VIEWPOINT

A New Business Model for Financial Services: Perspective on Utilities

What is Happening Today?

Given the reductions in trade volumes, reducing returns, and economic downturn facing several European banks, a significant number of our clients are considering restructuring options, including selling or buying assets or forming partnerships or joint ventures. The number of such clients has steadily been increasing over the past 3 years.

Europe's banks need to cut costs by a fifth and simultaneously grow revenues by 15 % just to get their profitability to match their cost of capital- Reuters[1]. European banks' return on equity, a key measure of profitability, is likely to average less than half their cost of capital again this year, lagging well behind U.S. rivals as lenders struggle with high costs and weak economic growth- E&Y[2].

As a result of these economic imperatives, banks and capital market firms must reduce costs and improve efficiency. Regulatory demands and increased capital requirements are forcing a very hard look at all internal processes and technology. The "low hanging fruit" of outsourcing and wage arbitrage is largely realised and we believe that regulatory and expense pressures on financial services firms, combined with rapidly advancing cloud technology, provide unique opportunities to standardize and mutualize processing of non-differentiating activities.

How are Banks Reacting to it?

We at Infosys are seeing a significant interest from banks seeking the co-creation of utilities – from those servicing post-trade processes to KYC/on-boarding to reference data to reconciliations. Financial institutions (FIs) are very keen to mutualize their assets and aggressively reduce their total cost of ownership across infrastructure, regulatory programs, operations, and technology as relating to non-core business processes. While each of the banks are keen to mutualize their assets, the most keen are the mid-tier banks who have a higher cost per trade as compared to the larger ones and therefore are showing much greater desire to form utilities. Additionally, size also adds complexity of the technology/operations/infrastructure environment and unwinding from this landscape is more difficult. The other candidates for whom utilities are best-suited are the new FIs who are opening digital-only services and are not beset with the baggage that legacy apps and infrastructure bring.

Utilities are also taking on different shapes / dimensions, from pseudo utilities that comprise a single platform creation for a single bank to full-blown industry utilities like SWIFT. In addition, we are also seeing different models for the creation of utilities emerging, such as co-creating with single clients and then expanding to an eco-system of a small number of similar sized banks. Alternative models include third-party technology vendors providing the technical backbone to leading market players and technology service providers partnering with leading product vendors.

Most recently, three banks – Goldman Sachs, JP Morgan, and Morgan Stanley – have been working to create a company that will clean reams of reference data at a lower cost than what they would spend individually.

Banks, product vendors, market infrastructure players and leading technology players are realising that without some type of close collaboration or interplay through formal structures (e.g. JV), wide acceptance of any industry-level utility would be very limited.

Key Challenges

Regulatory – All the utilities need to be regulated in some shape or form and there is a fundamental question about who will manage the overall liability when things go wrong? It is also crucial that a relationship with the local regulators be maintained.

Utility Structuring and Commercial Models – The choice of the type of commercial structuring to be undertaken based on the strategy for the utility is very important. Does the partnership (bank / third-party provider / technology firm) wish to restrict this to only a few clients or make it industry-wide? What shape or form will the partnership take – JV / synthetic JV / purely royalty-based arrangement and what roles and responsibilities will each participant in the utility take?

Long Term Business Case – Banks need to understand what the true cost of ownership of their existing estate is versus the cost reduction the utility will deliver. Some banks will have highly written-down infrastructure assets and have potentially achieved significant savings already from offshoring IT and operations. For them, the business case needs to stack up over a much longer term and take into consideration other factors that can accelerate the savings, including financial engineering.

Utility Roadmap, Implementation and Operationalization- At the strategy level there are multiple considerations including shared vision, governance of the utility, and risk management / transfer. The roadmap is a long and complex one and involves several phases including forming an enterprise platform, driving towards SaaS, creating a solution on the private cloud and then finally migrating to a full-fledged utility. Additionally, there are several technical and functional challenges to consider:

1 & 2: http://uk.reuters.com/article/2015/03/08/uk-europe-banks-study-idUKKBN0M40YX20150308

- Understanding the data privacy and security requirements
- Determining the scope of the utility
- Determining the choice of product (both from a current and a future road-map perspective)
- Agreeing whether to buy versus build for the core of the utility
- Architectural complexities in banks' spaghetti landscapes
- What partner ecosystem to choose for the journey
- Deciding how to go about the multiple phases involved in the highly complex creation of utilities
- Determining the non-functional requirements (NFRs) that the utility should meet (performance & scalability)
- How do you deliver and run the utility for multiple tenants

Adoption by the Market – Who will support the overall marketing and industry adoption? Banks need to think about the segmentation, targeting, and positioning of the utility in a way that allows the participants to have an equal voice in the roadmap while retaining the core functionalities that will support the majority of the industry's requirements.

Innovation – With banks demanding over 50% savings on existing spend, it is critical to focus on the innovations impacting all the elements of the utility e.g. robotic process automation, robot advisors, NLP-based tools, self-service portals, self-learning systems, creation of thin-trades, open technology platforms for regulatory reporting, and several others.

Infosys' Point of View

We believe utilities, specifically servicing non-core / common bank functions, are going to be commonplace going forward and banks should not ignore it. It would suit banks better to focus on their strategic business direction and on the industry transformation at large– for instance, the influence on banking of peer lending, mobile payments, block-chain, the technology revolution being injected by Fin Tech firms, and robotics (e.g. robot advisors). These will have a much wider implication for the industry and banks with bloated balance sheets need to shed non-core assets and re-focus on the future.

We see utilities helping banks in several ways:

- The biggest benefit is the overall cost reduction these can result in- we have seen up to 60% reduction in cost per trade
- Helping banks move from fixed to variable costs – the commercial constructs can be as basic as transaction-based pricing or at the other end be linked to the business outcome that banks are driving (e.g. linked to the size of the distressed asset book reduction)
- Helping banks move away from focussing on a series of unconnected business / technology problems to a business problem clearly linked from end-to-end
- Enabling faster time-to-market
- Achieving simplified architecture and bank-in-a-box standardised workflows
- Improving service delivery, quality of output and full transparency of costs
- Significant lowering of capital requirements
- Improving response to regulatory changes
- Supporting formation of new revenue-generating business models for the partners who join together to create the first utility through a gain-sharing model

The Way Ahead

Looking ahead, the growth of industry utilities will unshackle banks from the burden of performing several non-core activities and allow them to focus on core differentiators, and possibly operate more like hedge funds. Their clear focus then would be on pure business-generating activities such as sales, marketing and relationship management; focus on bank-specific pricing and risk management and on value-add services.

What is Infosys Doing in this Space?

Infosys has been involved in several initiatives over the past several years to support platform and utilities co-creation with banks. Within financial services, we set up a formal Domain Consulting Group structure to not only provide extensive domain capabilities across engagements but also to identify financial service platforms to co-create, based on industry-wide problems related to KYC / on-boarding, reference data, and reconciliation. The first was released last year – a Reconciliation Platform – and is already in use at three of our top tier financial service clients. We have also created an open source-based reporting platform servicing regulatory reporting, data distribution and several other use cases – this is the Infosys Information Platform based on Hadoop. We are also providing point technology solutions to several banks, and creating roadmaps for moving such solutions to platforms and then to utilities.

To specifically focus on platforms and utilities across industries, Infosys has created a 100% Infosys-owned Strategic Business Unit called EdgeVerve. Thus far, EdgeVerve already has 45 active customers across Financial Services, Manufacturing, Retail, CPG, and Logistics.

Our Infosys Labs is creating cutting edge IP that is bringing major transformation to our offerings. We are also investing in innovation in countries such as Ireland to set up labs and co-create platforms and utilities with local and highly innovative firms.

Infosys has partnered with global 100 clients and created platforms and utilities for a diverse range of industry problems such as mobile payments, micro credit, trade management, procurement, asset management and the like. These platforms are available on a stand-alone basis or in the cloud – private, hybrid or public. Even our own banking-in-a-box product – Finacle – will be soon available on the cloud for smaller clients to leverage and is the oldest platform in our stable.

In Conclusion

Infosys has built up solid experience in combining business consulting, technology, operations and infrastructure services to support the creation of platforms and utilities for enterprises. With innovation at the core of everything that Infosys does going forward, we believe we will see an explosion of opportunities to co-create platforms and utilities not only with banks but also with firms across industries.

About the Authors

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Mohit Joshi is an Executive Vice President. He is the Head of the Financial Services practice at Infosys. He holds additional responsibility for Infosys operations in Brazil and Mexico. Mohit has over 18 years of professional experience working across the US, India, Mexico, and Europe. His area of expertise lies in the intersection of financial services and technology. Mohit was also selected as a Young Global Leader (YGL) by the World Economic Forum, Davos earlier this year. Mohit holds a Master of Business Administration from the Faculty of Management Studies, Delhi University and a bachelor's degree in history from St. Stephen's College, Delhi.

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