do differently in 2011? One of the most striking lessons of 2010 is to be found in the findings of two surveys that we commissioned with EFMA and The Asian Banker respectively, which showed that despite citing customer relationship management as an important outcome of innovation, few banks had put that belief into practice.

If we had to pick one resolution for banking innovation in 2011, it would be to make the customer the bank's topmost priority. The customer is king once more and is using that power not just to demand better products and services at lower cost, but also enforce 'ideal bank behavior' founded on transparency, integrity and adherence to the principles of sustainability, inclusivity and social responsibility.

How else can banks deliver these tall expectations other than through the medium of innovation? Fortunately, they have a strong ally in technologies such as mobility, social media and pervasive computing which have the potential to revolutionize the way in which financial institutions reach, understand and serve their customers going forward. And this is *Banking Next.*

This issue of FinacleConnect brings to you perspectives from various global industry leaders on the role that innovation plays in shaping *banking next.* **Cover Story** by S. Gopalakrishnan, Chief Executive Officer and Managing Director, Infosys Technologies Limited highlights what building tomorrow's financial enterprise entails. **Inside Talk** features viewpoints from Carole Berndt, Head of European Global Treasury Services at Bank of America Merrill Lynch, David Gledhill, Managing Director and Head Group Technology and Operations, DBS Bank and Richard Dunlop, Regional Chief of Staff for HSBC Technology and Services and Leader of Innovation on the HSBC Group IT Executive Steering Committee.

In **Stratagem** Tim Franklin, COO and Member of the Board, Co-operative Financial Services discusses their approach to business that focuses on sustainability built on the foundation of customer-led ethical policies. Anne Weatherston, Chief Information Officer, ANZ, in *Banking Efficiencies: Not Just About Cost Cutting,* shares with us the need for an appropriate operating model which provides clear visibility of the costs of a bank's products, services and activities.

Other sections like **Statute,** featuring a quick appraisal of Basel 2 and Basel 3 implications, **People Perspective,** deliberating on the payoffs of the co-creative enterprise, and **Big Bet,** highlighting the changing perspective of banking worldwide, complete the read.

And as always, we'd love to hear your thoughts on these subjects. After all, it's your perspectives, suggestions and feedback that truly makes our day.

Till next time!

Haragopal M

Global Head - Finacle

Infosys Technologies Limited

M-Commerce:
The Next Step for Prepaid Mobility

Précis

Prepaid mobile subscription drives communication and financial inclusivity in many parts of the world. Having revolutionized small savings and money transfer, particularly in Asia and Africa, it is now poised to lead inclusive m-commerce full-on. With mobile consumers increasingly willing to transact over the air, and the availability of applications to cater to their every whim, the sky is the limit for mobile commerce. This opens up great opportunities for banks, which can play an important intermediating role as payments processors in mobile transactions.

The flip side is that telecom operators have been unable to extract full value from their prepaid customers because they lack detailed consumer data, so vital to effective marketing. Even so, there's a lot of insight to be gained from mining prepaid usage patterns, as many innovative operators have shown. Banks and telecom firms must collaboratively find creative ways to hurdle this challenge. They will find that it will be worth the effort.

The Chief Executive of the African operations of a well-known telecom firm says that they value the customer stickiness created by their award-winning mobile money service more than its revenue or profitability. In the Philippines, the success of mobile money is closely linked to the perceived reliability of networks, the nation's status as the texting capital of the world and a strong need for financial access in a market where just over one in four has it.

That mobile adoption has spread financial inclusivity in several developing regions is well known; by logical extrapolation most of this credit should go to the prepaid segment, which constitutes as much as 90 percent of a large market such as India. Interestingly, the high prepaid penetration of developing markets is being mirrored in developed countries, where customers are looking to get the best deal for their dollar in a post-crisis economy. A global communications leader added nearly 2 million U.S subscribers during a three month period this year, of which 75 percent were on prepaid plans.

Indeed, the prepaid mobile model has a lot going for it. For customers, it is a way to get on-board quickly, without the fuss of too much paperwork, at an outlay as little as $1. It is also a medium of instant settlement, a factor behind the growth of peer-to-peer lending. To telecom operators, it provides a safety net of advance collections and lower operating cost since there is no need to dispatch millions of itemized bills each month. And although these companies are facing increasing pressure from regulators to ensure KYC compliance which was somewhat subverted earlier in the rush to acquire customers, all projections say that the prepaid business will continue to grow. In fact, some analysts believe that mobile subscriptions may follow a contrarian pattern, with mature markets following in the prepaid footsteps of emerging ones, rather than the other way round. Since this trend may be attributed to Gen Y's preference for fickleness, micro-consumption and pay-as-you-go options, it also implies that future prepaid subscribers will be tech-savvier, with greater financial resources and high service expectations.

However, despite the euphoria, closer analysis suggests that the industry hasn't fully exploited the wider opportunity contained within the prepaid business, which goes beyond airtime revenue to encompass not only mobile banking and money transfer but also a wide mobile commerce spectrum. This is a matter of some concern because once the market saturates, the only source of business growth will be the existing customer base, dominated by prepaid users.

But first, what is the opportunity?

Indications are that the prepaid mechanism will drive much of the future innovation in the mobile space, stepping out of its domain into other sectors like distribution, retailing and entertainment, to name a few. This ubiquitous mobile commerce will work on a 'smarter prepaid' platform, embedded with all the business logic - such as KYC standards, transaction limits and a merchant account settlement mechanism - required to meet the security, reliability and performance expectations of regulators and consumers alike.

With that, the possibilities are only limited by one's imagination. Take a hypothetical example of consumer goods distribution in a geographically large country. Consumer product companies need to work their way through a maze of wholesalers, distributors, sub-distributors, stockists and retailers to reach the final customer. Significantly, much of this distribution works on a cash and carry mode; hence, a small retailer can get hold of supplies only after paying for them. Given the incidence of counterfeits in certain markets, retailers run the risk of being stuck with fake goods, and by the time they find out, it's too late anyway. One way of eliminating this problem is to get retailers to connect directly with the manufacturer or with their large, trusted distributors. A mobile wallet system could facilitate this by enabling retailers to place direct orders and pay for them; the elimination of fakes from the market and the smoother flow of merchandise across an integrated supply chain is simply collateral advantage! The result is a win-win for the company, its genuine distributors and also for retailers.

Retail m-commerce is also ripe for enablement through prepaid accounts. A market intelligence company predicts that by 2015, eight percent of the world's e-commerce will be conducted over a mobile phone. That's nearly U.S $120 billion in sales! Interestingly, the firm also says that a major driving factor is that in some less developed nations, the mobile is pretty much the only gateway to the Internet. Since prepaid subscribers account for the bulk of mobile users in these regions, the derivative insight is that this platform is shaping the way people will buy and sell in future.

Also, let us not underestimate the convenience and versatility of this medium, in which a single handheld device not only works like a credit card, debit card and wallet all rolled into one but also enables the user to find, send and receive purchase-relevant information.

This explains the new trends in m-commerce, namely, using the mobile to hunt down the best rates or to avail of price offers. A recent survey of 1,000 adults in the U.S revealed that about 60 respondents or 6 percent used their mobiles towards coupons and discounts. Sellers can straightaway improve the hit ratio of their coupon promotions by delivering context or location specific offers, such as a price-off at select stores when they find out that a target customer is inside a shopping mall.

These are just a couple of instances from an endless number of possibilities that can be realized by building various applications – to do with gifting, healthcare, payroll, travel, remittance and even government benefits – onto the prepaid platform. In their annual forecast of the U.S prepaid business, a leading research and advisory firm in the payments and banking space says that in 2013, a staggering U.S $670 billion will be loaded into prepaid cards, more than double the figure for 2009. Open-loop will grow at an annual compounded rate of 36 percent in this period to overtake the closed-loop market.

Banks, called upon to play a facilitating role in mobile transactions, are faced with an exciting future. For one, they can get various businesses to use their m-commerce payment processing framework. Taking the earlier example of the consumer goods supply chain, banks can sign up the companies' large distributors as corporate clients and allow them widespread access to other points down the chain via their m-commerce platform.

On the flip side, the prepaid play in financial services raises the spectra of cross-industry players such as retail and telecom firms stepping onto the banking turf of payments and money transfer. That being said, this emerging competitive threat is not without a silver lining and banks may actually gain by collaborating with these companies which have unmatched distribution to reach out their own financial offerings to a much larger consumer base.

So why has the prepaid opportunity not been utilized to the best extent?

No doubt, this segment has had its share of problems in terms of downward spiraling prices and high rate of churn. The latest consumer trend of using multiple connections to avail the best price for a call within each operator's network hasn't helped Average Revenue per User (ARPU) either. Hence, prepaid value has not kept pace with subscriber growth.

But even as it considers various methods to energize revenue, the industry cites lack of consumer data about prepaid customers as a major barrier to marketing effectiveness. Since prepaid user data collected under KYC guidelines is of the bare bones variety, telecom companies do not have sufficient consumer insight especially at a granular level, which is necessary for conducting meaningful marketing activity. The result is plain to see - generic promotions and across the board price cuts with a strong likelihood of value destruction.

However, rather than fretting about the data they lack, some enterprising operators have mined what they do have to great effect. These firms have unlocked the hidden meaning in usage data to create insights and re-design their marketing strategy, gaining both revenue and customer stickiness. Insightful usage metrics include calling preferences (for example, does the customer call only within the network?) top-up patterns, number of incoming versus outgoing text messages, among others. Since this information is readily available, mobile companies can finely segment their customers on this basis and target differentiated, relevant promotions at each, instead of carpet bombing them with offers that are mostly ignored or worse, needlessly decimate revenue from loyal customers.

With the upgraded profile of prepaid subscribers, telecom marketers have new opportunities to get entire families, friend groups and even small businesses on board besides shoring up per user revenue through high-end mobile broadband and data services. Importantly, it is easier to obtain detailed information about these consumers than it is with the outreach segments. Going forward, they could look at leveraging that with the help of Business Intelligence (BI) and Analytics solutions.

While this may call for investment of time and other resources, the potential upside should far outweigh these minor considerations. And since banks have a vested interest in the prepaid business, maybe they should get together with telecom firms to catalyze the process ■

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Also Read

Making Mobile Transactions Safe for All - *Whitepaper*
Till now, banks have taken several measures to secure mobile banking and payment transactions. The diversity of mobile handsets - from the very basic SMS-only phones to a huge number of intermediate phones to the sophisticated iPhone and BlackBerry, which support encryption and safe storage/ transmission - makes it impossible to adopt a single universal security solution. Hence, banks have no choice but to take a multi-pronged approach, relying on technology, regulation and infrastructure as needed, to ensure that transactions on every type of mobile device are made more secure.
http://www.infosys.com/finacle/solutions/thoughtpapers.asp

Leveraging Social Media to Win in a Digital Consumer World

Précis

Today, when power rests in the hands of digital consumers, business has no choice but to adapt to their changing behavior and expectations. Innovative companies across industries are paying close attention to these consumers, converting deeper engagement into higher sales. Of the top 100 global brands, those active in social media have significantly outperformed their peers. On the other hand, even new entrants are trying to grab quick wins by innovating over social media.

Until recently, financial services firms were more circumspect, viewing the online space as an alternative channel of interest primarily to their younger customers. But now, Internet usage statistics on financial product research by customers and their need for a multi-channel experience and personalized offerings has forced financial providers to reinvent themselves. After being acknowledged as a powerful tool to reclaim consumer trust, social media is now finding application in community building, product research and co-creation.

However, financial services firms face a dilemma of how to measure success of social media initiatives in the absence of established benchmarks. While they can accept ambiguity in returns in the short term, in the long run, they need well-defined metrics to justify their social agenda.

In the meantime, the industry must find ways to minimize risk without holding back its initiatives. Some ways of doing this are by encouraging small experimental innovations in-house, deciding quickly whether an idea is working or not, redeploying innovation resources and prior learning in other projects, and capping upfront investment.

Going forward, large financial organizations must capitalize on their natural advantages to forge ahead in the social space; innovation is crucial to retaining dominance in the long run.

The digital consumer has taken charge

The emergence of social media has turned the relationship between corporations and customers on its head. The days when companies managed information and public perception are gone: today, the balance of power has shifted and consumers are leading the charge. Empowered by social media tools, digital consumers are proactively questioning, critiquing, and recommending products and services on blogs, forums, and communities and increasingly completing transactions online.

Consumer behavior continues to change at a breathtaking rate, and companies have to adapt continuously to the digital consumer. The headlines are well known: Facebook has over 500 million users - if it were a country, only China and India have a larger population. More important than sheer size is the influence of these connected consumers. In a recent U.S study, 60 percent of Facebook fans and 79 percent of Twitter followers said that they are more likely to recommend those brands since becoming a fan or follower.

Winners and losers

While the pace of change creates challenges for most companies, innovators are seizing the opportunity by listening to consumers, earning rather than buying media, and converting consumer engagement into sales as well. Some of the examples are now iconic: Comcast leverages Twitter to respond to customer service issues in helpful way in real-time, and has transformed a reputation for indifferent customer service. Procter & Gamble (P&G) has created a community of 600,000 mothers who help co-create new products and become word of mouth advocates. Even those companies who used TV advertising to build famous brands and giant businesses are turning to social media marketing instead.

The business case for social media engagement

So what is the business case for using social media to engage with digital consumers? A study last year of the top 100 global brands found that companies which actively adopted social media to engage consumers substantially outperformed their peers in both revenue and profit performance. In the U.K Domino's Pizza recently reported a 29 percent increase in profits and said it had “led the way with social media initiatives.”

As technology and consumer behaviors shift, new entrants often drive innovation and can seize an advantage. Take Zappos.com, which was founded in 1999 and grew to be the largest online shoe retailer in 2009. It achieved that by aiming to provide the very best customer service possible, free shipping, a 365-day return policy and a call center that is always open. However, it was Zappos.com's distinctive use of social media which turned it into a winning strategy. By communicating with customers in a helpful way on Twitter, Facebook and YouTube, Zappos ensured that online recommendations and word of mouth travelled far and wide. CEO Tony Hsieh has over a million followers on Twitter, and every employee is encouraged to be active on Twitter to share their own stories and interact directly with customers.

Financial services firms seize the opportunity

Industries like technology and media first experienced the disruptive effects of social media. Enterprises in those sectors led the way in defining how to engage with digital consumers, driven by the necessity to change and adapt as their industries re-configured. Others, like financial services companies have been more cautious. Until recently, financial services firms viewed the Internet as an 'alternative channel' - and social media perhaps relevant only for their younger customer demographic.

However, market reality challenges that view: Industry analysis shows that as far back as 2008, over 60 percent of online U.S adults used the Internet to research financial products such as student loans, brokerage accounts and credit cards. Of those, over 35 percent of them applied for these products online. Today's consumers demand a rich and positive experience across multiple channels, personalized products which match their digital lifestyles, and efficient, responsive service.

In response, leading financial services are re-inventing themselves to be more customer-centric and adopting the Internet and the mobile phone in addition to the branch. The social web provides financial institutions an even more powerful way to serve their customers. As consumers increasingly use social media to research, rate and recommend financial products and services, change is inevitable. Innovation now is gathering pace in the financial services industry as well, where these trends are playing themselves out in a multitude of new propositions, from startups to established institutions.

In one sense, the opportunity to leverage social media to build customer relationships is clear. More than 50 percent of consumers lost trust in financial institutions because of the financial turmoil in 2008. As firms work to overcome the post-collapse trust deficit, engaging with consumers using social media offers a powerful way to re-establish a dialogue, regain trust and drive business. Moving beyond simply re-building trust however, leading financial services firms are leveraging social media for everything from community building to product research, financial management and crowd-sourced ideation.

For instance, a global bank has established a thriving community for small business owners to share their experiences and learn from their peers. A leading financial management solution company leveraged the wisdom of crowds to test and improve new products for small businesses. Social media also goes beyond marketing - A leading financial investment brokerage firm allowed active traders to exchange information within the community, supplemented by guest experts. As a result, revenues and profitability rose significantly for the most valuable customer segment.

A leading online discount brokerage firm in the U.K manages a community of top-performing members, and forums and blogs along with real-time news and updates. Users can share their portfolios and track community sentiment about investments. What sets it apart is a widget which allows members to research on other websites such as Yahoo! Finance or CNN Money and trade through the firm directly from another site.

Making change happen

As financial services firms adapt to the digital consumer context and design their social media strategy, they face a crucial conundrum. With the rate of change in leveraging social media we are witnessing, there is no established model for success. Yet there could be a penalty for acting hastily just as there may be a heavy price to pay for reacting too slowly. In the short term, it is hard to prove the financial returns from participating in the social ecosystem. In the longer term however, initiatives must demonstrate that value is being created in order to survive. So how can an established financial services enterprise seize the opportunity while minimizing the risk in its investment?

Encourage experimentation

Google is a highly-regarded innovator which puts to use the "portfolio of bets" approach in its business. Google has a policy which encourages engineers to spend twenty percent of their work time on projects that interest them. Many of Google's services such as Gmail, Google News, Orkut, and AdSense originated from these independent endeavors. Although some projects undoubtedly fail, Google could point to some half of all new product launches originating from small, experimental initiatives originated by employees.

Create a portfolio of early bets: back the winners and learn from the mistakes

Many financial services firms are already in an experimental mode. The importance of consumer engagement is clear, but winning business propositions are not. There may well be a number of different ideas on the table, across a range of businesses and territories, competing for scarce management attention and funding. Even with this uncertainty, financial services firms understand the need to quickly determine whether their initiative is working or not depending on the response and feedback from their prospective customers. Innovators encourage risk-taking and back their winning bets and limit their losses on those which don't succeed.

Create flexibility and retain institutional knowledge

If an initiative is not successful, a company must have the flexibility to move the people and resources involved to another project. Moreover, the learning gained from these new ventures need to become part of the institutional knowledge so that they can be successfully applied in the future. Allowing people and resources to shift smoothly between businesses and projects helps manage innovation and enables the company to scale up and roll new initiatives in quick succession.

Reduce risk and up-front costs

Social media is enabling change so rapidly that placing bets is risky. Understandably, firms who are experimenting in this space do not want to make significant up-front investments in hardware and software. In cash-conscious times, lower investments can make a major difference to a project's viability. Increasingly, major financial institutions are turning to cloud computing as an attractive alternative in a fast-moving space. A software-as-a-service model allows firms to rent the software platforms they need to support their initiatives, paying a monthly license fee based on actual usage rather than the significant up-front costs associated with traditional IT projects.

Looking to the future

Leaders will exploit their big-company advantages and cultivate flexibility

Even in times of disruptive change, established firms have natural advantages such as a network of branches, relationships with millions of customers, and multiple channels to serve them. Continuing leadership in a Web 2.0 world will come from effective innovating and experimenting. Smaller firms are naturally more flexible and quick to respond. If a larger firm implements effective innovation processes, it can create the speed and flexibility which are so important in establishing first-mover advantage and market leadership.

One simple indicator of effective participation in social media is the number of fans or followers on Facebook. By this simplified metric, nine of the top ten slots are occupied by established brands such as Starbucks, Coca-Cola, Red Bull, among others. In financial services, history suggests that major players will still lead in the future. The top 5 commercial banks in the Fortune 500 list are all household names. Innovative online-only banks in the U.K are still relatively small compared to incumbents.

Companies will organize for social media

Research and development is an established discipline in many industries such as manufacturing, technology or pharmaceuticals. Companies with an R&D function have an established process for developing intellectual property or launching new products. However, social media does not fit into these traditional constructs. The business benefits may be championed by marketing, public relations, customer service or corporate communications. The technology may be provided by IT and content managed by product teams. The legal, operational, HR and regulatory factors need to be considered and addressed as well. Given the cross-disciplinary impact of social media technologies, a cross-functional effort is the only sensible organizational response. Leading industry observers have seen this pattern across a sample of marketers across a number of different industries.

Leaders will gravitate towards a global technology capability

Most companies have a small group of early adopters who evangelized the power of social media and spawned a range of experiments within their firms. Over time and with experience, the pioneers brought structure to disparate efforts and initiatives. They wanted to tap into the full spectrum of opportunities created by collaboration technologies, but without the risk and duplication of efforts from multiple local initiatives. In a pre-digital world, each business unit or product or territory may have its own media plan and marketing initiatives. In today's world, most enterprises recognize that engagement cannot be undertaken in a haphazard manner, or it will fail. To ensure a coordinated approach, most global players are gravitating towards technology infrastructure which can keep pace with changes in the market and serve their needs across products, units and geographies.

Leadership in innovation will translate into long-term competitive advantage

Conventionally, startup firms funded by venture capital investments try to turn promising technologies into commercial success. Incumbents and established companies are biased towards waiting until a technology is established or consumer behavior has sufficient momentum before placing bets. Innovation in social media has started to chip away at the conventional paradigm. Leaders have moved quickly from early experiments to considered investments into far more sophisticated enterprise-wide rollout and transformation. Specific business opportunities, in every industry, are still emerging. However, the will and the capability to innovate are increasingly seen as critical competitive factors. A recent report found that 72 percent of top corporate executives consider innovation one of their top 3 strategic priorities in 2010. Even though which companies and initiatives will succeed is unclear, the ability to innovate is viewed as a key competitive advantage.

Conclusion

With the emergence of the digital consumer and social media technologies, companies no longer have the control they once used to. Every industry is affected by developments in social media, and financial services firms can take advantage of lessons learned - sometimes painfully - in other industries. Understanding the strategies and practices undertaken by innovators in other industries is a constructive start.

Financial services firms understandably do not like to take risks. The reality in the digital consumer world is that the capability to innovate is critical. In order to maintain leadership, financial institutions need to make a concerted effort to enable experimentation, organize for innovation, and de-risk their investments. As they engage with customers on the social web, they create real opportunities to build fundamentally new relationships - and businesses ■

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Also Read

Social Networking: New Opportunities for Banks -*Article*

Web 2.0 has already made a huge impact on human interaction. Now, it is up to individual banks to craft creative strategies that will help them make the most out of social networking, social commerce and social media opportunities. Recognizing the potential of this technology, forward-thinking banks have appointed dedicated teams for channel development under the leadership of a Chief Channel Officer. No doubt there will be many more initiatives in the days to come. Those banks that taste early success will be better placed to march ahead.
http://www.infosys.com/finacle/solutions/thoughtpapers.asp

Banking on Social Media - *Article*

We must recognize that customers born into a digital generation, are fundamentally different from their predecessors. For one, this generation is at ease and highly dependent on technology, which is borne out by the expectation that active Internet users worldwide will climb to over 2 billion from the current 1.5 billion within the next few years. This generation is strongly influenced by the larger community that it identifies with and will often seek and express opinion within online forums. They are as brand conscious as they are fickle – so, any product or service that's not visible in their popular hangouts, including social media, will soon be forgotten.
http://www.infosys.com/finacle/finacle-connect/Issue_19/inf.asp

Web 2.0 in Banking and Financial Services Industry -*Whitepaper*

Web 2.0 is changing the way we interact online. Web 2.0 tools like Wikis, blogs, surveys, ratings, polls, widgets and social networking are being widely used across industry verticals for improving customer loyalty and thus business. This paper attempts to explore the possibilities of Web 2.0 in banking and financial services industry and the ways in which such tools can be deployed to improve customer stickiness and bring increased business to financial institutions.
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Building Tomorrow's Financial Enterprise

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Précis

The world may have staged a smart comeback from the crisis, but this is not the time for self-congratulation. Businesses and regulators are faced with the uphill task of restoring growth and confidence, and fortifying the system against any negative developments in future. Today is about building tomorrow's enterprise.

While pursuing growth, cash flow and efficiency in future, financial enterprises will have to contend with a changing world economic order, shifting demographics, evolving technology and tightening regulation. Flowing from these, we have identified 7 themes which we believe are crucial to the success of tomorrow's enterprises.

The first of these is the digital consumer, an assertive, independent individual with a keen sense of community. Since they want flexibility and control in their transactions, they are drawn naturally towards self-service. They seek personalized products which cater to their strong sense of individuality. These tendencies also find expression in the digital consumers' desire to influence product development through co-creation.

Enterprises need to have a separate strategy to tap emerging markets, which apart from powering growth are contributing to innovation. Their abundant workforce and cost competitiveness make them the obvious choice for smart sourcing by businesses based in ageing, high cost regions.

Tomorrow's organizations have to be mindful of the fragile ecosystem. Enterprises are bound by a social contract to promote sustainability by cutting back on resource consumption and pursuing green innovation.

A new commerce - mobile, micro and inclusive - is taking shape to change rules of product consumption, delivery and payment. Mobile technology will be crucial to banking innovation, and to the spread of financial inclusivity and micro commerce.

Healthcare is exerting greater influence over the economy of a greying world. Financial institutions must not only brace against the impact of rising healthcare costs, but also extend their portfolio with health insurance and pension-related products.

Success will belong to smart enterprises that are rid of operational complexity, and therefore able to leverage their simpler structure to adapt, learn and respond faster.

The last theme is pervasive computing, conducted on the cloud, within sensor networks and over billions of online devices.

If globalization of the financial world accelerated the spread of the last economic malaise, then co-ordinated worldwide action, by nations and institutions, has also led to the recovery, at a pace few anticipated. While we may heave a sigh of relief, it's too early to rejoice for we have the onerous task of sustaining this positive trend before us. This is a time for contemplation, a chance to craft our success agenda, determine the fate of our industries, especially that of financial services five to ten years hence, and make sure that we are never caught off guard again. Today is about building tomorrow's enterprise.

For financial enterprises to become truly sustainable, they must first be made future-proof. There are enough indications that the abiding trends of the future will spring from changing global demographics, market economics, technology evolution, and accountability regulations. With the greying of developed, and some developing economies, their shrinking productive population has to help governments shoulder an expanding social security burden. Their industry will have to resource their workforce from elsewhere. On the other hand, emerging markets will be the global growth engine, thanks to their size and potential for expansion. Technology, which in a mere 60 years has evolved from mainframe to personal to networked computing, is now taking its biggest leap ever into the realm of pervasive computing. Going forward, back-end IT infrastructure will move to the cloud even as people, organizations and objects connect together on the Internet. And regulation, arguably the strongest trend of the post-crisis era, will be fortified not only to ensure financial institutions adhere to prudential practices and governance but also fulfill their larger responsibilities as global citizens.

How can the financial industry leverage these developments to achieve those goals which are, in the final analysis, the reason for their existence, namely growth, profit, cash flow and efficiency? What are the ways of expanding operations, implementing new models or improving customer loyalty more efficiently? What bearing does the digital revolution or environmental agenda have on their business?

The ability of financial services organizations to seize new opportunities will be linked more than ever to advancement in information technology. As the partner of several institutions across the world, Infosys has, after intensive research over two years, identified 7 key themes that will be crucial to the success of tomorrow's financial enterprise.

1. **The digital consumer:** Today's consumer is tech-savvy, active, independent and supremely demanding. She is fully engaged with her social communities, which are powerful shapers of public opinion and innovation. Being a knowledge-seeker, the digital consumer is highly context-aware and particularly sensitive to issues such as environmental protection, Corporate Social Responsibility (CSR) and governance.

   Since digital consumers seek both flexibility and control over their transactions, they are enthusiastic adopters of self-service, a trend that is transforming the way organizations engage with their customers. The journey of retail banking from the branch to the ATM, Internet and mobile is hard evidence of how today's customers would like to take matters into their own hands, literally!

   Consumers are also asking companies to personalize products and services at an individual level. **N=1** is the new reality of segmentation; thanks to the reach of social media, every digital relationship between a company and their customers can indeed be personalized. It is now left to banks to leverage information technology innovatively to deliver this 'extreme' personalization efficiently and viably.

   And now, customers are going a step further, demanding a say in shaping the products, services and channels that they are expected to use. Social platforms – online forums, blogs, communities et al – are connecting companies directly to customers and facilitating invaluable and open interchange of ideas and feedback in real-time to fuel collaborative innovation and **co-creation.**

For example, a Turkish bank has been quick to respond to the expectations of their digital consumers by introducing an ingenious 'Flexi Card' which allows users to manipulate a set of ten parameters including interest rate, fee, rewards and design to create a highly personalized product.

2. **Emerging economies:** The epicenter of economic growth lies in emerging markets including the BRIC nations and others like Indonesia, Mexico, Turkey and some African countries. Indeed, global banks with significant exposure to Asia fared better during the crisis than those which did not. Enterprises that wish to ride the **growth momentum** of these markets must recognize their unique characteristics and tailor their approach, systems and processes accordingly. It is no longer appropriate to force-fit standardized offerings or practices from the developed world to the developing one; in fact, a number of products are now tested and proven in emerging markets before being launched globally. Mobile payment is a case in point.

   Innovation too is undergoing a similar reverse osmosis. Forward-looking enterprises are disaggregating and opening up their innovation processes to include partners, and at times even competitors. Emerging economies are becoming **innovation hubs** which must be nurtured, not only because they serve strategically important developing markets but also because they have great future potential.

   With their abundant talent, cost competitiveness and strategic proximity to production centers, these countries are an obvious choice for **smart sourcing** by enterprises located in aging, high cost geographies that are looking to move individual work modules to the most optimal locations. Garnering the support of the right partners in the local ecosystem is crucial to the success of this endeavor.

3. **Sustainability:** By consuming between 1.7 to 1.8 times the resources available fairly to us, we are guilty of stealing from future generations. Enterprises being the worst offenders have an unwritten **social contract** to redress some of the wrongs by adding a strong sustainability dimension to all that they do.

   As the cost of energy rises with scarcity, every industry is looking for ways to cut back its **resource intensity.** Technology is enabling them to monitor and improve resource efficiency through intelligently designed buildings, vehicles, devices and processes.

   But even as countries and companies pursue sustainability, they have to ensure that it doesn't come at the cost of growth. It is here that technology plays a seminal role in making **green innovation** possible. Enterprises can green their computing, communication, products, materials and operations by employing various technologies from Smart Grid to Green Logistics.

   Green Banking, once 'nice to have', is increasingly becoming mandatory, forcing financial institutions to review their consumption of non-renewable materials and find ways to shrink their carbon footprint. Regulation apart, banks are facing up to their environmental corporate social responsibility, some going as far as refusing corporate accounts belonging to ecologically hazardous businesses.

4. **New commerce:** The failure of hallowed financial institutions took the sheen off

unbridled growth. Stung hard, customers have turned cautious and are monitoring their finances with great care. At the same time, financial enterprises are looking for ways to do more with less – sell more products at lower cost, reach customers everywhere with the same channels and fulfill more transactions using the same infrastructure. This is the new commerce: **mobile, micro** and **inclusive.**

Everything is on the move in today's world, be it people, products, information or capital. If the Single European Payment Area (SEPA) eased the flow of goods and money within Europe, the mobile phone revolution made basic financial services accessible to the masses in Kenya, who could now make small payments or remittances using their handsets.

People have become careful on how they spend their money. The digitization and delivery of content through app stores enabled customers to make micro-purchases – a song instead of the album or an article, but not the journal – and they are bringing these expectations to all consumption. This implies both challenge and opportunity for banks, which, as the financial intermediary between vendor and buyer, must strengthen their payment systems in order to handle huge volumes of low-ticket transactions.

The trends of mobilization and micro-purchasing admitted those who were erstwhile excluded, into the consumption net. New commerce is inclusive - the spread of micro-finance and rural banking is hard evidence. We can proudly say that once again, technology has been responsible for this development in no small measure.

5. **Healthcare economy:** The state of health and healthcare can greatly impact the cost of delivery, which is shared by all participants in the economy. The **affordability** of healthcare is impacted both by demographic and lifestyle characteristics; while little can be done about the former, there are instances of some enterprises and insurers promoting wellness and a healthy lifestyle among their employees to **prevent** sickness. IT can reduce the cost of delivery by minimizing errors and redundant treatment, and the science of bioinformatics and patient analytics is critical to the shift of healthcare focus from cure to prevention. It can also help make treatment more **patient-centric** by improving communication between physicians, care givers and patients.

   Financial services institutions anticipate healthcare services related demand, such as that for improved health insurance or pension products. As big employers of people, they can make a sizeable social impact by promoting good health practices within their organizations, too.

6. **Smarter organizations:** Organizations must be smart to succeed in a dynamic and competitive business environment. This is a Catch 22 situation, because as enterprises grow, they become more complex and hence less efficient in managing their work processes and knowledge. In a study of 75 companies across 12 industries globally, it was found that those with least complexity grew 1.7 times faster than their peers, on average. This is but one of the several compelling reasons why financial enterprises must reduce complexity and **simplify** everything from their structures to the way they manage compliance. Technology is both an enabler and a candidate for simplification and the industry can work smarter with a single digital nervous system and modern core systems.

   Improving agility is one way of dealing with a shorter learning curve. Enterprises are finding traditional methods of knowledge dissemination too slow, preferring instead to **collaborate** with and **learn** from the various constituents of their ecosystem. The power of social networking has brought financial institutions face to face with their customers and facilitated the interchange of ideas and information on a scale that was unimaginable not long ago.

Technology is also helping financial organizations **adapt** faster to changing market conditions by reducing unpredictability through the use of business intelligence and predictive analytics run on integrated systems using real-time data.

7. **Pervasive computing:** Is pervasive computing the defining innovation of our times? Today, 2 billion individuals and organizations are connected on the Internet; in ten years, there will be between 50 and 60 billion 'devices' – including human beings, because pervasive computing renders almost anything into a computer – online.

   Imagine the explosion in information as users integrate with technology and communication environments to access content over various channels, and particularly from social networks. With technology moving to the **cloud,** more information is available outside the company walls that within. This is a goldmine of data for **intelligent enterprises,** which realize the importance of using **sensor networks** to pick up localized data that can help them design better products, serve market needs and become better organizations in general. A bank based in Omaha, U.S has demonstrated this by redesigning their branches to deliver a 'coffee house experience' based on the demands voiced by customers in social media.

Clearly, financial enterprises of the future will have to factor all or a combination of these factors into their core strategy. Also, in the end, it is important to partner with an organization which can stand by them every step of the way, enabling their journey through these themes to help them realize their goals of growth and profitability ■

Also Read

8 Points to Ponder for Banks Seeking to Innovate - *Article*

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/cover.asp

Innovation in Practice

Richard Dunlop
Regional Chief of Staff,
HSBC Technology and Services
Leader of Innovation,
HSBC Group IT Executive Steering Committee

HSBC are known to be one of the world's largest banks and, behind the scenes, they have spent the last decade consolidating all of their disparate and fragmented systems onto single platforms. A single platform for Internet banking, a single platform for payments, a single platform for branch-based connectivity and so on. This rationalization has allowed the Group to look towards innovation from both a technological viewpoint and from a global perspective. Their innovation leadership includes Richard Dunlop, Regional Chief of Staff for HSBC Technology and Services and Leader of Innovation on the HSBC Group IT Executive Steering Committee.

In this candid conversation, Richard discusses their approach to innovation with Chris Skinner, Chairman of the Financial Services Club.

Q **I guess to start off with Richard, I would be interested to know how you see innovation within HSBC, particularly from a group technology viewpoint.**

A Put simply, innovation in HSBC is about harnessing opportunities to drive our future profitability. There are certain things that we can do today that can increase the margin for our businesses, but driving future profitability is really all about ideas that come from left-field. So we are supportive of that, and the technology innovation unit is a demonstration of the way in which we have set that up. In terms of how we source innovation, we get ideas from four key sources: our people, our suppliers, our customers and our research. We have over 300,000 people spread across most of the geographies of the world. These people are also our customers. Getting their input, from a customer and internal employee perspective to see how they can improve the way we operate is key. To enable that we use crowdsourcing capabilities. For example, we have a product that allows anyone to submit ideas and then for others to vote on those ideas positively or negatively. A little bit along the lines of Likes on Facebook or Digg. We now have 35,000 people in the U.K retail network using this, and it's been very well received both by the people, in terms of the number of ideas that are being put forward, and also by the management team who are courting those ideas. It's also a useful way to gauge where you should be putting your focus as the best ideas float to the top and those are the ideas that we will be taking forward. We also get ideas from our suppliers. We spend billions of dollars every year with technology suppliers, and what we have tried to do is to build both supplier relationships and partnerships, and to work with those companies to allow us to develop joint R&D. Some of those suppliers are also customers for example, in that we may be funding some of the R&D they are doing. We therefore get a view as to where they are taking their businesses and it works quite well from a symbiotic relationship view. A third constituency is our tens of millions of customers globally. HSBC has 100 million customers around the world, and this is a rich source of feedback and ideas. The bank uses the full gamut of customer feedback tools. We have been visiting customers in their homes in the U.K for example, to talk to them in a more relaxed environment and to find out where they see banking going in the future. We take all those sources and then combine that with research. We have research relationships with Oxford University for example, and work closely with them. Understanding our competitor's activity and broader trends is a key input here and this, together with specific arrangements with the top universities and their technology 'spin-off ' arms, allows us to remain aware of emerging opportunities at an early stage. We bring all of this together and try to decide from that what makes sense for us to take forward. We generally try to take a technology together with a proposition to create an opportunity that is something that is more concrete, and then we can discuss that with the businesses.

Q **Is there a framework or methodology you use to manage innovation therefore?**

A Yes, we try to put a framework around those sources of information to enable this, but it's not rigid. We don't want to stifle ideas or inputs. A good idea is not a monopoly of one person, and when you've got such a rich source of information we just want to create the flows for that information. That is why we have one central coordination point to pull all of this together and evaluate all of that information, and to do the sort of things that are best done once. I mean we are a very large organization and I wouldn't want every part of the Group speaking to the same supplier about the same opportunity. So we try to coral that in order to have one conversation taking place and to avoid wasting the partner's time and our energy internally. We then share that information back with the organization. We make extensive use of collaboration tools such as Lotus Connections and Microsoft Sharepoint, and have a lot of internal blogging. We are trying to maximize the use of all of these technology products to make that information available to the population of the bank. It's all managed through an approach of a single point of contact within the organization for internal distribution and external connection though.

Q **You mentioned that you have global reach with 300,000 staff, so you must see a richness of diversity of cultures and approaches too.**

A Yes, that's a competitive advantage for the bank. We are the world's local bank, operating in enough geographies that allows us to see the maturity levels of advanced products and technologies, and their adoption across various parts of the world. We can then place that in our armory and effectively deploy it when the markets are right to take those technologies and services. For example, the Far East is quite high up the adoption curve in terms of contactless payments in Japan, Korea and so on. They are also culturally far more accepting that governments and banks are safe places to provide data on their identity. They see that as enhancing the security of transactions they perform, rather than seeing it as some sort of Big Brother syndrome. That's why, in our Malaysian branches, we have facial recognition cameras at the teller points. Facial recognition data is held on national ID cards in

Malaysia, and this is used through chip readers and cameras to verify the identity of customers in our branches when applying for lending. Culturally that's accepted and is entirely OK but I couldn't imagine that working in the U.K today, but who's to say what the future holds? Nevertheless, by having that in our armory and being able to scale that across all of HSBC if needed, we can deploy that into geographies when it is acceptable from a cultural perspective.

Q **Are there any things that you see on those global horizons that will be disruptive, as in game changers for banking?**

A Mobile technologies providing access to services on the move on whatever device is going to be a game changer. That's going to create change. People want to be able to access their data, they want to be able to perform transactions and receive services from a bank 24x7, 365. The cultural piece around security is underplayed there, as people want that access. So providing services in an appropriate manner to a whole range of devices is going to continue to be a need. The iPad may be one of those devices, but there'll be another one along tomorrow and another the next day. Our focus is to understand how we can best deliver to those devices and to remain in conversation with the suppliers of that technology to understand where they are going next.

Q **It is a challenge as there are so many things happening so quickly with consumer technologies that banks cannot keep up, and certainly cannot change their core systems to accommodate it.**

A And they shouldn't unless they are convinced that the takeup of those consumer technologies will be in sufficient quantities to justify the investment. For example, a question we are asking is whether the Android phone from Google will get the same take-up as the iPhone? Do we need to put as much investment in that technology as in Apple's offering? It is a difficult judgment. The way we deal with that is to invest upfront and try these technologies out. In fact, from that perspective, everything we do from an innovation perspective is relatively cheap as working with these products is relatively inexpensive. It's when you try to make it scalable that the additional costs start coming in. So we would do something which allows us to understand that proposition and how it might function, and then look to see what is happening with the product from the consumer perspective. How many devices work like this? Where are they in the world? Who's using them and for what?... and so on. This is when we find the benefit of being global and being able to test in different geographies. For example, if Vietnam were an early adopter of that device, we would be able to test in that environment and then be able to scale, rather than trying to create something that could handle fifty million customers upfront.

Q **Is it a technology driven approach, or are there other factors in play here?**

A It's always a range of multiple factors. We look at technology, and at the business opportunities that are associated with that technology. In the same way, we have business needs that are driving us towards certain technologies. So there is a constant two-way conversation between us and our businesses, looking for the best opportunities arising from that connection.

Q **That's fine for a bank of your size I guess, but what advice would you offer to a smaller bank. Say, a mid-sized bank operating in one country that cannot afford a large innovation team.**

A Domestic banks generally operate in competition with the banks in their country, and I'm not sure how many of them look to other markets to understand what is going on in those other markets. The areas to innovate are then around channels and pricing, but very few new business models have emerged in banking driven purely by domestic banks. I mean how many ways can you package an account? Just by pricing? So I don't know how smaller banks can innovate, unless they are connected to the developments throughout the world. For example, the last big product innovation in the U.K was the offset mortgage, where assets and liabilities were wrapped together, and that innovation came from Australia. So a domestic bank really needs to look globally for innovation, not just within the borders of their experience and who they compete with. I would also advise them to look East. That is where economic growth will drive investment in new businesses and technologies. Latin America is also not far behind. These emerging economies are not saddled with the legacy investment costs and are already 'leap frogging' the developed world in the technology stakes. This means that you cannot be blinded by the old conundrum of being a 'big fish in a small pond'. Succumb to that syndrome and you will be at risk to new entrants.

Q **Finally Richard, what sort of innovations do you see coming downstream in the future?**

A Electronic communities is one key area. There's a very large number of people online in electronic communities like LinkedIn, Facebook and Twitter today, and many of those people are our customers, so we are asking how we could leverage those communities as a method of providing services to customers. There are sub-segments of those communities that are specific to banking and some to our bank, how can we play into this and assist our customers? That's something that will grow, particularly for trusted communities. Mobile technologies will also continue to grow and security around those will also be a concern, especially as people begin to transact. The result is that maybe we start to break that functionality into smaller and smaller components for customers, so that they can reconstruct this into their own interfaces. They may create entirely new types of interface, based upon bank APIs that are enabled via their mobile devices. For example, taking data from multiple sources and reconstructing it into something that you would like to see as your financial interfaces. I don't know if that will make a difference, but can see it coming downstream. It's all about having access to your data and being able to analyze it, on the move, in whatever way you want. I also wonder about access to the customer in the home, and how they might change their use of devices. For example, flat screen monitors all around the home and on mobile devices may provide a way to enable us to provide services to customers that are different to those of today. We are paying attention to those areas in order to provide that always-on, always-connected interface to the customer. That's going to be incredibly important. Finally, one of the key sellers for the bank is security and trust. We are looking at what other products and services we could sell to customers in that area. Being the safe keeper of their data, for example ■

Also Read

Delivering Business Value through Innovation -*Article*

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.
http://www.infosys.com/finacle/finacle-connect/Issue_21/default.asp

Technology Next: Crack the Reliability Game

David Gledhill
Director and Head Group Technology and Operations
DBS Bank

Voted by Global Finance as the 'Safest Bank in Asia' 2009 and 2010, DBS Bank is Southeast Asia's largest bank. Headquartered in Singapore, the bank has among the highest credit ratings in the Asia-Pacific region. Established in 1968 it was the catalyst to Singapore's economic development during the nation's early years of independence. Since then, DBS has transformed into a successful financial services institution, offering a comprehensive range of innovative products and solutions to meet its clients' needs. DBS Bank is now one of the most respected banks in Asia, with a presence in 16 markets. The bank is committed to building a high performance organization renowned for its customer service and innovative business solutions.

We spoke to David Gledhill, Managing Director and Head Group Technology and Operations, DBS Bank, about his vision for technology next and, the role technology plays in meeting reliability and performance expectations.

Q **So much has changed in the banking world as a result of the financial crisis. Do you think that technology must play a different role now?**

A Oh, absolutely! The crisis has singularly changed the positioning and perception of banks everywhere. Customer surveys highlight the negative sentiment towards the industry. Banks have fallen from grace, from being lending heroes to someone that its customers approach with caution. Consumer trust is perhaps at an all time low; criticism at an all-time high. In addition, customers today are more dependent than ever on their banks for carrying out regular activities and expect us to be always there for them.

Since technology exists to support the bank and its customers, we are now faced with a new mandate, which is to win back customers' trust and favor and prove that we are indeed as dependable as they would like us to be. Our biggest goal is to turn negative relationships positive once again, and I think one way of doing that is by bringing new and innovative products to the table. So, yes, technology has a key role to play in rebuilding confidence in the banking system and in banks in general.

Q Apart from being instrumental in restoring faith, how can technology help banks meet other challenges, particularly competition from within the sector and the more recent threat posed by cross-industry players?

A Let's talk of competition from outside the industry. So many firms from the Internet, telecom and retail space are stepping onto banking turf. PayPal, a path-breaker in the payments space, is a good example of a successful 'outsider'. Now, most telecom companies are making a play for mobile banking and payments.

But, having said that, I believe that while it is important to watch these developments, banks fulfill a much larger role which goes way beyond the niche services offered by these players. Mining and integrating this broad set of capabilities remains our focus.

As far as other banks are concerned, they are upping the ante, and we are seeing a tougher fight for share of customer wallet than before the crisis. We are all chasing a more concentrated revenue in certain markets. Therefore, being innovative and putting out products to market quickly is the road to competitive advantage. I think we must also do a better job of selling technology's 'ease of use' story to customers, who are demanding the same flexibility, speed and convenience offered by other online businesses from their banking experience. Banks that don't respond to this call will be taken out by those that do.

Q Where do you think co-opetition or collaboration with competitors, especially cross-industry players is headed? Many banks have done this in the mobile technology area - does it have a future?

A Good question. If you look at some of these emerging platforms of mobile and Internet services, you have many banks falling over each other to get to roughly the same place. So, whether it's a bank that has just enabled customers to do an auto deposit using a photographic cheque image, or one which has created a nifty payment system, we are all innovating in the same space and honestly, pretty much ending up with the same broad solution set.

Significantly, a lot of the innovation in the mobile space works with a short lead time. That means banks can't take too long over innovating and implementing new offerings. To me, though, the real challenge in the mobility and Internet space is ensuring reliability and dependability. It's easy to get a quick thumbs-up from customers for introducing a new-fangled gadget along with your mobile offering, but that joy can vaporize in the case of pure gimmickry on a platform which does not provide adequate stability and dependability. Unfortunately, we are seeing a number of players rush headlong into the market without thinking the vital questions of stability and reliability through, and suffering immense damage as a result. I think that the innovative upside of cute gadgetry is mostly short-lived, but the downside of instability can be dramatic and very long lasting.

Q You mentioned the need for product innovation and faster time to market. How can technology enable greater innovation in products, services and processes when most banks are doing similar things?

A We need to look at a couple of things here. The first is the core on which your innovation is built. At DBS, we place great emphasis on what we call the enablers - so, we are building a very strong core banking platform in association with Infosys and Finacle. We focus on establishing robust core infrastructure, and a set of enabling technologies such as SOA that we leverage to enable analytics and warehousing. All these components are coming together to make the bank more nimble, and shorten time to market. State of the art, flexible, reliable core technology is our path to innovation, rather than the 'gadget of the week'. We believe this is the way to create credible long lasting innovation.

Q The crisis restored focus on improving efficiency and lowering operating cost. How can technology serve these goals?

A Well, at our bank, we look at efficiency from two angles - our own internal efficiency and that of our customers. So, as you would expect, we are doing a huge amount of work around re-engineering our core. In the last two years at DBS, Finacle has rolled out to 12 countries. We have tried to standardize as many things as possible across the Group – for example, we have a standard GL, standard product codes, and reasonably uniform reporting, all of which has led to greater efficiency. Previously, if we wanted to create a consolidated report across the Group, We needed to do an enormous amount of re-work at the back end in order to achieve the data consistency that was needed to compare one country with another. Now, that issue has gone away thanks to the re-engineering which is part of our Finacle rollout program. Just to illustrate the point, launching a new product in India is so much easier when you need to use the same product codes that are being used in Indonesia. Standardization and a heavy focus on STP and elimination of batch processes is what we are aiming at in order to lower operating cost. Our estimate is that we've knocked off between 20 and 25 percent from our operations processing effort in the last two years. However, this isn't a cure-all, because if you use technology simply to automate a process, it is likely that that's all you'll get, with no real impact on efficiency. That's why we emphasized product and process re-engineering as part of new technology rollout. Smart thinking on the operational and business side of things is a prerequisite to extracting efficiency from technology.

Q **Finally, what can banks expect from Technology Next; what is the future of technology?**

A I go back to the point regarding what customers might expect from next technology. If you look at banking today, I think it still has some way to go before delivering the level of efficiency, ease of access and dependability that customers will expect from us in future.

For instance, it is unbelievably hard to make a payment from one bank to another that is located in a different country. PayPal has tried to bridge this gap with a commendable solution that enables bank-to-bank transfers, but by and large, it is still difficult to do, despite automated processes, online fulfillment and all these different channels. Again, creating a credit card or a new loan is not as seamless as one would imagine.

When we think about technology of the future, we must aim at revolutionary change and not incremental improvement. 'Technology Next' has a mandate of creating products that are distinctly innovative and accessible from our customers' point of view. The industry hasn't paid enough attention to this dimension until now.

Q **Thank you Dave. Any final words on what banks should be looking at, not only from a technology perspective but also from an innovation and customer needs standpoint?**

A The technology perspective must first address issues of reliability and dependability. When we evolved our self-service, mobile and Internet channels, we made customers fully dependent on them in their daily lives. As a result, the availability, performance and security of technology become critical. In my view, this is a huge opportunity for improvement. Every couple of weeks, we hear of one more bank which experienced a stability issue with their core solution or online platform. These things are no longer acceptable to customers who are completely dependent on what we do.

Although core banking has progressed, it can further improve on the reliability front, especially against the backdrop of the next wave of technology. We talk of 5-9's reliability, and I know this is an extreme example, but in the aviation context that standard would have one aircraft dropping from the sky every eighteen hours! I think banks which advocate such benchmarks are only deluding themselves. A key mission of next banking technology must be to crack the reliability game in a completely different way ■

Making Innovation Relevant to Clients

Carole Berndt
Head of European Global Treasury Services
Bank of America Merrill Lynch

Bank of America is known as an innovator in their domestic markets. They were one of the first American retail banks to commit to Internet banking and, as a result, have over 25 million customers self-serving online. They were then a first mover in mobile banking, with a fully functional service available to consumers in mid-2007 and over five million users today. More recently, they created Pariter Solutions, America's largest ACH in a joint venture with Wells Fargo. With the acquisition of Merrill Lynch and further commitments to SEPA processing in Europe, Bank of America is now a truly global transaction services bank. What does this mean from an innovation point of view?

Chris Skinner, Chairman of the Financial Services Club, finds out in this interview with Carole Berndt, Head of European Global Treasury Services at Bank of America Merrill Lynch.

Q How do you define innovation in banking?

A The way we think about innovation is really about continuing to be relevant to our clients as the business, market, tools and techniques that are available in the banking industry evolve. Innovation without relevance is just a hobby. Our ability to innovate our products and services requires equal focus in three key areas: it's about our people and our organization; our processes; and of course, our platforms. Platforms are the easy one to start with, as that's our product capability. It's what we deliver to our clients that meets their immediate needs and also delivers value and differentiates us from our competitors. In the transaction banking business, a payment is a basic transaction, put simply, we move money from Point A to Point B. Where the innovation component sits is with the speed and stability of how that gets done. Increasingly, it's around the information related to that transaction. So moving the money is a core competency, and the ability to educate the client about their monetary flows, their internal efficiency, how best to utilize their money and where to place it, is where we can then bring innovation. We do that in a number of ways. An example is our global liquidity platform, that enables our clients to leverage a range of functions, to optimize their cash efficiency, globally.

Q **I would like to pick up the comment you made about speed, stability and information. I often get the sense that speed and stability are in conflict, in that the more you speed things up the more unstable it becomes?**

A An interesting observation but not the case. When I think of the drivers for innovation, the one we normally think about first is technology. Technology enables us to deliver against those contrarian attributes. Technology enables us to transact faster; to move things more quickly; to have real-time processing; all of these things with increasing stability. If you think back over the years, this business was largely paper-based and as it has become more technically savvy it has moved from tapes and reels through to floppy disks to host-to-host connectivity, to today's global platforms. The stability and speed aren't that contrary therefore, when technology is such an enabler.

Q **You mentioned people and processes, as well as technology. Do you develop innovation as a culture, or is it usually just appearing from left field?**

A This is so much a three-legged stool for us - people, process and platform. We have to be relevant to our clients and that requires building up our people, our organization, our processes and our platforms to support that. Process is about how we process the payment, how we handle the manual instructions, how we do the OFAC checking, and so on. All of those things are areas in which we have a disciplined and systemic approach, but where it gets really interesting is when we think outside of the traditional transactional box and look at processes across the industry. Then we look at how we can partner with other organizations – whether they be other banks, vendors or clients – to improve processes. An example of that is in the U.S, where we have a joint venture with Wells Fargo to create a new company called Pariter. Partier combines the Wells Fargo and Bank of America Merrill Lynch operations to offer an ACH processing capability. Now, we could have improved ACH processing in-house but by looking outside our company, and partnering with a competing bank to build that core capability, is making the industry more relevant to the client.

Q **It sounds like you're saying that innovation is really focused upon delivering a better service to the client, in terms of information richness, value, cost, speed or all of those. So what are the key drivers for innovation in Pariter, and within Bank of America Merrill Lynch in the wider context?**

A It's a good example to come back to the speed, stability and technology aspects again. All of the traditional transaction banks built up ACH processing capability over a number of years, and a lot of the legacy systems' pipes and plumbing associated with that. Instead, Pariter started with a blank piece of paper in order to build an ACH processing utility leveraging the best technologies, processes and infrastructures of today. That delivers benefits to the end-user because you are delivering the stability and speed. Then you build the volumes and gain economies of scale, which lowers costs to the end consumer. All of that provides improved service, value and capability.

Q **And in the wider picture, Bank of America has been very aggressive in the U.S in building a mobile banking service that has gone from zero to over five million users in just under three years. How do mobile payments fit into the scheme of things?**

A Mobile is a focus of attention for us, it is not only relevant to developed markets, but also increasingly to fast growing emerging economies like India and China where they are bypassing a generation of technology. In places where there isn't any infrastructure, such as in Africa, it's a similar story there. Mobile doesn't change the core transaction or infrastructure or processes though; it just changes the access to them. For example, I use the phrase banking from the golf course. I don't think we are going to see people walking around the golf course with their iPads generating payments files, but I do think we are going to see more and more people being more in touch with the things in their life that are important. Their cash, risk, budgets and operational efficiency, all being made available to them through mobile services whether they be a consumer or corporate client. That might be alerts or things that need to be brought to their attention, things they need to authorize, transactions that are taking place, things that are critical in their cash flows, and so on. So mobile is very relevant in our space and we do offer apps for the iPhone, iPad and Android. As these trends evolve, we continue to invest in those that are relevant to our clients.

Q So, over the next decade, what is going to be relevant?

A The biggest drivers of innovation in our industry come from the markets and from the regulatory environment. In particular, regulations will increasingly play a greater role in the innovation space. In EMEA for example, look at something as fundamental as SEPA, the Single Euro Payments Area. Just look back five to eight years, and you can see how that has changed the industry. We haven't seen the full impact of that yet, in terms of how we think about transaction banking and how a corporate structures their cash management operations. It also changes the players in the markets, and fundamentally changes the need for the infrastructure that traditional banks have built up over the years. So regulation will play a big role.

On the market trends side, we have seen a shift away from the 'single global bank' model we were talking about a few years ago. Clients were looking to create shared service centers, factories and hubs, putting everything down a single pipe with a single provider, operational efficiency being the primary driver. We have seen that change, as the need to manage concentration risk and cash efficiency across diverse geographies will mean a shift back to relationships at a regional and local level. There will still be innovation and services coming from the big banks, but it will focus more around how to link those pieces together. That means bringing the best of the big bank infrastructure, together with the flexibility of using local banks where the client has a need.

Then there's this whole yield versus risk conversation, which will change how products are developed and structured going forward. We have had years of yield being the primary driver, but the risk component of that is now higher on the agenda. This is why we are seeing clients with balances that are left idle for longer, and we will see more of that going forward and products and services will develop around that.

Finally, just coming back to liquidity, the interest optimization capability is a really good example of the service required by clients to allow them to keep cash in different places and geographies, without compromising on cash efficiency. That's a great example of innovation driven out of markets, technology and client behaviors.

Q Thanks Carole and to wrap up, do you have any final point on innovation you would like to stress?

A Only that it all comes back to the original point: innovation has to be relevant to the client. There will always be big things you launch at major events, but most of it is about the value you deliver every day ■

Also Read

What Constitutes Innovation in Banking - *Interview*
Interview with Anthony Thomson, Chairman, Metro Bank.

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.
http://www.infosys.com/finacle/finacle-connect/Issue_21

CFS: Successful Business Strategy from Sustainability

Tim Franklin
COO and Member of the Board
Co-operative Financial Services

Précis

As the world's most sustainable bank, the Co-operative Financial Services (CFS) is a shining example of how ethics and social responsibility can go hand in hand with profitability. CFS' guiding principles direct their every activity and the bank believes that their customers favor them for precisely this reason. Their results appear to support this theory: In the first six months of 2010, current accounts increased by 38 percent, mortgage applications by 31 percent and general insurance business by 32 percent.

Some of the values cherished by CFS include the primacy of members and customers, taking personal and social responsibility, creating a great workplace for their employees, and being fair and open in their communication. This is why they allow their members to direct their priorities, which currently extend to fostering co-operation and development within the community, rehabilitating young people to make them productive members of society, alleviating global poverty through a sympathetic 'small and tiny business' lending agenda, battling climate change by supporting eco-initiatives and conducting only what they deem ethical finance.

CFS' values have been richly rewarded with widespread recognition. The public has named them the most Socially Responsible Bank in the U.K. A leading magazine rates CFS as the Best High Street Financial Services Provider and puts them in the top 3 in their People's Choice Survey. They were recently voted the FT's Sustainable Bank of the Year, beating 110 banks from over 40 countries.

All enterprises talk of values and Corporate Social Responsibility(CSR), but few believe that these can really drive business. At The Co-operative Group, it is our experience that taking personal and social responsibility are more than just buzzwords; they make absolute business sense. It is no coincidence that Co-operative Financial Services (CFS), U.K's only bank with a customer-led ethical policy achieved unparalleled growth during this year, at a time when others were still recovering from the ravages of the financial crisis.

At CFS, our approach is simple - to do business which is consistent with our values and principles. If it isn't right, then it isn't for us. Our purpose is to be a pioneering business delivering sustainable financial services to our members and the larger society – pioneering, because by making a bold move we wish to set higher standards and sustainable, because we take responsibility for the future consequences of our present actions. Last but not least, we aim to create a financially prudent and profitable business for our members.

We are pursuing our ambition of becoming the U.K's more admired financial services business by upholding the following values:

- **Putting members and customers first:** We exist because of our members and customers. When we make decisions they are at the center of our considerations. When we make mistakes, we put it right. Every customer complaint is a change request and needs to be treated as such.

- **Taking personal and social responsibility:** Nothing changes in our business unless each colleague takes personal responsibility for their actions. Our wider responsibility to society is delivered through community programs in the U.K and around the world.

- **Creating a great place to grow, work and develop:** We know that if we are to attract and retain the best talent in a competitive market, we must provide them with an environment in which they can be the best they can be.

- **Striving to be faster, better, more successful:** We focus on making processes and systems as efficient as possible and on eliminating waste.

- **Bringing openness, fairness and excellence to communication:** We communicate in a mature, easy to understand manner with our employees, customers, regulators and stakeholders, giving them relevant information at the right time.

Customers and members have rewarded these actions by trusting us with their money. In the first six months of 2010, our current accounts increased by 38 percent, mortgage applications by 31 percent and general insurance business by 32 percent. Our customers guide our ethical and social responsibility agenda as follows:

Co-operation in the community: CFS has always been rooted in the community and our 350 branches are located among the people we serve. We lend twice as much to customers in deprived areas relative to our size than any other bank in the U.K. Our commitment is reflected in the fact that we support credit unions by providing banking facilities and other services. Over 60 percent of U.K credit unions bank with us.

Financial inclusion is also at the heart of our social responsibility agenda. By catering to the financial needs of prisoners before they are released, we are helping them to become valuable citizens again and becoming integrated into society. Independent research shows that ex-prisoners with bank accounts are 33 percent less likely to re-offend.

Inspiring young people: No business can afford to neglect the young citizens who are the very future of our world. Although we bring a larger social dimension to our engagement with young people, we think of it as an investment towards creating a more financially responsible and productive community. We are working towards helping the young through financial and vocational education by sending out volunteers to work with various schools around the U.K besides setting up our own academies and creating an apprenticeship program for young people.

Tackling global poverty: How can banks succeed in their financial inclusion agenda when there are so many people lying at the bottom of the pyramid? We think dealing with poverty and issues of human interest is a logical extension of our business. That's the rationale behind our partnership with several NGOs including Action Aid and Amnesty International.

CFS' international microfinance projects enable small businesses around the world to generate income and become productive members of society through the pursuit of sustainable economic activity. The funding of 30,000 eco-friendly irrigation pumps over the next three years in the states of Uttar Pradesh and West Bengal in India is an example of how just one of our microfinance activities is cutting out 25,300 tons of carbon-dioxide emission.

Combating climate change: As the world's most sustainable bank, this goal is a given. Among the renewable energy projects in our portfolio is an investment in wind turbines in Scotland. We are going well beyond carbon neutrality to offset 110 percent, and thanks to initiatives such as the installation of Europe's largest solar panel at our Manchester Headquarters, will cut emissions at our Group by over 13 percent this year. Our members want to see stronger action on climate control, and so we have stepped up our campaign against fossil fuel extraction, particularly in those regions where commercial interests are threatening both the natural surroundings as well as the livelihood of indigenous people.

Ethical finance: Our ethical policy, formulated in 1992, guides all decisions including whom we will and will not lend to. This has meant turning down almost £1 billion worth of funding business since then, and over £100 million in the last year alone. That being said, we aren't short of ethical commercial opportunities; some of our new endeavors include a social banking unit which has already supported lending to organizations in the U.K. We also create innovative ethical products and sustainable unit trust funds.

Our promise to customers that we will keep things fair, responsible, easy and personal is also consistent with these values. Everything about our business – products, services, systems, behavior – is built around our strategy and values. This has stood us in good stead, and we have thrived at a time when financial institutions worldwide are losing the battle against eroding customer confidence.

How do we measure achievement?

We use a balanced scorecard which balances financial performance – which is clearly important – with other key metrics to evaluate our progress in the areas of customer, process and people. Hence, our focus is not only on improving our profit and balance sheet, but on building customer advocacy, increasing product holdings, improving efficiency and creating an environment that nurtures engagement between colleagues and puts our core values above all else.

All these metrics make business sense.

The public has consistently named us as the most Socially Responsible Bank in the U.K. A leading magazine rates CFS as the Best High Street Financial Services Provider and places us in the top 3 in their People's Choice Survey; we are also the only financial services provider to be recommended by them in every product category. We were recently voted the FT's Sustainable Bank of the Year, beating 110 banks from over 40 countries.

Our detractors might think that by upholding such high standards and principles we have lost out on business. The truth is that we have gained far more. Our commitment to sustainability and other values has given us a distinct and much admired identity, which draws those who share our values and others who are disillusioned with their financial services provider to bank with us. In other words, we have succeeded because we are customer guided and member led. Hence, we owe it to our customers to stay true to our values and weigh every decision against its impact on long-term sustainability.

This is our opportunity to make a difference to society and to become the U.K's most admired financial services business and we are going to seize it! ■

When Foot Traffic from Checks Goes Away

Cascading changes from declining checks to transaction and sales automation

Précis

While on one hand self-service channels mean lower costs vis-à-vis branch setups, on the other hand the increasing erosion of branch foot traffic is leading to a decline in face-to-face cross-sell and up-sell opportunities. With growth in self-service "intelligent" depositing technologies - check and cash deposits - banks are seeing a negative impact on deposit volumes and, loan and product sales.

So how can banks maximize the opportunities that self-service channels offer? Responding effectively, as observed in several high performing banks, requires changes in culture, technology, organization structure and employee sales compensation. Simultaneously, banks must realize that rather that operating each channel independently, they must invest in tying all delivery channels together so that customer information is accessible across channels through a single file.

An efficient CRM system goes beyond branch automation and focuses on automating routine transactions, simplification of administrative activities and presenting a 360-degree view of customer information. Such a system will enable banks to create a multi-channel environment that is both efficient and effective.

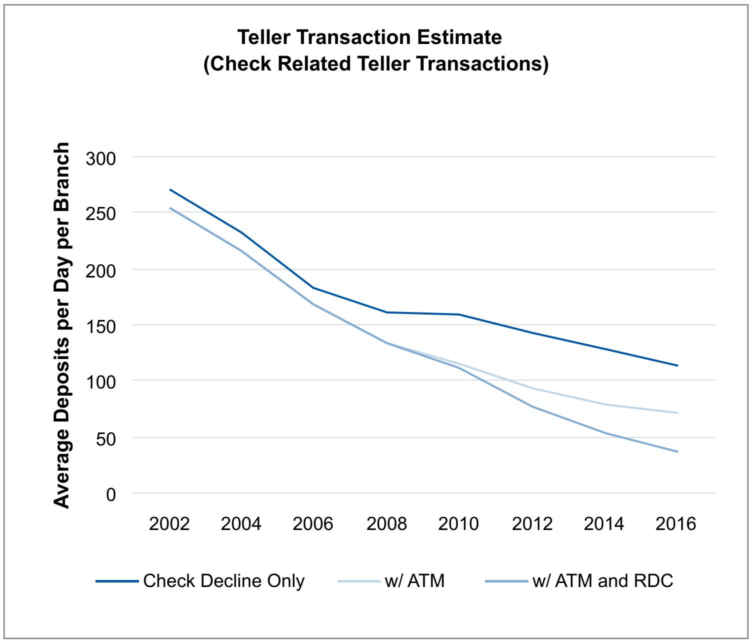
Less check writing alongside growing use of self-service channels is eroding branch foot traffic like never before. It's no shocker that check volumes in the United States have been declining for the better part of the last decade. What appears less well understood is the long-term impact of this decline and what banks should do in response. U.S banks could learn from European colleagues who have walked the road of declining check usage earlier.

Self-service isn't new either, but self-service check and cash depositing is. Historically, self-service channels (ATMs, telephone and Internet banking) have had only modest impact on branch traffic. Instead of primarily siphoning transactions away from branches, self-service channels have added net new transactions. As a result, branch building continued alongside investment in self-service channels. But, growth in self-service "intelligent" depositing technologies – image ATMs and remote deposit capture (RDC) - is taking a big bite out of branch foot traffic among financial institutions that deploy them, presenting both opportunity and challenge. Customers love these technologies and their use results in a lower cost-to-serve compared to branch transactions. But, the resulting erosion in branch foot traffic is causing its own set of problems. Here's why.

The gradual decline of check writing (six to ten percent per year by many estimates) leaves consumers and merchants with fewer checks to deposit. In turn, deposit frequencies are declining, which leads to a corresponding reduction in branch foot traffic. Two technologies, image ATMs and remote deposit capture (RDC), are only hastening the reduction in branch foot traffic.

Celent estimates that in 2010, some 700 US financial institutions have deployed image ATMs, representing roughly 55,000 devices, or 40 percent of deposit taking ATMs. While often installed for the servicing cost reductions they represent, "intelligent deposit" ATMs have consistently demonstrated the ability to alter the ATM transaction mix. Deposit activity in particular is considerably higher among many FIs deploying these ATMs. This has had a significant impact on branch deposit volume among deploying FIs. Several large banks, for example, collect as many deposits via the ATM channel as they do in the branch network. A short while ago, this would have been a laughable proposition.

Remote deposit capture client adoption in the U.S is also on the rise. In a September 2010 Celent survey, 246 financial institutions across the asset size spectrum reported that only about 8 percent of their small business customers use RDC, but the use of RDC is expected to triple to nearly 25 percent of small business over the next few years. This will be hastened by the emergence of low-cost desktop and mobile RDC solutions. More than two-thirds of financial institutions in the survey said they will be offering these products to consumers and small businesses alike. Early signs point to a similar pattern in Canada in the next few years. The chart below shows a conservative Celent estimate of resulting average impact on branch foot traffic.



It follows then, that as branch transaction volumes decline, banks can expect declining loan and product sales results under current face-to-face cross-sell and up-sell methods. Thus, unless significant improvements in cross-sell ratios can be made, many retail-oriented banks could be looking at substantial revenue shortfalls.

So what's a bank to do?

While there are no easy answers, Celent observes several common threads among high-performing banks. Responding effectively will likely require changes in culture, technology, organization structure and employee sales compensation. We will look at some technology implications here.

Branches have historically been banking's primary sales channel. However, to remain competitive all financial institutions will have to learn how to effectively sell a growing array of products and services using all available customer touch points. Ally Bank and USAA are two examples of big banks gaining significant market share without branches. But doing so means, at a minimum, having competitive ATM, online, mobile and call center platforms tied together to provide a single view of customer activity. Simply having multiple delivery channels for customers will no longer be sufficient. Instead of operating each channel independently, banks need to tie all delivery channels together so transaction history and key customer, account and household information is available in a single customer information file equally accessible by all channels.

Customer Relationship Management (CRM) systems linked into each customer delivery channel and the customer information file will become a standard competitive necessity for all institutions regardless their size or markets. The basic idea with CRM is to gather useful information on each customer, make product suggestions based on the unique needs of each customer and keep track of what has been offered. In the process, banks can learn with great precision which offers are most successful and which staff are most (and least) effective. These CRM systems can also include campaign management tools to offer individually tailored product recommendations to each client across multiple channels rather than a one size fits all approach. Sales lead management tools within CRM systems keep track of who generates sales leads (in the branch, call-center or real-time chat session on the bank's website) and can help ensure each lead gets directed to the right staff member for follow up. Taken together, these systems don't just make branch sales efforts more effective, they help transform multiple transaction channels into a coordinated multi-channel sales and service delivery mechanism.

Seeing a future of fewer brick-and-mortar retail outlets, however, many banks have invested in branch automation systems designed to improve sales effectiveness, but without giving sufficient attention to automating routine transactions. Invariably, this results in a disappointing return on investment.

Celent's research shows that many modern CRM systems are ineffectively utilized because branch staff is too busy with transactional and administrative activity to derive maximum value from the system. But banks that combine investments in both transaction and sales-and-service automation (For example, CRM) maximize the effectiveness of their branch staff. Examples of transaction automation solutions include teller cheque image capture, teller cash recycling and automated account and loan origination systems, all of which considerably reduce the time and effort branch staff must devote to administrative and transactional activity. Some banks further invest in self-service kiosks within the branch environment so staff can be 100 percent devoted to sales and service activity.

Think of the following two systems as complimentary investments – two sides of the same coin. The most powerful transaction automation technologies, in Celent's opinion, are teller cheque image capture and teller cash recycling. The use of both systems has been growing by double digits over the past several years in the U.S.

Transaction Automation	Sales and Service Automation
• Automated account opening	• Referral generation and tracking
• Automated loan origination	• Campaign management
• Teller cash recycling	• Portfolio analysis
• Self-service kiosks	• Sales prompts and scripting
• Teller image capture	• Next best product

Once these technologies are in place, banks have the freedom to create a multi-channel environment that is both efficient and effective. The role of the retail branch in our increasingly multi-channel world is clearly evolving, and their care and feeding is as important now as it ever has been. Branches aren't dead – just different ■

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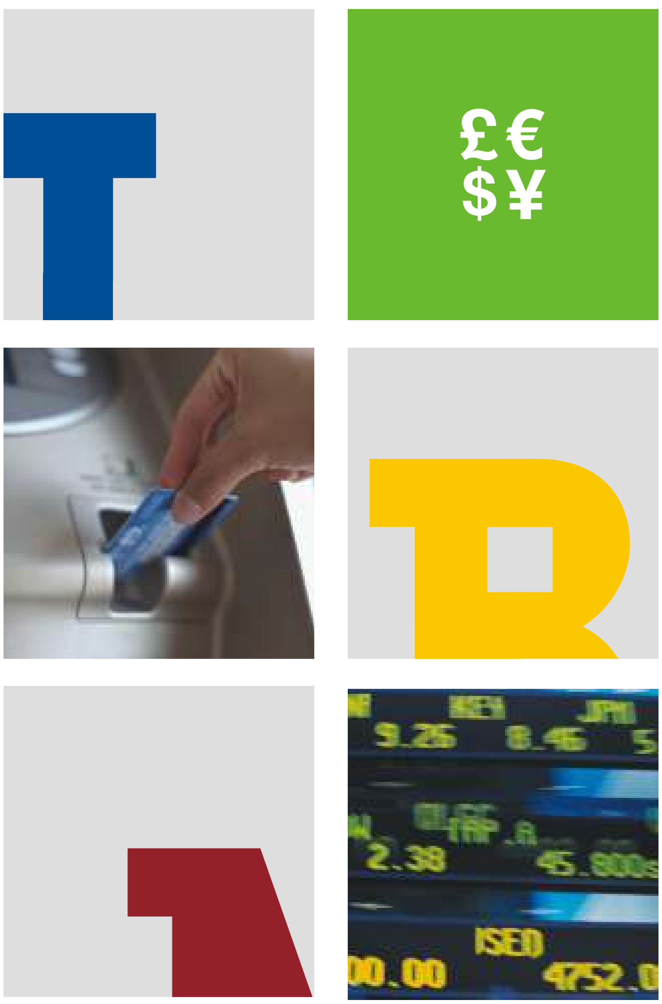

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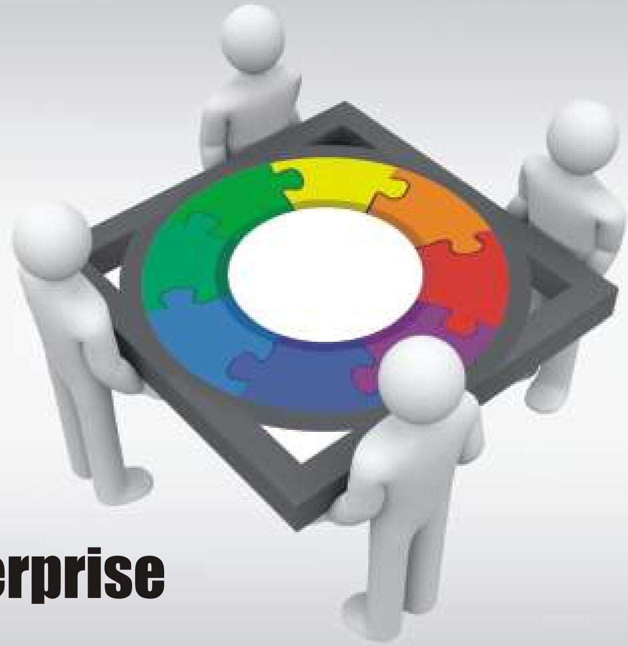

Building the Co-Creative Enterprise

Précis

Realizing that interactive technologies have changed people's behavior, a small but growing number of companies have invited customers to participate directly in the design of products and services.

In doing so, these pioneers have discovered that other stakeholders, like employees and suppliers, won't wholeheartedly participate in customer co-creation unless they are allowed to generate value for themselves, too. That requires giving them the opportunity to design and manage their own work experiences and to help identify and solve problems.

The payoffs of the co-creative enterprise are greater productivity and creativity, lower costs and employee turnover, and new business models and sources of revenue.

Virtually all companies worry about their customers' experiences with their products and services. But how many care about the experiences of their other stakeholders who directly or indirectly shape customers' experiences - from employees, suppliers, and distributors, to NGOs and regulators? We mean *seriously* care.

Sure, companies have strived over the years to build more trusting relationships with stakeholders and to involve them more deeply in solving problems. We've seen Japanese-style participative management, "partnerships" with suppliers, quality circles, lean production, and Six Sigma. And the latest thing, of course, is to invite everyone to trade ideas and opinions on company websites and through social media like Facebook.

The reality is that the experiences of most stakeholders still get short shrift. That's because the stakeholders have no significant say in designing them. But people are inherently creative and want to engage with organizations; they don't want to have products and processes imposed on them. And thanks to interactive technologies, they now expect to be able to communicate directly with one another and share and shape their own experiences. At most companies, however, managers are behind the times: They cling to their hierarchies and their control over the definition and creation of stakeholders' experiences.

Some companies, though, are beginning to get it. The shift began in the late 1990s, when a few pioneers began to let customers participate in product development. Lego, for example, invited consumers to create designs of toy robots and construction models, write applications for the robots, and offer them to other consumers on its website. C.K. Prahalad and one of the authors of this article (Venkat Ramaswamy) coined the term *co-creation* to describe this emerging relationship between customers and companies. Over the past decade, dozens of other firms - including Cisco, Dell, Procter & Gamble, Sony, Starbucks, and Unilever — have embraced "customer co-creation" and discovered something crucial: Generating new experiences for end customers often requires designing better experiences for internal players, a fact frequently overlooked in conventional process analysis.

A project in which we were involved - a large European bank's launch of a low-end life insurance product with an investment feature - is a case in point. At the time, the bank's life insurance division was facing a serious challenge from a relatively new player, ING of the Netherlands. By offering its products on the Internet, ING had slashed its distribution costs, putting bricks-and-mortar competitors like the bank at a significant disadvantage.

Classic process design would have addressed the problem by asking, "How should we redesign the steps in developing and launching products to minimize cost and time to market while meeting the requirements of the customer?" The team would have interviewed some customers to understand their basic requirements, analyzed the existing product development and launch processes, tried to reduce the number of steps and handoffs, and ended up with more efficient, streamlined processes. Nobody would have cared about the overall experience of the bank's employees. And the customer experience would have been defined as a minimal threshold of features, such as a competitive rate, a well-trained adviser to help the customer make the right choice, and a comprehensive, easily deciphered product brochure.

Co-creation yielded a very different answer, because it used a different starting point. It began by focusing on the experiences of all the stakeholders who would be involved in or affected by the new offering. The bank held a series of workshops in which seven kinds of employees - insurance product managers, actuaries, IT people, bank insurance specialists, branch managers, senior branch advisers, and junior branch advisers - met first with one another and then with target customers to discuss their experiences with past product launches. During the discussions, the bank discovered that the answer to its problem lay in the experience of its junior customer advisers.

The junior advisers had largely been limited to performing front-desk duties in the branches, such as opening checking accounts and handing out brochures. Most of them were 25 to 35 years old and felt they were in dead end positions; many would quit after just a few months on the job. Though they needed to master investment products to get ahead at the bank, the branch managers and senior customer advisers had repeatedly ruled that they were unqualified to handle offerings that were somewhat risky. The junior advisers saw the new life insurance product as an opportunity to change their circumstances—to learn how to handle complex securities-based products and advance their careers.

No one leading a reengineering or Six Sigma initiative would ever include the junior advisers' desire for career advancement as a design factor. But a premise of co-creation is that by sharing experiences, all the parties involved will acquire a deeper understanding of what is happening on the other side of an interaction, enabling them to devise a new, better experience for both sides.

In the workshops, it became clear that the junior advisers and the target customers had a lot in common: The product was aimed at people who didn't have a lot of assets or experience in investing and were in roughly the same age bracket as the junior advisers. Like the junior advisers, these customers wanted to improve their financial know-how but were intimidated by investment theory and the language of risk and return. They also were afraid of losing their capital. It became apparent that junior advisers and customers could learn the basics of investing together with the help of senior advisers and investment specialists from headquarters.

The junior advisers and target customers decided to experiment with informal evening and weekend sessions in branch offices, at which the specialists from headquarters would explain the new product to both groups. During the workday in the branch offices, the junior advisers would serve as relationship managers for the customers, and the senior advisers would offer their expertise as needed.

Shortly after the informal community sessions started, the junior advisers asked the bank to launch an intranet where they could teach one another how to sell the new product. The bank agreed. Later it launched a similar website for the target customers, where they could exchange tips on how to save money (one of their main challenges) and the junior advisers could chime in.

The launch of the new product was the most successful (in terms of revenues generated in the first two years) in the life insurance division's history. Thanks to the reliance on junior employees, the community sessions, and the websites, the bank was able to dramatically cut the cost of selling the new product. The community-based online-learning tools sharply reduced training costs. The loyalty of younger customers increased. And by creating a path for advancement for junior advisers, the offering and the processes for selling it dramatically reduced their high turnover. In summary, the co-creation process yielded a lower-cost model for the bank and a better experience for all involved.

The four principles of co-creation

In the past five years, we have studied or helped launch co-creation efforts at dozens of companies. From this work, we have distilled four basic principles that apply in any kind of business:

Stakeholders won't wholeheartedly participate in customer co-creation unless it produces value for them, too. Think about it. If something is not in your own interest, why would you enthusiastically participate in it? For the individuals involved, the value can be psychological (greater job satisfaction, feelings of appreciation, higher self-esteem) or economic (higher earnings, the acquisition of skills, opportunities to advance). For their organizations, the value is economic (lower costs, higher productivity, increased revenues, a smaller asset or capital base) and, in some cases, the chance to do social good.

La Poste, the French postal service, provides an example of a co-creation initiative that engaged multiple stakeholders. When its mainstay mail business declined rapidly because of the Internet, La Poste's leaders decided to try to expand its package-delivery and banking businesses. They confronted three obstacles: unmotivated, unionized tellers with rigidly defined jobs; dissatisfied customers who were annoyed by long waits; and frustrated local managers, who felt caught between the dispirited tellers and the command-and-control style of regional and national management.

La Poste's leaders decided to set a few high-level service goals and invite tellers and managers of post offices to talk with local customers about how to reach those goals. A critical step in getting the tellers' buy-in was giving them a say in their own work schedules. In local workshops, the three groups jointly decided what hours each office should be open and how its space should be configured.

The results: The redesigned post offices have reduced customer-waiting time by 50 percent. Customer satisfaction, which had long been in decline, is now on the rise. Job satisfaction among tellers and managers at the post offices touched by the program has soared. And last but not least, both the package-delivery and banking businesses have exhibited significant growth in the past year, despite the recession.

The best way to co-create value is to focus on the experiences of all stakeholders. Most organizations focus on creating economic value. Successful co-creators, in contrast, explicitly focus on providing rewarding experiences for customers, employees, suppliers, and other stakeholders.

The key to improving experiences is letting stakeholders play a central role in designing how they work with one another. Our experience at work, for instance, is a function of our interactions with our colleagues, bosses, sub-ordinates, HR department, customers, and suppliers. As long as we are passive recipients of processes designed by the company, our work experience tends to be mediocre - it's not optimized for us, and we can't influence it. But if we're given the latitude to redesign our interactions, we can change the quality of our experience.

When first exposed to co-creation, people often think allowing stakeholders to create their own experiences sounds like a recipe for organizational anarchy and economic destruction. In fact, the opposite is true. Co-creation is not a free-for-all. The management of the company sets the overall strategic direction and defines the boundaries between what can and cannot be co-created.

At 24/7 Customer, the strategy is to shift from providing call-center services and competing on cost to remotely reengineering the service processes of U.S and European clients. In India, to attract the higher-caliber college graduates needed to perform that more sophisticated job, the company went beyond just offering higher pay. Conscious of the hot competition for these employees, it decided to also offer them a better work experience. One way it did that was by inviting individual recruits to assemble a group of friends and apply as a team. This proposition was a hit with

The Co-Creation Approach to Process Design

Traditional process design strives to meet a defined set of customer requirements and focuses on streamlining existing processes. By eliminating steps and handoffs, it increases efficiency and saves time and money. It ignores the interests of all stake-holders but the firm and its customers.

The co-creation approach, in contrast, aims to serve the interests of all stakeholders. It focuses on their experiences and how they interact with one another. Here are the steps a firm typically takes:

1. Identify all stakeholders touched by the process (employees, customers, suppliers, distributors, communities).
2. Understand and map out current interactions intimidated among stakeholders.
3. Organize workshops in which stakeholders share experiences and imagine ways to improve them.
4. Build platforms to implement ideas for new interactions and to continue the dialogue among stakeholders to generate further ideas.

The Payoff

For firms: New business insights, new sources of revenue and profit, lower costs and risks

For stakeholders: Improved experiences, increased economic value (higher earnings, the acquisition of skills, opportunities to advance), and increased psychological value (greater satisfaction, feelings of appre-ciation, higher self-esteem) the target group and proved particularly effective in recruiting young women, who, in big cities like Bangalore, India often worried about working night shifts and getting robbed or attacked on their way home. In addition, the company gave the teams some authority over scheduling: If a team member wanted to take time off, the team made sure that someone else filled in.

The result: The joint-recruiting efforts have been more successful than traditional recruiting at attracting desirable college graduates, and turnover is lower among staffers hired in groups as well. And at operations where teams handle their own scheduling, productivity is about ten percent higher than average, and the incidence of shifts with unfilled slots is virtually zero, versus about ten percent at traditional operations.

Stakeholders must be able to interact directly with one another. In most organizations, work is hierarchical and sequential: Someone takes an order and passes it to somebody else to fulfill. What gets lost is the ability of multiple individuals to have a dialogue. And that's a big loss. Most business problems are complex, and their solutions are not obvious. To address them, people with a wide range of expertise and perspectives often need to come together to hear and see the issues firsthand and work on a resolution. Deciding up front who exactly should be at the table is not always easy. The best approach is to simply invite all interested parties to interact directly and to reach out to yet others along the way.

This is the tack Starbucks took when a sizable number of customers suggested on its My Starbucks Idea website that the chain begin serving nutritious food, including hot sandwiches. One challenge, of course, was figuring out precisely what customers meant by nutritious food, how much they would be willing to pay for such items, and the cost of producing them. Toward that end, the product marketing function initiated a discussion on My Starbucks Idea involving not only customers but also in-house nutritionists and potential suppliers. During this process senior managers expressed concern that the smell of hot food might smother the aroma of coffee in the store, thereby undermining "the coffee house experience." In the end the resolution of all these issues (including hot sandwiches that wouldn't overwhelm the coffee aroma) required a great deal of back-and-forth among all the parties.

Traditional Strategy Versus Co-creative Strategy

Traditional Strategy

Value: Creates value by delivering defined customer experience to targeted customer set

Goals: Establishes strategic goals at the outset and doesn't significantly change them

Key focus: Focuses on the interests of the firm: that is, how the firm can maximize its share of the created value relative to the shares of its industry competitors and the other members of its value chain

Advantage: Achieves advantage through realizing economies of scale before competitors do and making big, bold moves (such as acquisitions and investments in proprietary assets)

Co-creative Strategy

Value: Creates value by constantly enhancing experiences for all stakeholders

Goals: Uses the initial strategic goal as a starting point and lets the full strategy emerge over time

Key focus: Focuses on the interests of all stakeholders and how the ecosystem can maximize the size of the pie; maximizing the share of value captured by the firm is secondary

Advantage: Achieves advantage through the increased engagement of stakeholders and by continually building new interactions and experiences, which lead to higher productivity, higher creativity, and lower costs and risks

Companies should provide platforms that allow stakeholders to interact and share their experiences. The Internet and other information technologies, of course, have made collaboration among stakeholders vastly easier and cheaper. Despite this, a lot of businesses' IT systems don't actually help people share their experiences and develop an understanding of other key players' problems and priorities.

For instance, when a shortage of a critical component could threaten the delivery of a product, the raw data that can alert people to the looming problem is frequently in the company's ERP system. But often there is no mechanism to ensure that all the people potentially affected (the operator in the components plant, the manager of the factory that manufactures the finished product, the sales people responsible for the end customers, and those customers) are conducting a dialogue. All of them need to be aware of the shortage and understand the other parties' concerns. If they do, they can work together to devise an optimal solution, which might be paying a steep premium to obtain the part from an alternative source or delaying shipment of the product to clients that can afford to wait.

My Starbucks Idea is a co-creation platform that facilitates this kind of dialogue. Another is IdClic, an intranet site that Orange, the operating brand of France Telecom, built to encourage employees to submit ideas for improving processes, redesigning products, and optimizing their workplace. It's more than a mere suggestion box. Employees can promote their ideas through a blog and gain visibility through a point system that rewards people for commenting on others' ideas. By early 2010, three years after Orange had rolled out the site, about 93,000 ideas had been posted on it. More than a third of all employees had contributed or commented on an idea, and more than 7,500 projects had been implemented. Collectively, the projects had produced more than €600 million in earnings or savings.

As we hope is evident by now, the payoff of broad stakeholder co-creation is much greater personal engagement by all stakeholders, which in turn can result in greater productivity and creativity, reduced turnover, and lower costs.

Work design and strategy

Co-creation changes the way companies think about operations and strategy. In conventional approaches, activities and processes are the two building blocks of business design. Each link of the value chain or step in the process is judged on its economic merits, which leads companies to produce where the cost is the lowest (for example, by offshoring manufacturing) or to cut steps out to save time and money. The experiences of people that could lead to new sources of competitive advantage and new business models are largely ignored.

Reengineering focuses predominantly on identifying "pain points" that cause inefficiencies in the system, which are bounded (the firm, not the individuals affected, defines the process and the problem), negative (the easiest thing to do is to fix what's wrong), and incremental (in spite of messianic incantations about "clean sheet design," nearly all reengineering projects start with an "as is" view of the process and its shortcomings, limiting the scope of change). Co-creation has none of those constraints: The people involved in redesigning work imagine new, positive experiences for themselves and develop interactions that did not exist before - like the informal community sessions and websites that the European bank's junior advisers and target customers dreamed up. Moreover, co-creation avoids other critical disadvantages of traditional strategy formulation.

We believe that conventional thinking about business design and strategy suffers from three limitations:

It is solely focused on the economics of the firm and its industry. In this world a firm fights to appropriate as much of its industry's and value chain's profits as it can. Toward that end it tries to gain a competitive advantage that allows it to hold as strong a bargaining position as possible. In all cases, competitive advantage is located within the walls of each firm.

Traditional strategic moves tend to be big and highly visible - taking the form, for example, of acquisitions or large investments in new technologies. But competitors can counter these moves by acquiring the next best candidate or investing comparable amounts in the same technologies. With co-creation, the careful weaving of new interactions between stakeholders and new experiences tends to stay below the radar screen of traditional strategists. However, because these interactions and experiences are difficult to monitor and copy, they often can provide a more enduring source of advantage.

It fails to allow for the possibility of co-creating an ecosystem whose members all win. Strategy formulation in the co-creation paradigm, on the other hand, starts with a focus on the entire ecosystem - not the individual firm's position in it - and tries to imagine a new value chain that benefits all players, including, of course, the company itself. The top priorities are growing the pie and maintaining the vibrancy of the ecosystem; maximizing the firm's slice of the pie is secondary.

It assumes that a strategy will be completely defined at the outset, though uncertain circumstances often make that impossible. In the co-creation paradigm, strategy emerges slowly through a process of discovery by the individuals in the firm. A firm starts out with a strategic objective and a target customer whose needs it is trying to serve. In pursuing that goal the firm enlists the participation of the members of its ecosystem by striving to improve their lot as well as its own. The full strategy can be discovered only through a live process organized by the company but conducted by the stakeholders themselves.

This more expansive view of value, competition, and strategy is attuned to the realities of today's business world, where technological advances and economic shifts are rapidly rendering traditional business models obsolete. Emerging markets are a case in point. As managers have discovered, traditional business models built to serve developed economies often can't be applied in emerging economies, where costs must be an order of magnitude lower if the company is to compete and the infrastructure for distributing and servicing goods is often lacking. But as ITC, a $6 billion Indian conglomerate has demonstrated, co-creation can provide a way to invent effective business models for the developing world.

Co-creating an ecosystem in India

In 2000, ITC faced challenges in two of its businesses: improving its position in the global export market for commodities, particularly soybeans, and sourcing high-quality agricultural products for its new packaged-foods business. In India the quality of farmers' production was not up to the level demanded in international markets, and farms' productivity was too low to support ITC's growth. The main causes of these problems were clear: the plethora of small, inefficient farms that dominated the country's agricultural sector, and corrupt and opaque state-run markets.

The conventional strategy would have been to consolidate farms by employing two tactics popular in the United States and Europe: acquiring or leasing lots of small farms and rolling them up into vast agribusinesses run by trained professionals, and forcing small independents to merge by imposing stringent purchase contracts that stipulated farming methods and quality and productivity standards that only much larger operations could achieve. A traditional competitor would have raced to take these steps in order to seize advantage through economies of scale. The farmers' human experience — their aspirations and concerns — would not have entered into the equation.

ITC followed a different path. Because it was a company with an Indian soul, its leaders empathized with the struggling small farmers and their fierce desire to stay independent, and wanted to help lift them out of poverty. ITC's leaders reasoned that the best way to raise the farms' productivity and quality was to help growers discover and implement better practices. So improving the individual farmer's experience was a primary goal at the outset.

ITC decided to involve multiple stakeholders that shared this goal, including NGOs and the Indian government, from the start. In early workshops with farmers, the idea of holding forums that taught them how to improve yields and upgrade crop quality quickly emerged. The farmers also expressed interest in learning how to store their crops and when to sell them to maximize the price received.

In response, ITC built a series of kiosks with Internet access called *e-choupals*. (*Choupal* means "meeting place" in Hindi.) Each was located within walking distance (four or five kilometers) of several villages. Each provided information in the local dialect on the daily weather forecast, crop prices, and other agricultural news; advice on farming methods; an e-mail service that let farmers interact with scientists at agricultural universities, technical people at ITC, and fellow farmers who may have dealt with challenges similar to theirs; and access to land records, health and educational services, and information from NGOs on the latest developments in cattle breeding and crop seeds.

ITC field people identified a natural lead farmer, or *sanchalak* in Hindi, to manage each e-choupal. They trained him to operate the kiosk and lead the group education process, but he did not become a corporate agent; he remained one of the farmers and publicly swore allegiance to them. His compensation was a commission on farmers' sales to ITC and an increase in prestige in his community.

As you would expect, the sanchalaks proved to be an effective means for surfacing and discussing the main issues on farmers' minds. The online network allowed the sanchalaks to compare notes and discuss with each other and ITC personnel where the e-choupal program should go next. High on the list of farmers' frustrations were the *mandis,* the traditional government-run marketplaces where the farmers sold their crops. The mandis were (and many still are) notoriously inefficient and corrupt. Farmers were frequently cheated on weight and price and often were not paid in full on the day of the sale — a violation of government regulations.

In working sessions, ITC, the sanchalaks, and the farmers started imagining a convenient and comfortable new market where farmers would receive fairer prices. ITC would be able to buy more high-quality products directly from them there, reducing its handling costs. The upshot was the creation of a network of ITC-owned marketplaces. Each of these *choupal saagars* (or hub facilities) serves about 40 to 50 e-choupals. In contrast to the mandis, they employ electronic weighing systems, conduct objective quality testing, pay farmers in full on the spot, and offer modern amenities such as clean bathrooms. Today, ITC has more than 6,500 e-choupals and nearly 150 hubs, which serve more than 40,000 villages and 4 million farmers across ten Indian states.

This system has cut the firm's procurement related transaction costs by 25 percent to 30 percent. Most important, it is providing ITC with a stable, growing supply of high-quality products capable of supporting the expansion of its export trading and packaged-foods businesses.

At ITC, co-creation never ends. Discussions among farmers, sanchalaks, managers of the hub facilities, and the company's employees led to the creation of other facilities at the choupal saagars, such as centers that sell fertilizers, seeds, pesticides, and equipment and offer farmers soil-testing services and agronomic advice. The centers have the scale to obtain much better prices from manufacturers than the villagers could get on their own, and, of course, are a new source of revenues and profits for ITC. At the hubs, ITC also opened retail stores that initially sold grocery products and other consumer goods and have since expanded into financial services. And a mobile-phone platform now being rolled out will allow millions of additional people, including rural villagers, to obtain agricultural information and other consumer services for about a dollar a month.

Meanwhile, ITC's competitors have adhered to the conventional strategic path and raced to consolidate Indian farms by establishing corporate and contract farms. To date, few, if any, have been successful.

In taking a co-creation approach, ITC has achieved its initial business objectives and then some. It has built a business model and a competitive position in India that no rival can easily match. The farmers have seen their productivity dramatically increase, the quality of their crops significantly improve, and their income rise, and they now have access to products and services that have enhanced the quality of their lives.

The new paradigm of co-creation presents an enormous opportunity for enterprises that can figure out how to harness it. Individuals are far ahead of most organizations in their eagerness to engage in co-creating value, and organizations must now respond. Managers accustomed to focusing on process efficiency and the protection of the competitive advantage in their value chain are faced with the challenge of designing new multi-party interactions and building new engagement platforms, generating new experiences for all stakeholders.

Undoubtedly, the biggest challenges to getting managers on board are deeply entrenched attitudes and behaviors. HR people may feel threatened when employees participate in the design of recruiting or performance measurement processes. Purchasing people may find it difficult to accept that the firm should care about its suppliers' experiences. Plant managers may dislike having to engage with environmental activists who challenge their firm's sustainability practices. Conceding that people at the receiving end of traditional processes may have better ideas than the experts who have been designing those processes for many years requires a new humility.

The best way forward is to start small. Begin with a platform that focuses on the experiences of two or three key stakeholders and a specific purpose like gathering customers' requirements for a new product, improving order fulfillment, or figuring out the best sales pitch for a new offering. Then let the perimeter of co-creation naturally expand over time to include a wider range of experiences for those stakeholders and then new stakeholders. At each stage, the organization will realize new economic benefits, giving it the motivation to continue the journey and explore more and more strategic applications of co-creation.

Ultimately, co-creation is about putting the human experience at the center of the enterprise's design. The time has come for a democratic approach, in which individuals are invited to influence the future of enterprises in partnership with management ■

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Basel 2 and Basel 3: Facing the Next Regulatory Tsunami

Précis

Against a backdrop of growing uncertainty in credit conditions and sustainable growth, the financial services landscape continues to evolve rapidly. A complex and formidable array of banking reforms are emerging - with Basel 3 being only one piece of the jigsaw, albeit a highly significant piece, which aims to strengthen financial stability and overcome the limitations of the Basel 2 recommendations.

Over the course of its evolution, the Basel framework has progressively intensified capital requirements to provide for more risks and capital buffers. And although the timeline for Basel 3 implementation is still unclear, banks are advised to take anticipatory action including reviewing and improving risk management and measurement for credit risk, adopting loss forecasting based on the expected loss methodology, strengthening Pillar 2 capital and existing liquidity management processes, and engaging technical teams early on to ensure that their risk technology is up to the requirements of Basel 3.

Even those banks yet to operate under the Basel 2 regime must accelerate and ensure the success of their initiatives in order not to be left far behind the rest.

However, bankers need to be aware that new regulations are usually reactive and might distract management focus from anticipating and addressing emerging risks. Hence, early preparation is the key.

Basel 3 will change the dynamics of banking in the next decade. Risk infrastructure will be vital to an institution's ability to differentiate and converge the management of risks more effectively, practice dynamic liquidity management, and gain access to competitive funding.

Basel 3 and later regulatory dispensations may cause structural disruptions and widespread industry changes putting new demands on data infrastructure, reporting, and governance. All these will be a source of competitive advantage and determine winners and losers in the longer term.

This article will assess the road ahead for banks, compare and contrast the current and emerging Basel regimes, and provide perspectives for firms to navigate this transition.

Post-financial crisis, responses continue to be characterized by the issuance and implementation of numerous complex regulations, with more changes expected as a result of ongoing deliberations. What the industry terms Basel 3 stems from the resolve by the Bank of International Settlements (BIS) Basel Committee to safeguard financial stability as well as address the gaps in Basel 2 - gaps that were exposed by the credit crisis.

The following schematic highlights the evolution of the Basel framework and a summary of what each "version" entails. Bank capital requirements have become increasingly onerous and "additive" because more types of risks and capital buffers have to be taken into account.

Areas where capital is required to be allocated

	Market Risk	Risk-Weighted Assets (RWA)	Credit Risk	Operational Risk	Counterparty Credit Risk (CCR)	Liquidity	Capital and Leverage
+ Basel 3	Not changed, as in Basel 2.5	• Capital charges counterparty risk	Not changed, as in Basel 2	Not changed, as in Basel 2	• Multiple approaches calculating capital from CCR exposures in derivatives, repos and securities financing activities	• Liquidity coverage ratio (short term measure) • Structural liquidity ratio (long term measure)	• Stricter capital criteria • Leverage ratio • Additional buffers to counter cyclical effects • Additional systemic capital buffers
+ Basel 2.5	• Incremental default risk • New trading book rules • New treatment of securitized assets	• Capital charges for incremental risk, trading book and securitized assets	Not changed, as in Basel 2	Not changed, as in Basel 2	Not specified	Not specified	Not specified
Basel 2	Not changed, as in Basel 1	• Pillar 1 - Capital charges for credit and ops • Pillar 2 - Internal capital adequacy assessment process • Pillar 3 - Disclosure of risk capital	• Multiple approaches for assessing credit risk and associated capital	• Multiple approaches for assessing ops risk and associated capital	Not specified	Not specified	Not specified
Basel 1	• Static and formulaic capital calculation for market risk	Not specified	• Static and formulaic capital calculation for credit risk	Not specified	Not specified	Not specified	• Loose definition of capital buffers

Areas and Requirements

Source: Celent

Despite uncertainty around the final implementation of Basel 3 proposals and their specific timelines, we believe there are a number of actions banks should take now. These actions are not only consistent with the proposals and other likely regulation, but also represent best practice risk management. Consequently, they apply equally to banks that are required to be Basel-compliant and to other financial institutions (For example, US regional banks, which are under the qualifying asset threshold for Basel 2).

- Review and, where necessary, improve risk management and measurement techniques for counterparty credit risk, including collateral management processes and systems, CVA methodologies, and the measurement of wrong way risk.

- Introduce loss forecasting based on expected loss methodology to augment current loss reserving and provisioning methodology. While it is unclear whether FASB will introduce expected loss-based provisioning methodologies, there are other ways the regulator could introduce countercyclical (or at least less cyclical) provisioning. For example, the additional reserves over "known" losses need not run through the income statement but could constitute a special appropriation of retained earnings.

- Review and, where necessary, strengthen Pillar 2 capital and liquidity management processes. The proposals from the Basel Committee further increase the weight placed on banks' Pillar 2 processes (ICAAP, stress testing). Banks should ensure that their processes are robust and appropriately countercyclical.

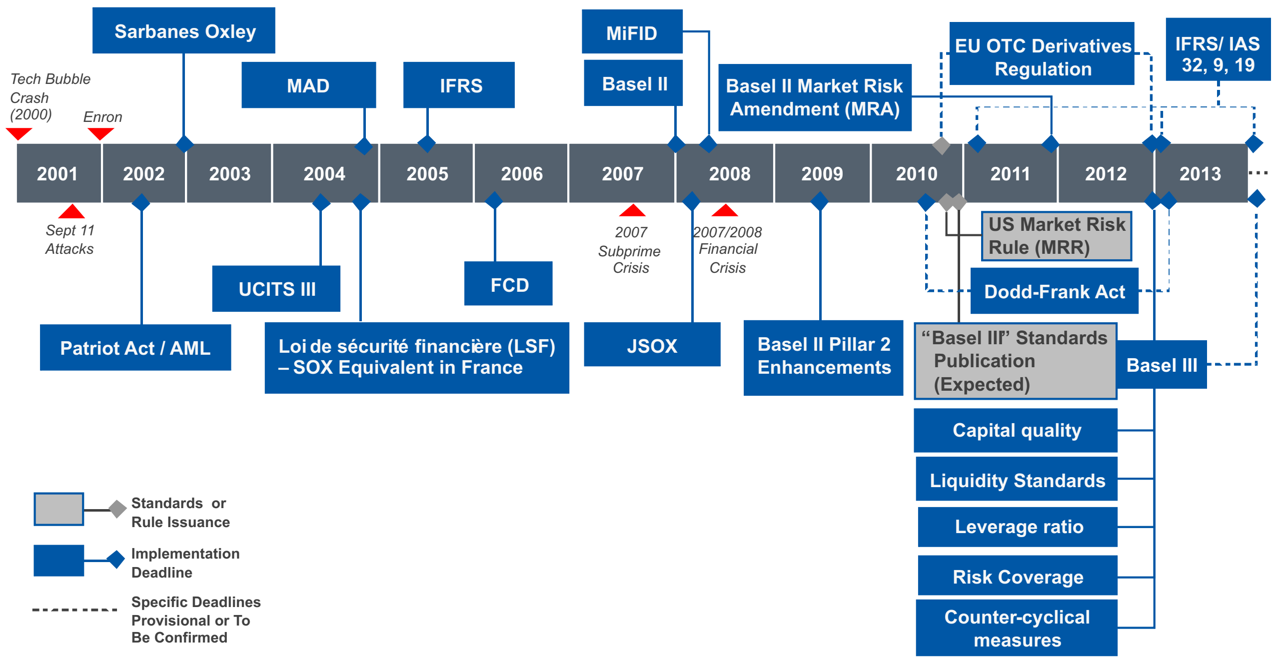
- Review and, where necessary, strengthen overall risk management frameworks. Based on recent U.S and European market experience, we believe regulators will increase the scrutiny given to institutions' overall risk management frameworks, with a particular emphasis placed on the involvement of the board in developing risk appetite statements, risk reporting, and reviewing and assessing the risks being taken by the institution.

- Engage technology teams early in ensuring that current risk technology architectures are flexible enough to cover not only current Basel 2 ambitions but also emerging Basel 3 requirements. Senior managers need to engage in partnership with IT to put the appropriate accountability mechanisms in place for technology investments to ensure that the firm's overall business, regulatory, risk management, and compliance objectives are well-defined and orchestrated. Financial services organizations can learn from recent sweeping regulatory mandates (Basel 2, Sarbanes-Oxley, Solvency II, Anti-Money Laundering), where companies that were successful responded by forming cross-functional teams working in a "SWAT team" mode - breaking down business as usual barriers to accelerate implementation activities. Beyond tackling regulations piecemeal, firms need to prepare an organizational response across all stages of the regulatory compliance lifecycle. A model for responding to emerging legislation or ongoing regulator data calls should be developed at every stage of the regulatory cycle (i.e., from cradle to grave).

Against a backdrop of growing uncertainty in credit conditions and sustainable growth, the financial services landscape continues to evolve rapidly. A complex and formidable array of banking reforms are emerging — with Basel 3 being only one piece of the jigsaw, albeit a highly significant piece. In fact, recent years have been characterized by the issuance of numerous complex regulations, with more changes expected as a result of the current crisis. Here, senior managers need to be aware that new regulations tend to almost always be reactive, and implementation efforts often distract an institution's management from addressing emerging threats. These are early days as far as Basel 3 is concerned, but lessons should be learned from the past wave of regulations - where, due to delayed responses and the pressures to deliver to aggressive deadlines, a financial institution's broader strategic objectives and Basel 2 ambitions left a lot to be desired in terms of business benefits and risk management practices. Without a doubt, the speed and success of execution efforts depend on early preparation.

For institutions yet to operate under the Basel 2 regime, the mandate to accelerate and ensure the success of these initiatives has never been higher. These firms need to ensure they do not find themselves too far behind. For banks already operating under Basel 2, lessons and synergies from prior implementations can be drawn out to address Basel 3.

As Basel 1 and 2 did, Basel 3's rules will change the dynamics of the banking game in the next decade. Risk infrastructures will play an important role in determining an institution's ability to differentiate and converge the management of risks more effectively, to enable dynamic liquidity management, to price for and cherry-pick customers profitably, and to gain privileged access to competitive funding.



Source: Celent

Towards and beyond the new Basel 3 regime, we expect structural disruptions and industry changes to take place, with the undercurrents of this regulatory tsunami capable of producing multi-order effects. Business configurations will take time to change. There will be new demands on data infrastructure, reporting, and governance. All these will be a source of competitive advantage and determine winners and losers in the longer term. While the adoption timeline for Basel 3 will differ by country, we anticipate that investors will expect banks to adopt "best practice" standards regardless, not merely adhere to regulatory minimums.

Firms that hear the rumble from afar should take heed, mobilize now, and prepare for impact. That means acting sooner rather than later ■

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Building an Effective Compliance Program for Banks - *Article*

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. 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.
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Effective Customer Relationship Management - Building an Analytics Solution

Précis

"The Customer is King" – this quote is a hard reality in the fast moving and intensely competitive world of banking and finance. In the truest sense, this implies treat the customer like a king and provide the best of products and services, resolve queries and complaints with lightning speed and make sure the customer stays engaged with the bank. Most banks strive to meet this end through a myriad of operational customer relationship management methods. These operational methods, albeit productive, do not always meet the specific needs of the customer or improve customer's engagement and satisfaction levels with the bank. Banks perennially face issues such as wrong targeting for a marketing campaign leading to inefficient usage of the marketing budget; "One and Done" credit card usage where the customer takes advantage of the promotional offer and at the end of the promo period goes dormant and disengages from the bank; customer attrition where customers switch from one bank to another at the slightest motivation or provocation.

What do the banks tend to overlook? While millions are spent to create operational software systems to manage customer relationship, what gets ignored is the gold mine of data that sits right under the banks' noses and can provide valuable insights. The data when sifted through properly and analyzed with the right questions in mind can be the proverbial "goose that lays golden eggs" for the bank. To achieve this what is required is a robust, data substantiated analytical solution that can help solve a plethora of plagues for the bank. What every bank needs, to have an edge over its competitors, is the ability to accurately predict the preferences of its customers, gauge customer satisfaction, analyze causes of disengagement with the bank and any potential chances of a customer leaving the bank. This can be achieved through a customer-centric analytical solution that uses a host of predictive analytical techniques and multi-dimensional reporting to provide deep insight into the customer behavior and enables banks take strategic decisions in a timely manner.

Traditional analytical set up and its challenges

Many top tier banks employ an in-house team of analysts and statisticians or outsource the work to third party vendor analytics organizations that mine the banks' data and build statistical models to recommend the right strategies. Generally these analytical requirements are outcome of intense brainstorming effort of the bank's strategy sessions held to identify areas of potential profit making or loss mitigation. As a consequence, the approach is often incomplete and targeted at low hanging fruits rather than an end-to-end holistic solution.

The other aspect of the traditional analytics employed in the banks is that more often than not the strategies are built on an "account based" approach rather than a "customer-centric" approach. Very few banks have successfully been able to implement a holistic customer-centric analytical strategy that covers the entire lifecycle of the customer. Bigger the bank the more cumbersome is the effort of integrating the disparate data sources, managing complex operational systems and fighting the challenges of internal bureaucracies.

An obvious question to this is how do we resolve this? Can a bank manage to build a data repository that will handle information at the customer level as opposed to an account level? If this data repository is stored how will the data be siphoned to make strategic decisions? Can the banks manage to build a customer-centric analytical solution without a complete overhaul of their existing systems? Let us dwell on these questions in the next section.

Customer analytics as a predefined solution

To address the list of questions in the previous section, let us look at this problem in the reverse order. That is, if a bank were to build a customer-centric analytical solution, what should be the core components of the solution. This approach moves away from the piecemeal reactive analytical strategies and focuses on a more proactive solution. A predefined customer analytical solution is aimed at assessing the challenges in effective customer management at every stage of the bank's relationship with the customer and then building an analytical methodology around it. This can be accomplished by building an initial list of predefined business metrics and statistical scores that help in the decision making process. For instance, for a cross-sell strategy, the list of metrics that will help in successful implementation of the same would comprise a scorecard with recommended next best products to cross-sell, customer demographics, credit bureau history, customer's "On-Us" transactional history, product holding, revenue generated and services rendered, among others. Along similar lines, for each area of analysis in the Customer Relationship Management space, a list of business metrics and scorecards can be created. Note, the proposed analytics solution being intended for effective customer management, the metrics for analysis are computed at a customer level while providing the flexibility to drill into an account view as well. For example, there could be a metric that gives the overall balance maintained by the customer in all liability products like savings, checking, among others. At the same time, the metric list will also contain the individual account balance of all liability accounts maintained by the customer.

Once the list of metrics is finalized, analytical methodologies are decided to arrive at the derived metrics. If the metric is a statistically derived field, predictive analytics or descriptive statistical methods can be employed to compute the field. If the metric is an arithmetical aggregation or computation, the field can be mapped to the source fields based on the computational algorithm. Thus an analytical data mart can be designed on the basis of the list of metrics and scores, from which analytical data can be called on to a BI or spreadsheet based front-end reporting tool in the form of analysis views. The bank gets a comprehensive solution on reporting and analysis completed with an analytical data mart.

Now the next problem is to integrate this analytical data mart to the right source data available on the bank's systems. Each metric will correspond to a source field or be a derivation of more than one source fields. The source fields can reside in the bank's CRM, core or other systems of information that the bank may store. The connectors can be identified with the right Extract, Transform and Load (or ETL) mapping logic that would integrate the diverse data sources into a common staging platform. From the staging area, the data can be mapped to the analytical data mart. Thus, while the bank's primary data sources store the data at the account level, the data can be linked with common customer identifier keys and stored at a customer level at the staging area from where these can be linked to the analytical data mart. The analytical data mart is transformed to a customer level data mart with aggregated analytical output. The BI tool or spreadsheet based reporting and analysis resides on top of the data mart layer to create analysis views and reports. A bank's analyst can use these reporting capabilities to derive the right recommendations for a customer centric strategy. The functional architecture discussed in this section is represented in Fig. 1.

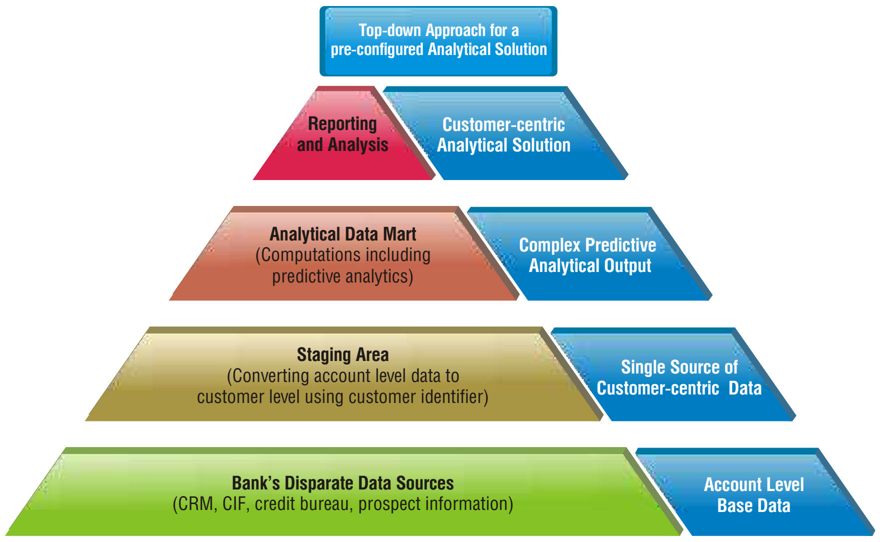

Fig. 1. Functional Overview of a Customer Analytical Solution

Move from back-end analysis to front-end "real time" decision making

While the analytics solution can be used to do a host of back-end BI based multi-dimensional reporting and analysis, the analytical output can also be used to take decisions during interactions with a customer thus enabling a "real-time" decision making. The pre-configured set of analytical scores can be transferred back into the bank's core systems and thus displayed on to the operational screens.

Let us consider a scenario that can be applied to make the customer dashboards and the screens that the customer sees when they log in to the bank's web portal more informative and analytically rigorous. Many of the bank's portals conduct web-based cross-sell campaigns on the dashboard screens of the customer. Most of the campaigning is done on a broad based screening of the customer's profiles based on their balances maintained and demographics. This can be further refined by a more in-depth profiling of the customer on the basis of social attributes like type of employment, age, marital status, household size, transactional information on number of times shopped online, booked movie tickets, booked air travel tickets on travel sites using bank's card, purchased concert tickets or responded to advertisements on specific items featured on the bank's portal. This inward profiling of the customers gives detailed insights into the likes-dislikes of the customers and their specific needs. This will enable banks to create more personalized product offerings, make travel site recommendations, shopping ideas, hobby ideas and also provide advisory help on financial investments. In short, the bank's portal can be converted into a one-stop shop for all the needs of the customer. This creates a much higher degree of engagement with the bank, way beyond just the banking and financial needs of the customer. A predefined analytical solution can extract relevant information from tie-ups like travel sites, online shopping portals, bank's own transactional information repository (by tracking the merchant id for each transaction made on the bank's card) and thus create this inward social profile of the customer. The host of recommendations made on the basis of the profiling analysis can then put to display on the net banking portals to the effect of servicing the customer with more relevant products and offers while empowering them with accurate decision making capability.

Similarly, let us consider a scenario where a customer walks into the bank to inquire on a request. If specific analytical attributes of the customer like risk behavior score on the bank's asset products, customer's lifetime value, attrition score, transactional information, product holding, product preferences, response score on past campaigns are made available on the operational screen, the bank's representative can offer a host of services and products while in conversation with the customer. If the customer is high valued, he can be provided better queue management services and faster query resolution. If the customer is high valued and shows a high score on attrition, he can be given loyalty bonuses and offers and checked on the causes of dissatisfaction with the bank. Based on the customer's risk, transactional, demographic and social profile a host of rules can be created that will enable the bank to have a more "real-time" decision making capabilities.

Comparative assessment of pre-configured analytical solution and traditional analytics

A pre-configured analytical solution has some distinct advantages over traditional analytics in a customer relationship management context. Let us explore these benefits in this section.

- **Integrated customer-centric data structure:** The staging layer that is a precursor to the analytical data mart creates a uniform, consolidated data source thus removing the complexity of sifting through multiple disparate data sources. The mapping and integration of different data sources at the customer key level allows the data analysis to be done from a customer centric point of view as opposed to a product centric analysis. This gives the banks a bird's eye view of the performance of a given customer on the books in terms of their product holding, relationship value, risk behavior and so forth.

- **Holistic end-to-end analytics reach:** While a traditional analytics set up in the banks or their vendor services organizations approach the strategy for analytics on a piecemeal reactive basis, a solution based approach has a much wider reach. Given a specific area of analysis, analytics as a solution will addresses the nuances of the problem in its entirety. The output from a given analysis can be used as an input to another area thus making the solution more informative and robust. For instance, to identify segments for a loyalty incentive program, a traditional approach will take this problem in isolation by individual products and segment on the basis of product level performance and attributes. In case of an analytical solution, the segmentation will tie customer management inputs like revenue generated, lifetime value projected, and product holding size and marry these with a customer attrition model to arrive at a more holistic segmentation technique.

- **Comprehensive reporting and analysis removing redundancy:** A solution will have a comprehensive list of reporting and analysis views residing on top of the analytical data mart, given that the business metrics and requirements are scoped out at the onset. This will eliminate redundancies in reporting and analysis. The reports and analysis views provided by the solution becomes a one-stop shop for all bank users to view the business metrics and statistical scores thus saving on the effort and cost of maintaining multiple report inventories.

- **Capability to move output to front-end for "real-time" decision making:** Given that the scores and analytical metrics for a customer are already scoped for, the data can be flowed back into the systems to be viewed on the operational screens. This will help engage the bank's relationship managers or customer service representatives to have more strategic conversations with the customer and also taking more informed decisions.

- **Low long term maintenance cost:** The maintenance of a predefined solution becomes easier and cheaper in the long term as once the solution gets set up in the bank there is a limited need for resources to maintain it. Regular upgrades of the solution based on the bank's strategy changes or macroeconomic shifts can be done with a team of trained analysts. Similarly, retraining of statistical models and ongoing model validations can be done at required intervals by the same team.

Conclusion

To summarize, every bank needs a robust customer-centric analytics beyond the traditional product-centric approach, for effective customer relationship management. As discussed above, this can be accomplished through a pre-configured analytical solution that focuses on the customer end-to-end right from their acquisition to developing and nurturing the relationship and mitigating potential chances of attrition. The predefined analytical solution removes the redundancies in reporting and analysis as often seen in the traditional approach and also solves the problem on a proactive basis. The integration with the disparate data sources, though requires a onetime set up effort, gives a low cost maintenance in the long run as minimalistic human intervention is required. In addition, the data flowed back from the analytical layer to the operational layer enables the front-end bank users to view analytical attributes pertaining to the customer. This is a step ahead from the back-end reporting and analysis that enables a customer service representative or a branch manager to have a more meaningful, data substantiated conversation with the customer thus empowering them with better decision making ability. Clearly, there is a need for every bank to break away from a traditional strategy driven product-centric analytics approach and move to a customer-centric analytics based solution ■

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Spain:
Golden Days to Come

Précis

Although Spain is one of the largest industrialized economies in the world and has a well-developed banking system, it has been badly hit by the last financial crisis. The nation is moving away from its earlier interventionist and restrictive policies to establish a framework for macro-economic stability. Now is the time for Spanish banks to regroup and plan their strategies for a strong future.

For a long time, the financial sector was dominated by a clutch of private banks drawing strength from a protectionist policy which discouraged foreign competition; in 1965, the top five banks controlled half the capital. Accession to the EU in 1985 was followed by rapid deregulation and the opening up of the banking sector, with the result that today Spain is host to a number of commercial and international banks. The last 10-15 years have also witnessed the rising popularity of Cajas or savings banks.

Spain's banking system is regulated by its Central Bank, Banco de España, which in turn is supervised by the Ministry of Economy, Finance, and Commerce. In end 2008 - early 2009, the sector went through major upheaval caused by the erosion of real estate assets, to which it had an estimated exposure worth €445 billion. Even now, Spanish banks are restructuring and being urged by the Central Bank to take greater care while assessing credit-worthiness of clients. Other regulatory moves include imposition of strict guidelines on asset restructuring, provisioning and reporting, and the strengthening of banks' owned funds structure and deposit base.

Having the greatest branch density in the world, Spanish banks are known for their warmth and personal touch. They offer a wide range of products, singly and in bundles. But now, online banking is gaining popularity with over four million users. Banks have always been enthusiastic adopters of technology, and analysts estimate that investments will continue to grow smartly in this area.

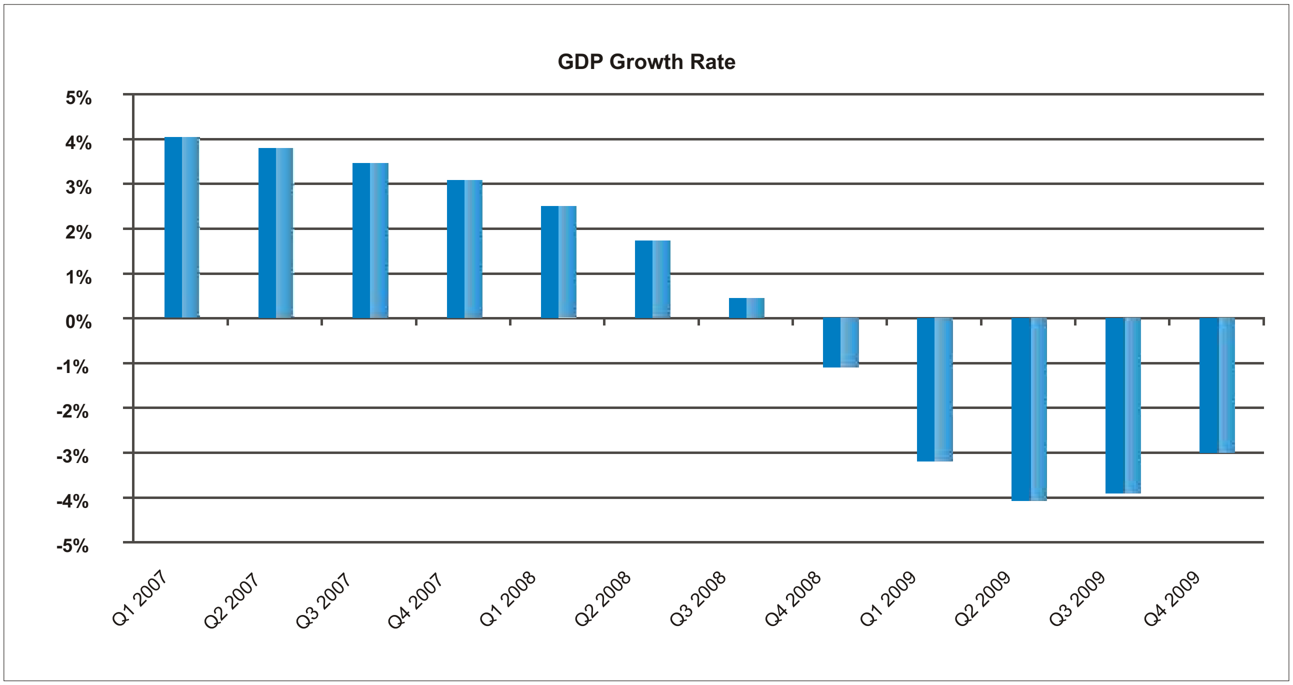
The significance of Spain in shaping the economy of Europe and the world can never be ignored. Historically, as well as in the modern era, the Spanish economy has played a major role in the trade and banking environment of this region. In the 15th and 16th centuries, Spain was the dominant economic power of Europe and the Western Hemisphere. Though this status has been lost to many other countries, Spain is still the fifth largest economy in the EU today and its banking system is one of the most developed in the world. Today, Spain is one of the ten biggest industrialized and developed economies. This change has been brought about by the EMU membership resulting in a strong place in the global economy, concerted efforts to abandon its interventionist tradition and regulatory rigidity, and the implementation of a strong framework of macroeconomic stability.

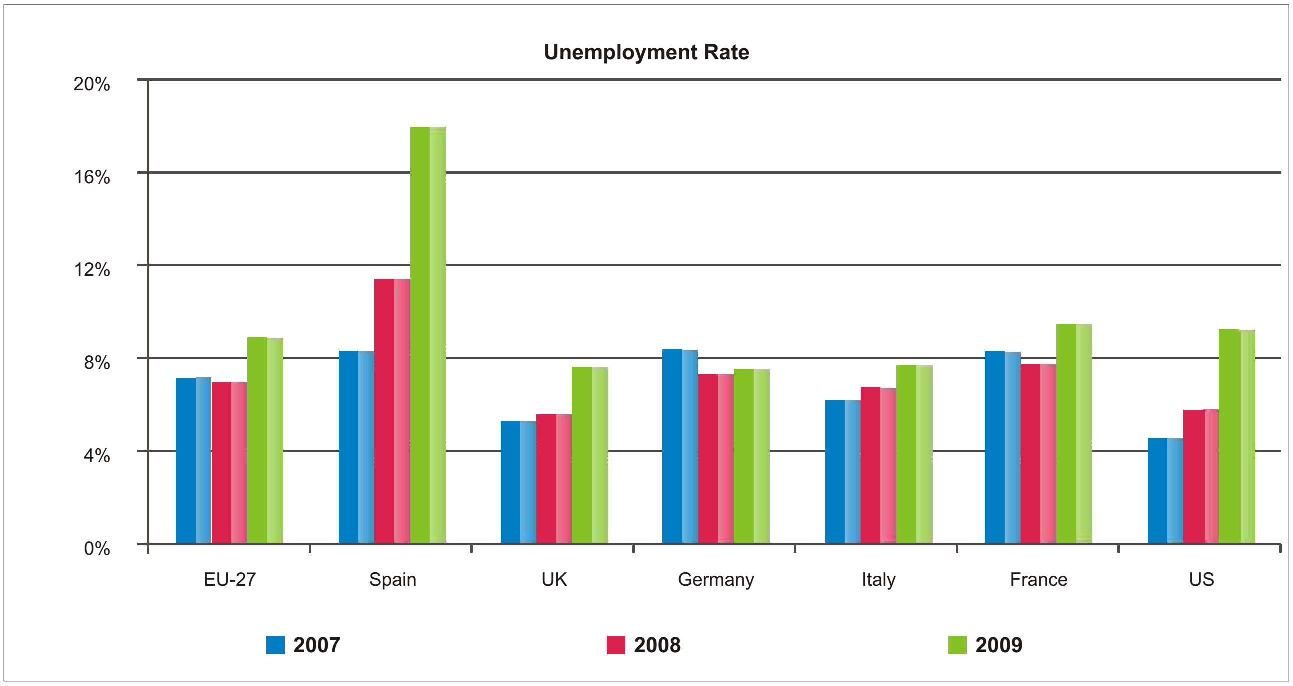
The last two years have been tough for the economy, hit hard by the economic crisis. The GDP growth in on the decline and compounding this problem is the exorbitantly high unemployment rates which is highest for any country in this region. It is however the right time for banks to make a fresh start by revamping their internal ecosystems to build a base for a financially sound and strong future.

Spain is a country of countries. Being an established constitutional monarchy, it has also enjoyed political stability for quite some time now. The present minority government is committed to supporting the financial system and its advancement. Spain has also enjoyed the status of being a favorite destination of foreign capital flows. Attracting investment in 'Spanish Villas' by locals and super rich Europeans and Americans alike, the Spanish real estate market went to dizzying heights in the early 2000s. This unprecedented boom saw a major influx of private real estate funds into the country. The construction and real estate sectors grew exponentially and banks were naturally among those to ride the boom. Spain is also an export economy – its agricultural produce is exported to all countries in Europe and industrial products sold throughout the world.

The Spanish banking system

The Spanish banking system has undergone a major change. For a long period in history, Spain's banking structure was largely a throwback to the post-Civil War period, when



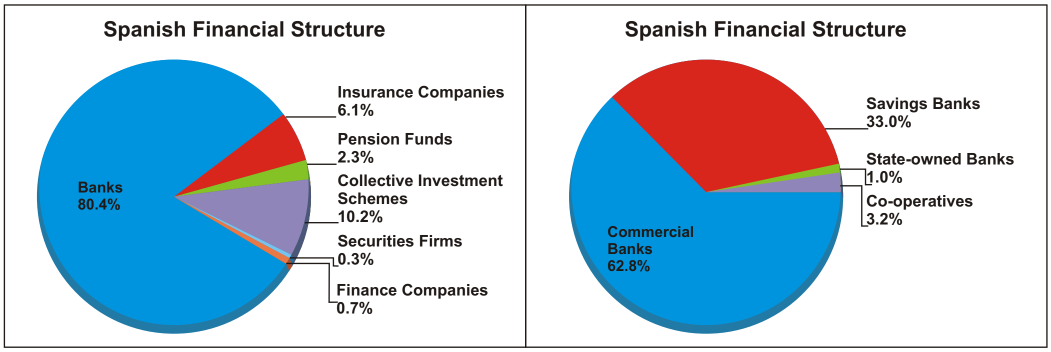


private banks dominated the industry and played a lead role in financing the development of the country's economy. Their role was strengthened by an economic policy that emphasized self-sufficiency and barred foreign investment capital and banking competition. By 1965, the five leading private banks controlled over 50 percent of Spain's capital. Their influence extended not only to the private sector, but also to autonomous institutions such as the state railroads. Subsequently, as industry grew stronger, many of the banks' equity holdings were sold to the public through stock exchanges. The banks, however, continued to play a vital role in providing new funds for industry. Following accession to the EU in the year 1985, Spain adopted rapid de-regulation which vitalized the dormant industry and enabled it to flourish beyond protectionist policies. Today, the vibrant banking structure is dominated by large commercial and international banks. Also growing in prominence are savings banks or Cajas, which are more concentrated in nature and quite popular. Cajas have grown in size and stature during the last 10-15 years and now compete with established commercial banks in all areas of business.

At one branch per thousand inhabitants, Spain has the highest branch intensity of any country in Europe, and within the country, Madrid leads the pack. Branches enjoy a high degree of independence in product and service pricing for individual clients.

Supervision of all Spanish financial institutions rests with the Ministry of Economy, Finance, and Commerce; the country's Central Bank, Banco de Españaor Bank of Spain which is responsible for overseeing the country's banking system, is subordinate to this ministry. Formed in 1847, and granted the sole right to issue currency in 1874, the bank was nationalized by the Bank Reform Law of 1962. Apart from supervising the banking system and setting reserve requirements, it executes the government's monetary policy through open market operations, and oversees foreign exchange along with the Directorate General for Foreign Transactions. In 1977, Bank of Spain helped set up the Deposit Guarantee Fund, which protected deposits in troubled banking institutions.

The banking system underwent a major shake-up during the financial crisis at the end of 2008



Source: IMF Report, Bank of Spain

and early 2009. Many banks' holdings against credit eroded due to the slump in the real estate market, taking them to the brink of failure. In December 2009, the exposure to the real estate market was estimated at euro 445 billion, of which euro 170 billion was considered either doubtful or bad. Right now, Spain is in the midst of a massive restructuring of its banking system. The Central Bank is focused on pulling out the root of the problem, which is excess lending in the residential private sector market. The main fallout of this has been tightening of credit to this particular sector and a higher check on credit-worthiness and credit quality of clients. The Central Bank imposed strict guidelines on asset restructuring, provisioning and reporting, resulting in some stability being restored in the market.

Trends in banking products and services

Spanish banks are known for their customer service and friendly atmosphere. Managers are known to interact with customers in the course of their day to day business. Obviously, customer delight remains high on the priority list of banks. Spanish banks offer a wide variety of products ranging from the simple to the complex. Asset products such as consumer loans, small business financing and mortgages are offered with innovative product features and services. Mortgage variants - hat-trick, zero and security to name a few - are highly popular. Banks offer products bundled along with bancassurance and cards to a wide range of segments. The payments framework is tightly interconnected with two payment systems - one for large value and another for retail.

Online banking is growing in popularity with an increasing number of bank customers using it for their day to day transactions. It is estimated that 4 million Spaniards use Internet to communicate with their banks. Online banking is aggressively pursuing the retail segment by offering attractive interest rates on savings accounts. The top five online banks in Spain are ING-Direct, Patagon, Banco popular-e, Uno-e and Inversis.

Trends in regulations

The Central Bank introduced new regulatory norms in order to facilitate the adjustment process of institutions to ensure to a medium term profitability path in the treatment of its assets. These provisions which are self-regulatory in nature advocate strengthening the owned funds structure and increasing the deposit base instead of encouraging foreign inflows and containing operating costs. The FROB (Fund for Orderly Restructuring of the Banking Sector) is based on the dual principle of avoidance of widespread recapitalization and accountability of shareholders and managers. Its objective is to manage the restructuring of the banking sector with as little tax-payers' money as possible.

Trends in IT investments

Spanish banks are known for their affinity and speed of technology adoption, especially to improve efficiency. Not lagging behind are the cajas as well as rural banks, which have set a trend by forming affiliations to adopt common networks. A leading research firm predicts that banks' spending on technology initiatives will grow at a compounded annual rate of 7.5 percent. It also identifies the main areas of spending as specialized lending systems, process outsourcing, cards, payments and risk management solutions. A recent survey by another consulting firm on smart IT spending ranked Spanish banks as the top four performers in strategy IT investments. The reasons were disciplined spending, early adoption of technology and close linking of IT and operations.

Conclusion

Technology plays a vital role in the existence of Spanish banks, which are slowly recovering from the economic crisis to show renewed strength in their business. The banking environment will see more technology investment, new deployments and innovation in time to come ■

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Banking Efficiencies: Not Just About Cost Cutting

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Précis

In a post Global Financial Crisis (GFC) world, the search for banking efficiency does not end with cost cuts. In fact, the real goal is to meet the expectations of customers, regulators and shareholders. This needs an appropriate operating model which provides clear visibility of the costs of a bank's products, services and activities, something which is taken for granted in an industry like retail, but is surprisingly absent in banking.

With this goal in mind, a bank can resort to a variety of strategies to improve efficiency, from increasing the productivity of staff, building process efficiency using modern systems and automation; sourcing to deliver best in class operations; and migrating more transactions to electronic channels.

However, this decision must be based on clear objectives. All too often, banks adopt new systems and channels without really knowing what to expect from them. As a result, they end up with layers of technology and infrastructure which add to their costs. There are many lessons to be learnt from the way the retail industry optimizes its supply chain and distribution infrastructure.

While cost-saving technologies like direct banking and cloud computing hold much promise, they are effective only when deployed within a new operating model.

Senior management must also be responsible for spreading cost consciousness, not only to improve their banks' financial health but also to regain the trust of their customers through fiscal prudence and circumspection.

Banking efficiency isn't about blunt cuts.

In the months following the GFC, we saw a number of beleaguered financial institutions cut costs indiscriminately. Thankfully, ANZ is among the successful banks in the world which haven't needed to slash and burn.

I feel strongly about banking efficiency, but I also believe that across the board cutbacks are rarely the answer to building lasting brand value. Today, our biggest challenges include regaining customer trust through better service, giving confidence to regulators with a healthy balance sheet, and at the same time, delivering growth and profitability to shareholders. Uninformed cost cuts are likely to undermine these aims and also damage a bank's brand in the medium-to-long term.

It's crucial to link costs to products and services.

Banks need to look inwards at their processes, products and services to develop a clearly defined strategy and supporting operating model. This requires a deeper understanding of how and where costs are incurred during product development and service delivery. Manufacturing and the retail industry are good at this. In fact, these industries look at how to satisfy customer needs first and then work backwards through what this means for their product portfolio, supply chain and end-to-end cost structure. While this sounds obvious, it's amazing how often the banking industry overlooks the importance of linking costs to products and services.

Once banks gain visibility of the cost of their products, they can look for ways to become more efficient and profitable. Being able to identify profitable customers, products and channels will be increasingly important in the more competitive world of financial services. To get to this place however, banks will need to understand their current target cost base and operating model. But before it can take remedial action, banks must analyze every detail of their cost structure, an arduous task at the best of times!

The operating model must meet several expectations beyond cost efficiency.

Once the cost analysis is complete, the next step is to build a business model which delivers a better cost to income ratio, enables better customer service and meets shareholders' expectations. There's a big opportunity to automate and e-enable banking products and services - and customers want it too – but our industry has been slow to take advantage. Most banks continue to maintain older distribution channels despite offering online and mobile banking. If you contrast this with the retail industry, there is closer scrutiny on the relative profitability of its distribution channels and individual outlets. When the retail industry first introduced the supply chain concept, it did so to enforce activity-based costing, but it has now evolved into a tool for designing and improving customer service.

Unfortunately, banks haven't organized their distribution in this way, and over the years have created multiple product silos linked to numerous customer touch points. Naturally, they don't have the granularity of cost and profitability information about products, services and channels, like retailers do. And, historically banks were never under any pressure to do things differently. However, now that the world order has changed, perhaps it's time they employed best practice from other industries.

Understanding the cost of each activity is central to improving productivity.

Productivity improvement – another pillar of banking efficiency – involves understanding the core business of the bank and the activities needed to support it. A bank that has grown inorganically for example is probably grappling with multiple duplicate processes to deliver the same outcome to customers, making for a very confusing experience. In fact, most banks face the same issues because their systems don't provide them with a single, unified customer view. This can mean that the bank contacts the customer many times. For example a customer who has a mortgage, deposit and current account is contacted separately by each department because their bank hasn't integrated these products in its operating model. Basically, the bank has found a costly way to deliver customer *inconvenience!*

To help prevent this, the first thing that can be done is to examine the current operating model for duplication, and understand what can be removed without major investment.

One further option banks have is to implement a centralized system to consolidate HR, finance and sourcing data to provide standardized management information. That information can be analyzed to gain serious insight into continuous cost improvement. As a minimum however banks need management information which gives them an understanding of the costs of various activities so that they can find opportunities to rationalize them.

Banks must maximize the benefits of automation.

Having efficient process is important in any organization and automation is often a key part of this. But replacing legacy systems with modern technology can mean making a significant investment which can be a deterrent for many. However, current manual processes, for example during loan approval, could be successfully automated in most cases. This would deliver many benefits such as lower costs, quicker processing and improved customer experience.

Arrive at the right product-channel combination.

I think banking has matured as far as migrating transactions to electronic channels is concerned. Interestingly, this wasn't driven by the industry, which was fearful of security risks, but by the customers who wanted greater convenience and accessibility. With so many transactions becoming electronic, banks must compare the relative cost and relevance of each transaction over each channel, to arrive at an optimal combination. This is exactly what retail distribution – which is the gold standard – is all about.

Most banks support several transactions in their branches which can be costly to process but generate no income. These will disappear over time, following in the footsteps of cheque processing. This was traditionally an enormous banking activity but is now slowly dying out to make way for electronic clearing and settlement, enabling faster settlement and reducing processing cost to benefit both the bank and its customers.

As customers draw confidence from the security safeguards in Internet and mobile banking, and transact online more frequently, the challenge for banks is to deliver a better user experience over electronic channels.

Outsource to deliver best in class performance.

Right-sourcing – that is using external support selectively - is a good idea, provided it's thoughtfully executed. In my view, the goal of outsourcing is not merely divesting non-core activities or saving a few dollars, but achieving best-in-class performance. So, before a bank outsources an activity like loan processing, it must compare its own performance against industry benchmarks and go ahead only if there's a favorable difference between the two. Another goal of this analysis must be to demarcate what is core or strategic to the business and what is not; obviously, only the latter should be farmed out to vendors with core capability in that area.

If we don't think this through, it could mean the bank ends up with an expensive, customerunfriendly alternative to an in-house process which does nothing for its supply chain. Right-sourcing, as the name suggests, is about getting it right first before sourcing it! And although ANZ is not big on outsourcing, we recognize the value of using the services of specialist vendors in areas like network and desktop support.

Keep products simple.

Product rationalization is very relevant to the banking industry, which has been over zealous in creating multiple variants of what is actually a single product. Take the case of deposits, which have only two distinct variations, attracting either a fixed or variable interest rate. Banks have generated hundreds of deposit products from these two themes, and are stuck with managing them on multiple fronts such as customer service, operations, IT, and regulations, each coming at considerable cost.

What's worse, this practice only confuses customers who actually want to deal with simple financial products. Many universal banking solutions, including Finacle, enable banks to standardize their products and set parameters for any variations. I think this is a much more efficient way of satisfying nuanced market needs as well as being easier to support from a cost and technical point of view.

New products and technologies don't work with old business models.

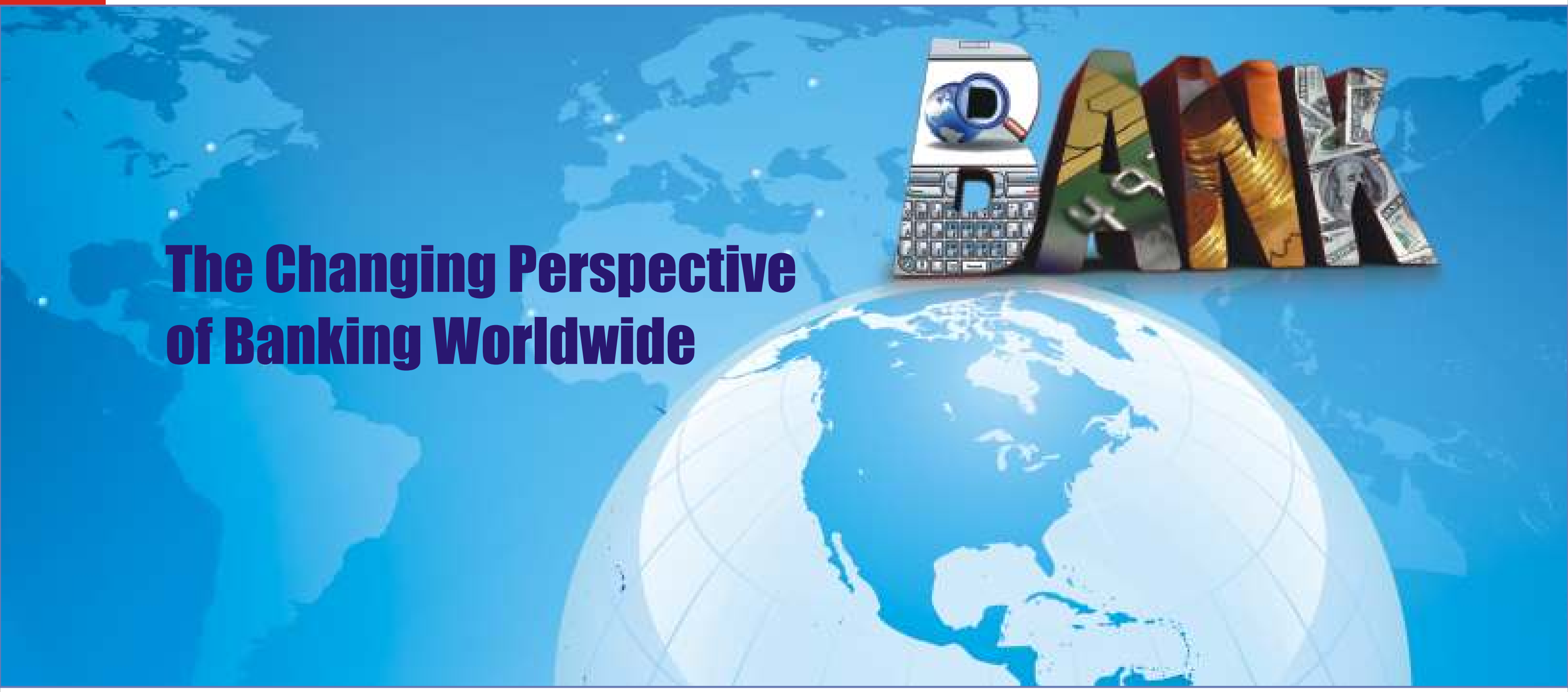
A low cost business model such as Direct Banking is really an opportunity for banks to streamline their operations and product portfolio. It transforms the supply chain, reducing the cost of ownership and radically improving customer experience. I personally know of a successful credit card company in the U.S, renowned for its customer service, which actually operates on a very thin business model. The entire infrastructure is actually hosted by a third party who excels at this job. The only thing the company owns is customer data and management information, which it uses to gain intimate customer knowledge to input into designing highly relevant products and services.

I believe that financial services will see more instances of disintermediation of banks, with new entrants stepping into different niches in the supply chain ultimately creating a more efficient banking model. A new operating model is also strategically important to make the most of new technologies such as cloud computing, external hosting and social networking, which if deployed on the traditional banking model will only add to confusion and cost.

Develop a psyche of cost consciousness.

Automation and low-cost business models are great, but they can only thrive in an environment of cost consciousness. The onus of creating that culture is on senior management. Several banks in the U.K have suspended office celebrations at the request of employees, who felt it would send out wrong signals to the market and customers. It's very important to be sympathetic to the sentiments of consumers to regain their trust. Because customers think of banks as custodians of their money, the industry must guard against any kind of profligacy, even with its own funds.

Because the retail industry works on slender margins, it sets the benchmark for cost consciousness. In contrast, banks have traditionally been highly profitable, and therefore, have not felt the need for austerity measures, until now. At ANZ we are taking a number of steps such as conducting meetings via videoconference and encouraging staff to use technology alternatives to reduce cost and help the environment. Over time, we hope to all our employees will have a more customer-centric way of thinking, which is really the key to cost consciousness ■



The Changing Perspective of Banking Worldwide

Précis

This edition of the Big Bet talks about how the various global themes discussed in the previous issue will impact the most important aspects of banking.

Government intervention to revive flagging economies in North America and Europe has manifest in diametrically opposite forms, with the former stimulating sales and spending and the latter encouraging savings. As expected, non-regulatory bodies like the G-20 are also advocating reform for their member nations, putting further pressure on the already stretched global liquidity. Meanwhile, several European countries are poised on the brink of fiscal crisis. All these developments are stoking fears of inflation and liquidity shortage in the rest of the world.

Banks are fighting to restore trust in the financial system by providing customers greater control, choice, convenience and confidence. But at the same time, they should be taking a fresh perspective of customer management, seeking ways to stay relevant across all life-cycle events of the customer. It is also important to create an emotional connect with merely satisfied customers, since that is the key to building loyalty.

At a time when the first priority is to re-establish rapport with customers through a show of openness and right intent, the industry must question whether it is wise to reduce personal contact by asking customers to switch to electronic channels. Since the mobile is rapidly growing into an influential banking channel, banks must quite rightly invest in it. However, the branch is still relevant, especially to the delivery of high-end advisory services, and when there's a need for lending a human touch to a transaction.

Products need to become more innovative to cater to the new demands of right-selling, customization and social responsibility. The banking industry can learn how to make products more efficient, consistent and performing from the manufacturing sector and combine that knowledge with their expertise in creating customer-centric, personalized offerings.

The bet is that banks will have to deal with greater complexity and volatility.

In my last column, I spoke of the major shifts in world economy and business. I would like to expand on how some of these forces are shaping the most important elements in banking, namely the global macro economy, customer preferences, channels, products and services.

Reviving confidence in the macro economy is a top priority, but the impact of most measures is uncertain.

Despite being aware that public sentiment hasn't recovered fully, the findings of a joint Finacle-BAI survey conducted in August 2010 still came as a shock. Customer confidence in the economy was down by 14 percentage points compared to six months ago and there was a three percent negative swing in feedback about the financial situation of American households. Meanwhile, what action has the developed world taken to revive its economies? A comparison of the North American and European approaches is a study in contrast. The former region has chosen to breathe life into its markets by stimulating spending, whereas the latter has gone down the austerity route. While only time will tell whether 'sell more' works better or 'save more', the rest of the world is observing both these agendas with a measure of trepidation.

There are fears that the American stimulus, which has now entered its second phase of Quantitative Easing, will only increase capital inflows to emerging economies and further stoke inflation. That might in turn set off a vicious cycle of 'reduced savings – credit squeeze – lower economic activity – slower growth – lower per capita income' and back. On the other hand, the poor macro-economic indicators of European nations, much worse than that of the U.S, foretell tough times ahead. Numbers speak louder than words: Greece, the whipping boy of crisis-ridden Europe has an external debt to GDP ratio of 187 percent, public debt to GDP ratio of 125 percent, unemployment of 9.8 percent and fiscal deficit of 12.7 percent. Portugal, Italy and Spain fare no better. Even if the world were to dismiss these as relatively small economies, it couldn't possibly do so in the case of Great Britain, where external debt to GDP is a roaring 365 percent and unemployment stands at 11 percent! In contrast, the corresponding U.S numbers appear relatively benign at 96 percent and 9.3 percent respectively. What might a European blowout do to the rest of the world?

Expectedly, debt-dependent consumers in developed nations have started to save a bit, and this is reflected in the 2.5 percent uptick in the personal savings rate in the U.S. But that is small consolation considering that this number is on a 30 year downtrend. Clearly a savings rate hovering around low single digits is not sufficient to give a fillip to the economy, which needs something closer to a double digit if not the 36-37 percent rate recorded by Asian biggies.

How has the other big actor, the regulator, reacted to these macro-economic rumblings? As mentioned in my previous article, international bodies other than the usual regulatory authorities are also setting up various governing frameworks. Thus, the G-20 has its Financial Supervisory Board (FSB) suggesting capital maintenance requirements to its member nations and their Central Banks. Coupled with the forthcoming Basel III restrictions, these changes will drive the need for additional banking capital between $300-600 billion globally. Therefore, banks are faced with a huge challenge of raising this money amidst a twin liquidity and confidence crisis.

The Dodd Frank Act will become regulation within the next couple of months to enforce a slew of new guidelines and restrictions bringing a sea change in the way U.S banks are run, monitored and regulated. Among other things, these rules will give consumers greater financial protection, reduce banks' risk through higher capital requirements, monitor credit ratings for possible conflict of interest at the issuers' end, separate proprietary trading, investment and consumer banking businesses, enable shareholders to vote on executive pay and prevent taxpayer funds being used in future bailouts. The legislation also provides for several new supervisory agencies. While the actual impact of this bill on customers and banks is still uncertain, compliance will cost more time and money.

Customers are in charge, but still not confident.

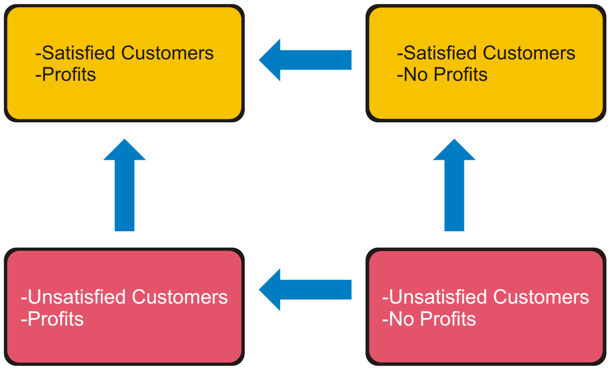
The customer perspective has changed radically after the financial crisis. Now customers have primacy in their relationship with banks. Consequently, banks are striving to reclaim their trust by giving them better control, choice, convenience and confidence.

Self-service channels, personal financial management tools, and an empowering social media are enabling customers to exert greater control over their finances. Banks are forced to give a wider choice of product and service options now that the tables have turned and customers are calling the shots. But perhaps the greatest change is in the customer convenience perspective, which is constantly evolving within the context of technology, ethnicity, time and other factors. The definition of convenience has changed from having a branch in the neighborhood, to gaining access to Internet banking and now encompasses mobile banking and social commerce. Therefore, banks must keep pace with this shifting paradigm in order to stay relevant.

Also, they must pay more attention to customer life-cycle events, typically education; marriage, parenthood and at times divorce; home ownership and retirement, because customers switch their wealth creation and distribution roles at each stage. Take for instance the 18 to 24 age segment. With a first job in hand, these youngsters are starting to build savings towards future wealth. The prime earning stage of the 30's and 40's also coincides with marriage, children and housing investment; hence, while people in this age group are creating wealth, they are actually savings negative. Closer to and beyond retirement, seniors begin to distribute their savings to charity or their heirs. It is very important for banks to understand the nuanced needs brought on by each life-cycle event so that they can fulfill them with relevant offerings. Consider the 'ages 18 to 34' digital generation which is totally wired to technology and the web. They are the future inheritors of distributed wealth of about $15 trillion in the U.S alone, the size of the economy! What can banks do to ensure that most of this wealth flows back into the banking system considering that this generation, unlike previous ones, would rather spend today than save for tomorrow?

Part of the answer lies in developing the right breed of satisfied customers. A 2002-03 Gallup-HBS study of over ten million customers and ten million employees concluded that there were two types of satisfied customers. While both were good to have, an emotionally satisfied customer was superior to a rationally satisfied one in every way. The rationally satisfied customer limited the relationship to transacting, but the emotionally engaged type advocated the service to friends, bought more products, connected with the brand and stayed on for longer. It is obvious that banks must differentiate their product and service offerings in such a way that their rational satisfied customers begin to connect emotionally with them. Once again, understanding life-cycle events is crucial to developing a suite of offerings that can emotionally charge customers and bind their loyalty.

Another analysis stratifies customers by satisfaction and profitability, placing them into four quadrants with unsatisfied, unprofitable customers at the bottom right and satisfied, profitable customers at the top left. Obviously, the first endeavor must be to convert the satisfied but unprofitable segment into a profitable one. This can happen by taking a right-selling approach, which is, proposing the right combination of product-service-channel-price to the right customer at the right time.



As far as the unsatisfied, unprofitable customers are concerned, banks have two difficult choices – either letting them go or making a concerted effort to redeem them. Doing nothing is not an option because unattended, these customers are likely to be a negative influence on others. While it is true that selling to a new customer is five times costlier than selling to an existing one, banks must measure customer satisfaction not by the number of products held but by service quality rating and measurement of satisfaction

Although the above arguments may suggest otherwise, the change in the bank versus customer dynamic is not entirely one-sided. Now, customers will also have to accept greater responsibility for managing their finances. Customers had better beware; they can no longer use ignorance as a pretext to shake off all personal responsibility when stuck with loss making products in their financial portfolio, nor can they claim protection.

Branches are integral to reviving consumer confidence.

Research by a globally renowned firm shows that it costs about $80 more to acquire a customer through a branch than over phone. Worldwide, banks are moving an increasing number of transactions to low-cost channels to improve efficiency.

However, we must debate whether the industry needs to do an about-turn in its channel strategy to win back public favor. With public confidence so low, can banks afford to distance themselves from their customers? Now, more than ever, banks need to look customers in the eye in a show of openness and support. Branch staff has a key role to play in winning back customers' trust, and viewed in this light, the charge of $80 seems justified. The following numbers reinforce the argument for more bank branches.

Barring 2010, branch numbers in the U.S have risen consistently since 1995, inspite of the explosion in electronic channels. Worldwide, opportunities abound. Spain has a high branch density of 1050 per million people; at the other end, Singapore has only 100. U.S, U.K and Japan all have nearly 400 branches serving each million of their population, a tad lower than the global average of 450. What this means is that brick and mortar branches are still very relevant, although their goals may have changed from facilitating routine transactions to providing higher end advisory services. Certainly no other channel can match its efficacy in building a rapport with customers and infusing warmth and credibility into a relationship.

At the same time, banks need to invest much more in their mobile banking channel because by 2014, 2.2 billion people will conduct transactions worth $20 billion over it directly or indirectly. Therefore, the call is for a two pronged strategy to increase brick and mortar as well as electronic distribution. However, banks have an interesting alternative to investing in owned branches. Where regulations permit, they can follow the example of the auto and retail industries to arrive at a distributorship or franchise model for expanding the branch network.

Products need more innovation.

Naturally, the product perspective too needs to change from 'one size fits all' to a broader approach which accommodates right-selling, customer specificity and social responsibility. Compared with precision manufacturing where the emphasis is on quality and efficiency, banking is more personalized and individual-driven. The latter can draw valuable lessons from manufacturing to create a product factory inside the bank to facilitate faster, cheaper and more efficient delivery of personalized products and services.

Banking institutions must also develop social sensibilities and project online distribution and P2P lending, among others. as their contribution to a greener planet. In fact, the industry needs to think about products including their pricing, distribution and other aspects much more innovatively, to manage the various expectations of customers, regulators, shareholders, among others.

Their complex task is made harder by volatile conditions in the macro-economic, market and regulatory environment. But for the time being, banks must reconcile themselves to the reality of business as unusual! ■

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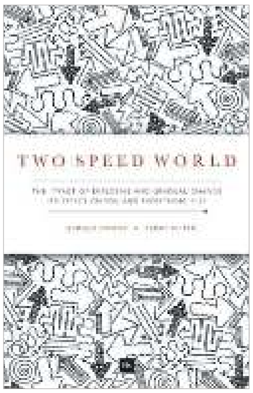
Setting the House in Order - *Article*

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.
http://www.infosys.com/finacle/finacle-connect/Issue_21/default.asp

Two Speed World

The impact of explosive and gradual change – its effect on you and everything else
By Gerald Ashley and Terry Lloyd



What's the next change round the corner? What if you were the first to equip yourself best to deal with it and get a head start over the next person? If that thought intrigues you, *Two Speed World* will not fail you.

Put quite simply, this book slots the nature of change as binary - incremental (low speed) and disruptive (high speed); and tracks how change can migrate from one state to the other. The key to maximizing the opportunities inherent in change, according to the authors, lies in identifying the nature of change correctly and tracking its transition from one state to the other. And more importantly, the book then goes on to arm you with a whole host of tools you can easily leverage to not just successfully deal with turbulence but emerge enriched from it.

What really struck me about the point made by *Two Speed World* is that both types of change play different roles – incremental change ensures survival, but disruptive change invites progress. While we may think otherwise, disruptive change is not the same as incremental change in overdrive, but something much more fundamental. While most decision makers tend to see issues in incremental terms they fail to grasp that disruptive changes demand a different analysis and approach.

Gerald Ashley and Terry Lloyd show us how people can deal with change by learning from stories from the past. "We find that although circumstances may differ the basic characteristics of change do not." - they explain. The authors go on to state that by looking back over the past 150 years, by taking a small sample size and studying how changes such as technical innovations, war and social upheavals affected the lives of earlier generations, we can derive an understanding of what to expect in the future.

Drawing deeply from their decades of experience in the world of finance and technology, as well as from major historical events, the authors create a simple construct to understand change better, and while not proposing a panacea, discuss how classical change management techniques may be applied in different contexts.

While the book may seem a tad academic but you will nevertheless come away better informed and quite certainly better prepared to handle the changes you encounter in the everyday business of life ■

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