

The Core Banking Juggernaut Rolls On

A lot has been said on the crying need for and the challenges and risks of core banking replacements with arguments and rationales flying fast and thick on both sides of the fence. 2005 has, in many ways been a watershed year in this regard, with the dust having settled down to a large extent and new age core systems leaving an indelible imprint on the banking landscape, at least to the extent of gaining acceptance and engulfing few legacy systems in its wake. The verdict is finally out given the move by some of the larger, Tier 1 banks in taking the plunge and embarking on a total overhaul of their core processing platforms.

This article seeks to highlight some of the trends in the core banking space and what 2006 holds out for banks and ISVs, as well as some of the critical success factors that banks need to be mindful of, in order to derive the maximum out of their core banking transformation initiatives.

The Story so Far...

What started off more as a promising outlook in the beginning of 2005 has been transformed into a huge wave that is only accelerating in momentum. The last 12 months have seen a number of Tier 1 universal banks take that first big step towards transforming their core systems. This wave has attained global proportions with banks across Europe, Asia Pacific, Australia etc. biting the bullet with the Americas looking at the proceedings with keen interest and likely to follow suit as well. After the whole-hearted acceptance of channel technologies through the 90s and the turn of the millennium, designed to provide an "anytime, anywhere" banking at virtually the customer's fingertips, it is now the turn of the transaction processing systems to dominate the arena and transform banking processes and practices the world over to achieve higher levels of differentiation, agility and operational efficiency.

According to a well-known research firm, core system replacement spends in 2005 stood at about USD 13 Bn and are expected to rise to USD 34 Bn by 2010. It is estimated that the total spend on core system transformation (including hardware, software, network, IT services etc.) by European banks over the next 10 years could be as high as E100 Bn with budgets for software and services going up to E250 Mn for some banks. With 69% of European banks having embarked on a transformation of their core systems, either in terms of taking the plunge or having taken the

first steps in staking out the core system space, the stage is set for new age core systems to dominate the European banking landscape, after having tasted major success and acceptance in the Asia-Pacific, Australian and CEE markets. The next couple of years alone could see core banking vendors, ISVs and IT solutions and services providers raking in as much as E10 Bn only through core banking replacement projects.

The clear growth potential as well as the highly fragmented nature of the core banking market (presently there could be well over a hundred solution providers and over a score of global vendors) with no clear market leader emerging saw some of the big names training their sights on and slowly moving in to take advantage of the opportunity. Among the notable ones are Oracle's recent announcement of taking over an Indian vendor and SAP making the right noises about developing their own solution as well as explore possibilities of alliance/ buyouts of existing, well-entrenched core banking solution companies. This also saw the emergence of alliances like SAP-Accenture and a large number of such partnerships borne out of a need to leverage each other's strengths and offer an end-to-end IT services and solutions proposition. It is only logical to assume that this trend is here to stay and will only snowball into gargantuan proportions given the attractive growth rates and margins this segment has to offer.

Crystal-Ball Gazing

While there are quite a few numbers and statistics to suggest that the core banking wave will only accelerate in momentum, size and force, what is probably of greater importance and interest is how this journey will pan out in 2006 and beyond.

Going forward, one would see a complete confluence in the paths of banks and ISVs through the role of core banking systems in the banks' quest to re-define their very existence and survive and flourish in an intensely competitive and globalized banking landscape. Factors like operating efficiency, scalability, agility and time-to-market, harmonization of enterprise-wide processes, a proactive approach to risk management and regulatory reporting, and most importantly a lowered total cost of ownership (TCO) of their IT infrastructure have assumed considerable significance for contemporary banks and will be the key drivers in selecting the chosen

platform to power banks into the next orbit and beyond. This bodes well for new-age systems given the overwhelming and (now) oft-talked about limitations of legacy platforms in terms of architectural rigidity, complex interfacing needs, considerable manual hand-offs and lack of STP, real-time capabilities as well as high costs of installation and ongoing maintenance apart from the massive risk of technological obsolescence that could well be a major dampener in a bank's quest for agility, efficiency and greater regulatory compliance.

With the high adoption rates of new age core processing platforms (few examples that come to mind are DBS' adoption of the Finacle solution from Infosys and various banks like HSBC, ABN AMRO etc. at varying stages of transformation), more and more banks will embark on this path. An equally significant number of banks would go through 2006 closely watching the outcome of these transformations in the banks that have taken the bold, first step before embarking on a similar step.

For long, the North American banks seem to have been by and large untouched by this transformation given the greater dominance of legacy applications and the myriad of systems that have mushroomed around these legacy platforms. The threshold of transformation for these banks is probably a bit higher than for banks in Asia Pacific, Europe, and the Middle East. Few banks have tried to delay the inevitable through some process re-engineering initiatives, large customizations of their existing, dated technologies through superficial wrappers, costly workarounds and porting of old technologies to new, faster platforms. However, banks are realizing that they have probably "capped out" on the benefits through these initiatives, and nothing short of a complete overhaul of their IT platforms will enable them to sustain the onslaught of the new age banks as well achieve their stated financial, customer and stakeholder objectives. So, whilst the pace of transformation may vary based on the banks' operating environment, the relative degrees of maturity and consolidation of their respective businesses, what is inevitable is the eventual transformation of the banks' platforms to new generation technologies.

Consolidation in the core banking space will continue at a frenetic pace. More and more of the larger ISVs will want their share of the core

banking market and are more likely to buy out existing platforms and leverage the advantages of an existing, proven solution and a captive customer base rather than engineer a solution from scratch. This obviously foretells bad tidings for the relatively smaller, marginal solution providers, who could see their market shares evaporate rapidly and eventually become acquisition targets for the majors. Successful ISVs and solution providers will need to operate through a combination of organic and inorganic growth strategies to capitalize on this wave and deepen their hold in this market. Like the ERP wave, this wave is likely to well last for quite a while; at least through this decade and beyond.

Strategic challenges facing the bank's stakeholders

Whilst new age platforms undoubtedly offer great promise, banks need to be mindful of the critical success factors, which if properly understood and addressed will ensure a smooth transition for the bank and its customers as well as provide a vastly improved and agile business environment. Some of the critical success factors could be:

When to Transform – Banks need to clearly understand the maturity and readiness levels of their own businesses, their stated long-term as well as short-term business imperatives as well as their own operating environments before embarking on a core system change. This will enable them to set ambitious, yet realistic expectations from the transformation, both in terms of time and business benefits.

Key Expectations From the Transformation – Banks need to identify clear business, customer and any other tangible/ intangible benefits they need to achieve from the transformation. Whilst most stakeholders could have varying expectations i.e. A CIO will expect a well-integrated operating environment and a low TCO, a marketing manager the flexibility to design and roll out new products, whereas a COO would be more concerned with streamlined, straight through processes and minimal operating risk. It is critical to have complete clarity on the desired outcomes from the transformation, at a short, medium and long-term level.

Change management and transitioning strategy – Adopting a new technology without streamlining the existing processes (which typically

would have been configured keeping in mind the limitations and capabilities of the existing platform) seldom yields the desired business benefits. Hence, a core banking replacement inevitably brings with it changes not only to the IT environment, but also a major overhaul of business processes, greater degree of process consolidation and harmonization, and therefore, a re-definition of the organization structure and roles and responsibilities of the bank staff. This transition needs to be properly managed in terms of clear, consistent and timely communication on the business benefits expected from the transformation and the consequent impact on the bank's financials, its market position and the employees themselves. Ultimately, employee buy-in and acceptance of the new operating environment will be the single most factor determining the success of the replacement.

Choice of Technology– Given the trials and tribulations associated with core system replacements, it is important that the bank's stakeholders identify the "right" technologies to work with – right in terms of future-proofing the bank against technological obsolescence, ease of interfacing to other applications within and external to the bank, as well as ease of modification of business processes and features to respond to business opportunities in a fleet-footed manner, and most importantly the extent of automation, STP and real-time capability the system offers.

Conclusion

The core banking landscape is poised at one of the most exciting and defining phases and is likely to witness considerable momentum, debate and analysis over the next few years. This is also the most opportune period for banks and ISVs alike to leverage off the transformation opportunity and create history for themselves. The next 2-3 years will undoubtedly see, in good measure avid discussions of bank's success stories enabled through new-age technologies as well as the odd instance of new-age systems not being able to deliver on their promise. What is of essence is that this is probably a unique era in the age of core banking systems, which banks and ISVs need to fully understand in relation to their business dynamics, define a clear vision of their expectations from the technology transformation, align their stakeholders and operating environment towards the same, and most importantly monitor this transformation closely to re-define the battleground and etch their names in the banking hall of fame.



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