

FIS Executive Roundtable: Winning in Financial Services through Innovation in the Digital World

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Summary

Catalyst

FIS organized a financial services executive roundtable on the 29th June 2017 attended by executives from leading institutions across banking, insurance and investment management. The event was hosted by FIS' Martin Boyd, Division Executive. Dan Cobley, a FinTech investor and former Managing Director of Google UK & Ireland, led the discussion on the topic of 'Winning through Innovation in the Digital World'. This brief provides a synopsis of the topics and key points discussed during the executive roundtable event.

Ovum view

There was a broad consensus from executives agreeing with the core propositions advocated by Dan Cobley and Martin Boyd of the necessity for innovation, and the need for institutions to prepare themselves for the digital age. The main challenge seen by executives is how they equip their institutions to move successfully to the required future state. Executives are thinking radically here: looking to focus on core differentiating services, and either buying or outsourcing low value-add activities, and work rather than compete with FinTech to increase the pace of innovation within their organizations.

Executives are looking to take advantage of emerging technologies, with machine learning and artificial intelligence (AI) being of particular note, but a core challenge identified was the need to attract and retain required talent for a wider set of digital skills. According to the attendees, the value of AI is greatest when used in conjunction with humans. Firms need to recruit and train as well as retrain and supplement their workforce with new skills, but simultaneously also ensure support for legacy systems.

Key messages

- Impact of the digitally, connected world is forcing need to innovate
- Institutions need to be unafraid to threaten their own business and drive for 10X innovation
- Readiness of platform to drive growth is related to performance
- Industry has largely started on path to digital transformation, but most remain work-in-progress
- Technology change requires firms to buy or be the platform
- Artificial intelligence will be an enabler, but its combination with humans will produce strongest results
- Developing and obtaining talent for digital world is core underlying challenge

Recommendations

Executives at the roundtable represented a broad cross-section of the financial services industry, covering banking, insurance, capital markets, payments and treasury sectors; however, the need for innovation and transforming to deal with a digital age was seen as common for all. The industry has already started to move and firms need to be completing rather than starting the shift within the next few years.

Digital disruption is requiring a new approach to innovation

The roundtable discussion was kicked off by Dan Cobley, who based on his current role as a FinTech venture builder at Blenheim Chalcot, and previous experience as Managing Director for Google UK and Ireland, gave an overview of the disruptive technology trends changing the financial services (and other industries) and his views on how institutions should be thinking about and preparing to innovate.

Impact of the digitally, connected world is forcing the need to innovate

The world is undergoing a time of change occurring at a rate higher than any time in history. This is driving disruption and structural business model shifts across many industries, with photo, travel agents, and music/media sectors notable illustrations of this. The key drivers of this change are cloud connectivity and ubiquitous mobile computing, which when combined with Moore's law of decreasing cost of processing power, is resulting in more people becoming more connected at higher speeds with more computing power. This is allowing provision of enhanced services, such as multi-party, high definition video conferencing from almost any location; something that would have seemed a wild dream even a decade ago when mobile bandwidth even limited sharing of photos over mobile device. It is also driving the provision of new services, such as voice recognition with cognitive understanding, with services now available that not only understand voice instructions, but are able to understand meaning and answer relatively complex queries.

As Moore's law continues, Dan's perspective was that the cost of current storage, bandwidth and processing standards would become effectively free in the future, allowing the provision of new capabilities in the future much beyond current thinking. With these trends continuing, the impact of change brought on by the digital world is one that is very much still happening rather than complete, and the pace of change will continue to accelerate.

From a financial services perspective, this disruption is still very much in progress. The shift in cost dynamics and potential for new services in a digital, connected world has catalyzed the emergence of the FinTech sector with over 4,000 new start-ups entering the financial services sector since 2011. These start-ups have been able to challenge existing business models, often providing existing financial services for free. For example, one firm has disrupted the stock trading market offering zero commission costs. The use of cloud-based business models and focus on mobile delivery also means many such start-ups have been able to scale-up rapidly to become significant in months rather than years. Another example, a credit scoring service, went from its first employee to having over 4.5 million customers within 2.5 years.

However, despite this disruptive impact, the overall impact of digital on banks is such that the benefits should outweigh the cost. While margins will be compressed and innovative new offers will squeeze profits, banks can look to drive new revenues through innovation themselves, and operational costs can be reduced from automation and digitization. Crucially here, financial institutions need to embrace the digital world, and ensure that they adopt the same innovation-based thinking as seen by these newer FinTech rivals.

Institutions need to be unafraid to threaten their own business and drive for 10X innovation

Having identified the criticality of innovation, Dan also provided some thoughts on how institutions should look to drive an innovative culture.

Decision-making should be data-driven rather than based on HIPPO

One key challenge for institutions is that decision-making is often done by the HIPPO (highest paid person's opinion). While this may be appropriate for the broader, strategy-level decisions where big-picture market experience and knowledge is valuable, HIPPOs are often far-removed from the picture for making more tactical, lower-level decisions. Rather, firms need to use as much data as possible to drive objective decision making.

Institutions mustn't be afraid to cannibalize themselves

The other key challenge for institutions is that most are highly reticent to drive innovation where it has a damaging impact on existing business. An example is the home movie industry, in which the major incumbent had the chance to purchase a firm specializing in home delivery, but chose not to primarily due to the concern that the home delivery business would undercut its core retail-store business model (with late fees on DVDs providing attractive margins). While the concern that the business model would be disruptive was a genuine one, firms will find that if they aren't willing to cannibalize their business model, another firm or new entrant will.

An opposing illustration here is from a media company operating in the same market. The company was originally a DVD-by-post business model, but once the company had made the realization that the market was moving to streaming, even though this was only 10% of its business, it removed the DVD by post executives off the main management board. The point here being that these executives would, by their business focus, be inhibitors to the company making the required change. Similarly, a search engine firm made the decision to focus on mobile (when its desktop application was highly profitable), once it realized that mobile would eventually drive most search activity. This led it to develop its operating system, which allowed it to eventually dominate the mobile search market, whereas it would have been quite easy to remain focused on its core, high profitable business at the time.

Seek 10X innovation rather than incremental

While the use of data to drive decision-making and being prepared to change business models are critical for success innovators, the other key characteristic is in the approach to innovation. Here firms need to balance a focus on core, more incremental innovation, with a focus on adjacent, less proven markets, with a little bit of 'crazy', blue-sky thinking mixed in. The suggestion being that there should be a 70:20:10 ratio split in resources between the three areas.

Institutions need to be prepared to shoot for step-change types goals rather than just seek incremental improvements. An example, is corporate customer on-boarding, where an objective to shorten onboarding from ten to nine days would drive a focus on improving the efficiency of existing processes. In contrast, a goal of reducing from ten days to one day would likely force a more fundamental re-evaluation of the processes themselves. This would force the institution to think differently.

Readiness for change is related to performance, but institutions are still on the path to digital transformation

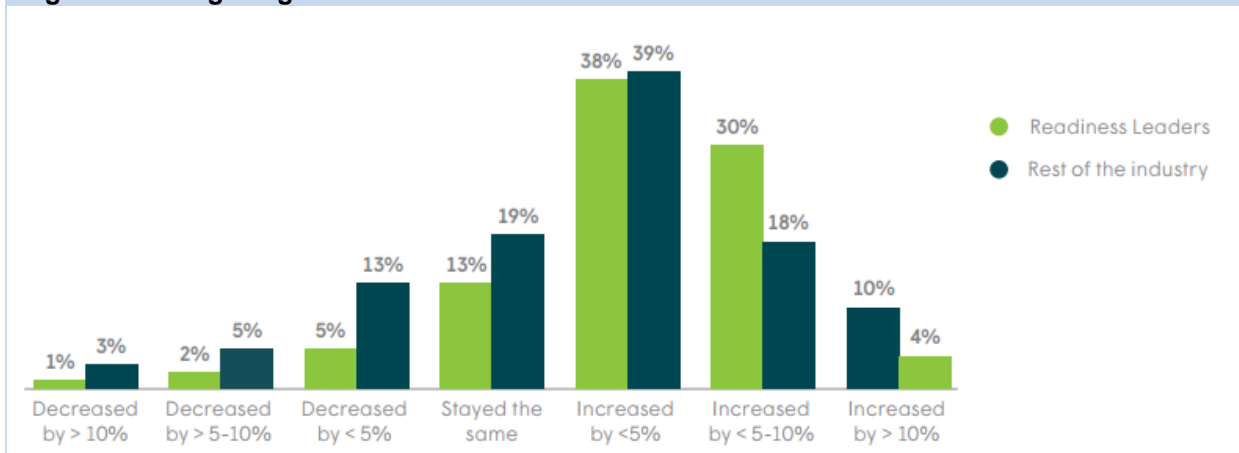
Martin Boyd, Division Executive at FIS, and Daniel Mayo, Chief Analyst, Financial Services Technology at Ovum, shared their views based on research each company has conducted around the readiness of financial services institutions to deal with the new environment.

Readiness of platform to drive growth is related to performance

FIS' recent research, published in the FIS Readiness Report: The Hunt for Growth, looked at strategic objectives and readiness for meeting these in the buy- and sell-side sectors. Based on interviews with leaders in over 1,000 institutions, the research found that over half of the sector considered that the economic outlook would create growth opportunities over the next three years. However, while the industry has shifted back towards a growth mentality, the challenge for the majority is that they are not confident that their current technology capabilities or operations functions are strong enough to support growth ambitions. In response, many institutions are looking to outsource activities lower down the value chain in the next 12 months, while pushing to deliver greater process automation over the next three years.

The research also evaluated the readiness of the surveyed institutions, indexing them against key enablers for growth. These included capabilities around automation, data management, adopting emerging technologies, digital innovation, customer experience, and talent. FIS has done additional analysis of the industry comparing the performance of institutions obtaining top 20% index scores against the rest of the market. As shown in Figure 1, these 'Readiness Leaders' have tended to outperform the rest of industry in recent times: 40% of these leaders have grown their revenue by more than 5% while only 22% of other institutions have done the same. There is a significant correlation between operational excellence and innovation, and achieving growth.

Figure 1: Change in global revenue in last 12 months

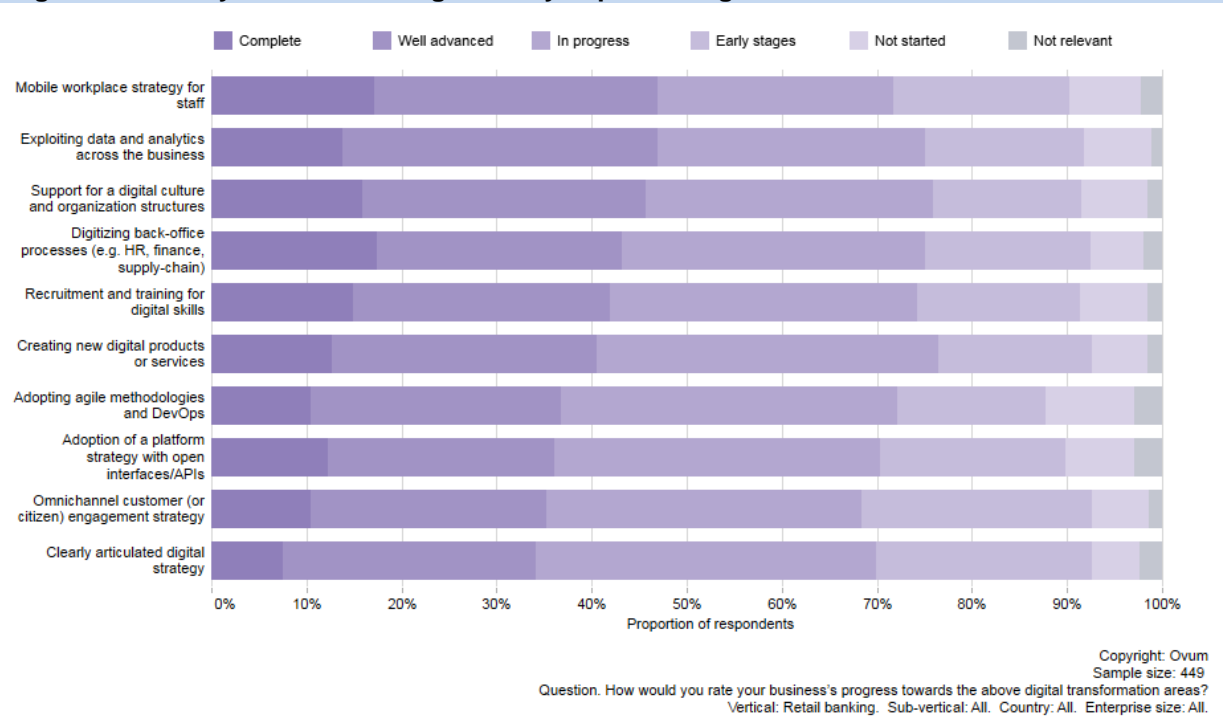


Source: FIS Readiness Report: The Hunt for Growth

Industry has largely started on path to digital transformation, but most remain work-in-progress

Ovum’s recent ICT Enterprise Insights study, a primary research program with senior technology executives of over 7,000 enterprises across the world, provides insight into the industry’s progress towards digital transformation. Part of the study looked at the progress institutions feel they have reached on the path to digital transformation, based on an evaluation of their maturity across number of business and technology level areas important for development.

Figure 2: Maturity of retail banking industry in path to digital transformation



Source: Ovum ICT Enterprise Insights

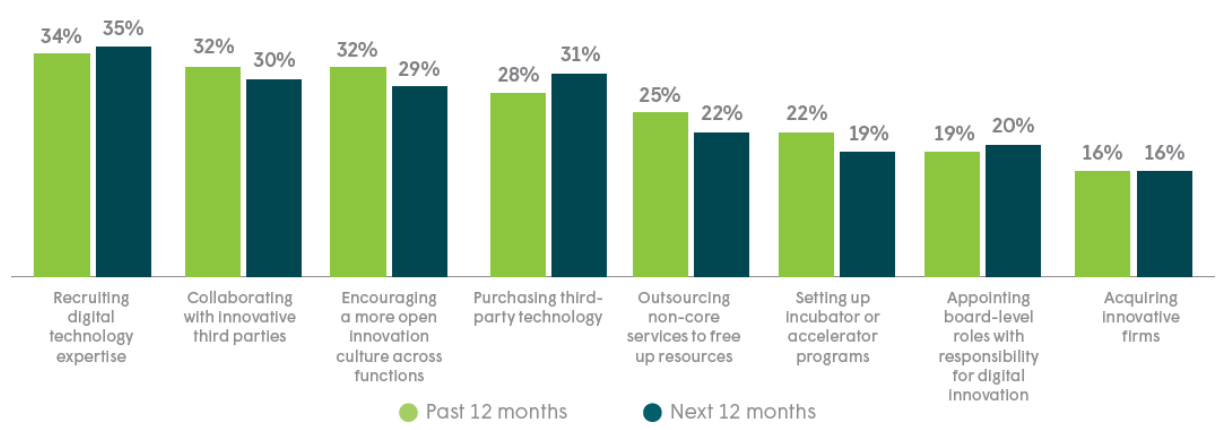
As shown in Figure 2, which pulls out data specifically for retail banking institutions, the majority of firms have started to transform themselves for the digital world (typically fewer than 10% have not started in any area), however, the majority for most areas sees the industry either in progress or at the early stages of transformation. For most areas, only 10-15% see themselves as complete.

Interestingly, while many institutions have made progress in areas such as developing a digital culture and changing the organizational structure for digital, very few have actually created a clearly, articulated digital strategy.

Firms need to embrace innovations like artificial intelligence, but buy or be the platform

Another discussion theme was whether institutions are truly ready for innovation and technology disruption. Debate revolved around how institutions can move to the future state required, and the role/impact of such key emerging technology areas, such as machine learning and artificial intelligence, as well as the need to bring in and develop talent to deal with digital world.

Figure 3: Strategies to expedite digital innovation



Source: FIS Readiness Report: The Hunt for Growth

Technology change requires firms to buy or be the platform

There was a broad consensus amongst the executives that the need for innovation and digital transformation is no longer the question. Rather the core challenge for most institutions is how do they move successfully to this future state, particularly as job tenure for senior IT leadership is often short. Main points discussed were that institutions need to focus on strategic initiatives that deliver added value to clients or consumers, and that make a difference, rather than focus on commoditized functions and processes that do not provide competitive differentiation. For non-differentiating areas, firms need to be open to buy services (such as using cloud for storage or outsourcing business processes). The attendees' sentiment mirrored the FIS research findings.

Given the increasing cost of technology, there was also agreement that firms should seek to either buy or be the platform. For example, one top-tier investment management institution created its own risk/portfolio management platform and delivered it as a service for other firms. Today it would not make sense for other firms to try to replicate this capability internally for what is becoming a commodity function.

Within this topic, there was also discussion that while firms should look to drive innovation, the FinTech ecosystem has been evolving towards more of a partnership, rather than purely disruptive, relationship with incumbent financial institutions. Firms should look to partner and work with FinTechs rather than compete head-on, particularly as one of the challenges here has been the different regulatory landscape for incumbents versus the FinTechs which meant that institutions did not have the ability to move at the same pace.

Artificial intelligence will be an enabler, but its combination with humans will produce strongest results

One of the major topics of conversation was around some of the key emerging technologies, with machine learning/artificial intelligence identified as a key area of interest for the industry, although most institutions were just starting the journey into this area. AI was particularly seen as valuable for tackling financial crime, fraud, and ensuring compliance. Machine learning's potential was seen in its ability to assess data materiality, to be able to evaluate large quantities of data and determine what was important or not, as well as its ability to react rapidly and with scale for tackling cybercrime. Additionally, executives saw significant potential for using AI technology in areas such as robo-advice on the investment side, and for dealing with compliance requirements for areas such as mortgage interviews.

There was concern, however, that greater use of machine learning could introduce new systemic risks into the system (such as those cited with the potential of driverless cars), however, a key point was made that the best use of artificial intelligence is when it is used with humans rather than solely to replace them. For example, even in areas where AI has been seen to have made great strides (e.g., chess, or Go, a strategy board game), a combination of humans and AI is greater than pure AI. Likewise, there are many processes where a combination of employees and AI (e.g., chatbots) will produce best results, so that AI enhances the productivity of employees and provides process scalability, but is not fully removing employees from the picture. Institutions were also concerned that firms risk losing connection with customers if they move to a fully automated front-end channel.

Executives also discussed the longer-term impact of such technology, particularly in the area of driverless cars. The key point of the conversation was that driverless cars have the potential not to just disrupt the auto industry, but to eventually remove the need for car insurance, or even the need for carparks. Attendees also felt there is a general level of denial about the long-term potential for AI.

Developing and obtaining talent for the digital world is a core underlying challenge

While most institutions are looking to assess and work with these new technologies, a key issue identified by roundtable executives was the challenge of getting the right talent to work with these new technologies and to properly prepare for the digital world. This lies partly in challenges of retraining existing employees to deal with different expectations and requirements of a digital world, but also in challenges in both hiring, and then retaining, new young talent. Concerns lay both in the reputation of the sector, but also in different work-life approaches. There is a clear shift from the 'job for life' mentality of many of the institutions' existing workforce, towards shorter, faster work lifecycles. This is being compounded by the need to retain and ensure continuity of support for older technologies (e.g., to support legacy platforms), while also looking to bring in and develop skills for digital technologies.

One of the broader talent issues across both the business and technology side is that financial institutions still tend to be male dominated, effectively reducing the ability of institutions to harness both the potential of a wider labor pool, but also the broader perspective diversity of thought can bring to an institution's approach to the market and customers. The group concluded that institutions need to assess their recruitment strategies and hire managers equipped to address the range of talent issues.

Conclusions

The need for innovation and transformation to deal with a digital age is now seen by the majority of the sector as a key imperative, and most have already started to move and firms need to be completing rather than starting the shift within the next few years. This will require a change in mindset and culture within each institution to become 'digital', with a new approach needed to both acquire necessary platforms and benefit from emerging technologies. Similarly, firms will need to develop their capacity to obtain and retain necessary workforce skillset to benefit from new technology capabilities or partner effectively to allow this to be the case.

Appendix

Methodology

This report is based on FIS Executive Roundtable Dinner and FIS Connect keynote presentation, both held on the 29th June 2017 in London. The [FIS™ Readiness Report: The Hunt for Growth Across the Buy and Sell Side](#) is based on interviews with more than 1,000 executives from leading financial services institutions.

Ovum ICT Enterprise Insights program is a primary research interview program with senior ICT executives at over 7,500 institutions looking at technology investment priorities from an industry and technology perspective. Data referenced was published in Q4 2016.

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