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Driving change
Five questions every bank must answer to justify a core transformation

While banks around the world have tackled core transformation and are already reaping the rewards, U.S. banks, which have largely remained on the sidelines, are taking notice. Is it time for U.S. banks to finally take on the challenge of core transformation? For many, the answer today is a resounding "maybe," because while many banking leaders understand that core transformation could drive big benefits in the long term, they believe the costs and risks associated with transformation simply outweigh the benefits. End of story.

However, is that still the case? Recent seismic shifts in U.S. banking are spurring a growing number of banking leaders to rethink the whole issue of transformation. For many, it is increasingly difficult to ignore the benefits being chalked up by banking peers abroad, particularly those in Australia, Canada, and Europe – including the impact to customer experience, efficiency ratios, and reputation.

Perhaps the problem lies with the business case. In our work with banking leaders around the world, it has become clear that in many U.S. banks, a short-term, myopic focus on costs is obscuring the range of benefits that transformation can deliver. As a result, banking leaders are tempted to kick the issue of core transformation down the road, but by doing so, they may be sacrificing exactly the types of benefits the board, shareholders, and customers are seeking.

Doing nothing may be an easier choice, but can banks really afford to do that? As real costs climb, it's becoming clear that banking systems currently in use are unable to support future growth, enhance the customer experience, and mitigate the rising risks of operating in the current environment. No one is asking: What is the cost of doing nothing?

In this article, we've identified five questions – which our clients are being frequently asked about their business from a range of stakeholders, including investors, regulators, the board, and senior management – that can help sharpen your thinking about the impact of a core transformation. These questions aren't just for technology leaders. They span the C-Suite. Anyone who has a stake in increasing the effectiveness of the business should have an interest in answering these questions.

Five tough questions that every bank must answer:

1. Will the new core platform reduce the operation costs and by when?
2. Is a new core platform required to support future growth?
3. How will the new core platform contribute to a superior customer experience?
4. Will a new core platform improve our ability to respond to today's emerging risk and regulatory environment?
5. How will a new core platform impact our talent strategy?

Will the new core platform reduce the operation costs and by when?

Typically, the older the system, the more manual processes the bank has in place, and the more it's spending to support a complex patchwork of technologies. Additionally, because these patchworks break down frequently, they require a great deal of cost and effort to maintain. At a time when banks are looking to "trim the fat" from every part of their business to keep costs down, that's a big deal. Not only do manual processes contribute to massive inefficiencies, they affect accuracy, which in turn may require even more resources in the long run.

With a modern banking core in place, executives are better prepared to increase automation, support new operating models, and reduce the complexity of performing many tasks and functions. Not only can new core systems improve process efficiency, they can also help employees focus on more important tasks, and it may not take years to see cost and efficiency benefits from a new core transformation system. Banks can achieve benefits within the first few quarters of a new implementation.

Is a new core platform required to support future growth?

Many banking executives tie growth to higher account or customer volume. That view can obscure the connections between core banking systems and various growth strategies for the bank. With banks finding it harder to grow through traditional lending and interest income, they are increasingly focusing on mergers and acquisitions, new fee-based products, and expanding their share of wallet with their existing customer base.

In this environment, banks need an enhanced ability to support an expanding portfolio of accounts and customers, but overly complex and cumbersome legacy systems can impede, for instance, the integration of two banks following a merger. Additionally, these outdated systems can hinder a bank's ability to pursue growth through new products and services, flexible pricing, a better understanding of existing customers, and expansion into new customer segments.

How will the new core platform contribute to a superior customer experience?

A compelling customer experience is increasingly recognized as a competitive differentiator and contributor to growth. Today, banks aren't just battling one another to deliver a better customer experience – they're competing with companies in entirely different industries, which are raising the bar for what customers expect on any given day, a person is likely to measure their banking experiences against those they have with leading online and bricks-and-mortar retailers, travel agencies, shipping companies, and others. Many of those companies are operating with a distinct advantage: their systems are likely more modern, flexible, and dynamic enough to rapidly respond to changing market conditions.

For banks, their core systems are often disparate, resulting in a fragmented customer experience. Additionally, many banking leaders have developed a product- centered business rather than focus on the customer. Legacy systems that support this older, product-centered mindset have a myriad of manual processes and system veneers that do little to address customer needs or provide a personalized experience, such as cross-selling opportunities.

Innovation also has a big role to play in delivering a better customer experience. When a company releases a new product into the marketplace today, for instance, it employs advanced analytics to not only gauge customer feedback, but to quickly modify a product based on findings. Meanwhile, in banks that rely heavily on manual processes it can take several months to respond. That might have worked well enough a decade or so ago, but in this environment a product can be launched and reach maturity and commoditization within a few months.

Banks should implement systems that allow them to swiftly access and analyze data in order to develop innovative new products and services that take full advantage of a multi-channel experience and exceed customer expectations.

How will a new core platform improve our ability to respond to today's emerging risk and regulatory environment?

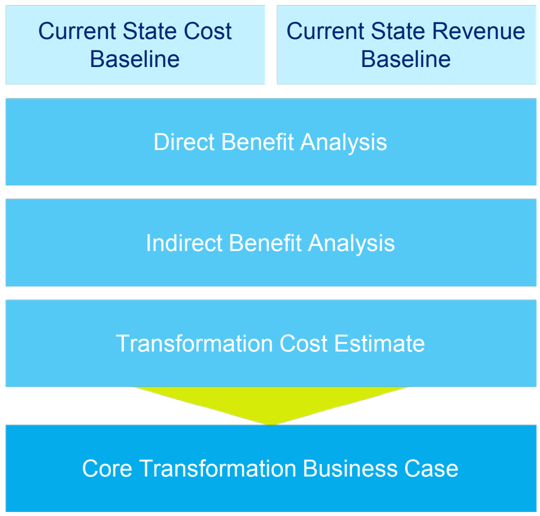
Back when banks originally implemented their current core systems, the world was a very different place. The pace of change was relatively slow, and the types of risks banks had to be prepared for were much different than those they face today. While the systems themselves have largely remained static, the surrounding landscape has evolved in ways few people could have predicted. Consider how customers can interact with banks from a branch, banking center, to ATM, online, and mobile channels – all in the same day. As a result, banks are interacting with their customers much more frequently and are handling a greater volume of transactions.

For many banks, their legacy systems simply haven't proved nimble enough to keep pace with such changes, exposing them to potentially significant risks. For example, anti-money laundering and "know your customer" regulations instituted in the last several years require banks to gather and analyze a tremendous amount of data on their customers, from who they are to what they're doing with their money, in order to identify suspicious activity. In many banks, this has created a huge manual workload—essentially a workaround for companies that lack the systems to keep pace with an explosion of data growth and analysis requirements.

Developments like these can have a big impact on a bank's reputation – and its bottom line. It's unlikely these legacy systems will be able to continue supporting the level and volume of changes that are almost certainly coming around the corner, and as regulators require banks to further reduce operational risk across their enterprises, compliance will only get costlier and involve more time and effort.

Deloitte Core Transformation Business Case Accelerator

In this formal view of a core transformation business case, cost remains a key consideration – but has a place alongside a host of other direct and indirect benefits.



How will the new core platform impact our talent strategy?

Even as legacy platforms persist, the workers who are familiar with them are nearing retirement, and they're being replaced by new generations of workers who bring a whole new set of expectations about technology to their jobs, regardless of whether they're coders or business users. For younger users who grew up with touch-screen computing capabilities in their pockets, they will face a jarring reality when learning their way around the core banking systems in place at most U.S. banks.

Consider the huge gulf between what these users are capable of doing, and what they may have to settle for when coming to terms with the limitations of these systems. This could represent a significant missed opportunity for value creation. Just as important, it can have a negative impact on recruitment and retention. Talented young workers may simply find another industry that offers more opportunities to innovate, rather than take the time to learn the arcane details of a woefully outdated way of doing business. Without a core transformation, banks may have to support new and emerging business needs and greater regulatory changes with a dwindling number of specialized workers.

These are very real risks being faced by the U.S. banking industry today – risks that are exacerbated by systems that, in many cases, date back to the 1970s.

[1] For most retail banking transactions, real-time is a matter of competitive parity and not necessarily a strategic benefit. For a host of other corporate and cash management functions, real time is a distant reality since industry processes, such as check in-clearing, are still highly batched.

Bringing it all together

Banking executives have their own specific reasons for undertaking a core transformation project as these five questions weigh on their minds, but if they don't clearly define and understand how an effective core transformation can address their needs and goals, they might not only veer off course, but have a hard time getting started.

For instance, a bank's stakeholders may not be aligned on the core transformation strategy, or it could be that targeted areas don't produce the expected results. In some cases, core banking transformation may offer promises (such as real-time, straight-through processing) that on their own do not drive real business benefits.[1]

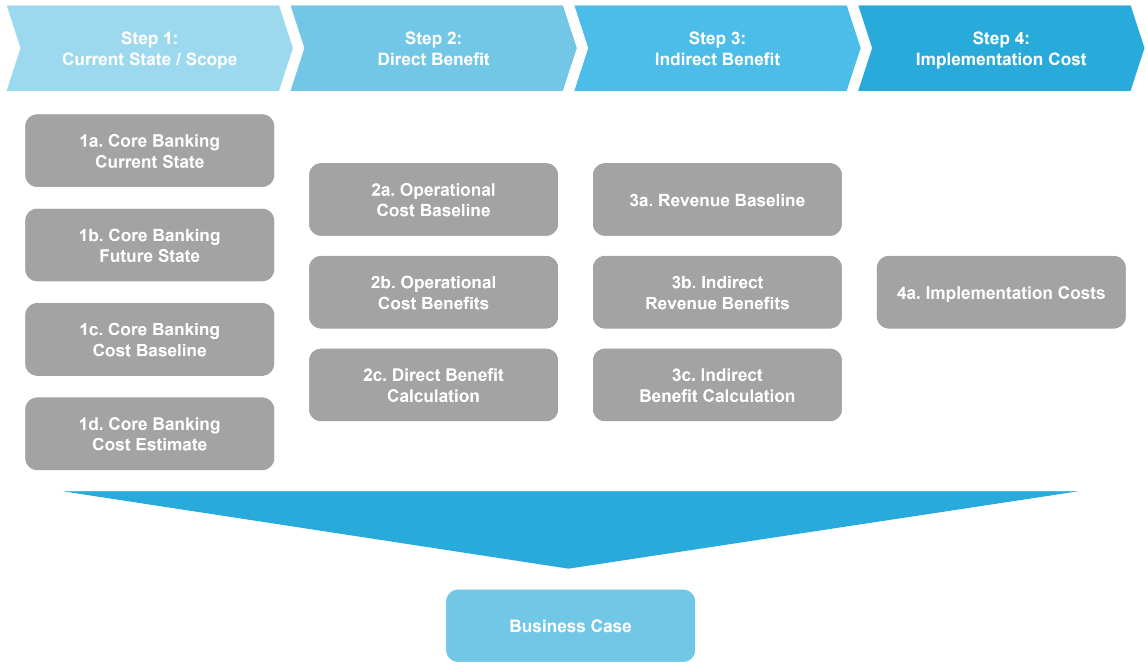
With increasing pressure to meet strategic business goals and increasing scrutiny over incremental expenditures and capital investments, banking executives need to develop a clear and strong business case for core transformation.

Critical factors to make the case

Cost will always be an issue – as it should, but it's one of a number of critical business factors that can be affected, positively or negatively, by core transformation. That's because these systems play a significant role in everything from growth and risk management to customer experience. A strong core banking business case typically includes:

- Direct and indirect benefits with an accounting for both.
- Structured calculations for direct benefits, such as operational and IT cost reductions and implementation costs.
- Flexibility in calculating indirect benefits, such as risk reduction or customer experience improvement by establishing a monetary value for these benefits.
- Real-life experiences to inform strategy, rather than treating it as a number-crunching exercise.
- Industry benchmarks on various metrics to help provide realistic expectations in achieving benefits.
- Publicly available and proprietary data from other core banking transformation projects that can support your requirements – especially in areas such as licensing costs, implementation costs, and timeframes in achieving benefits.
- Reports and analyses that can be used to track benefits through the course of the core banking program. This is crucial in measuring and realizing benefits both during and after the transformation.

Banks should develop a holistic business case to help not only to gain stakeholder support, but establish a foundation for effective implementation. This business case includes an assessment of the current organization as well as calculation of direct and indirect benefits, and implementation costs.



Hard to ignore

As banks endeavor to initiate core banking transformations, executives will inevitably need to address some tactical questions: Where do I begin? How aggressive should I be in implementing a new core system? Should I implement it at once or in phases? There is no one right answer to these questions, however the business case should help. For instance, it might indicate that your biggest pain point — and therefore biggest opportunity to achieve benefits — is your lending platform, leading you to start there. Or you could start with another area that provides a different set of benefits. Regardless, each step in a core transformation should be justified from a financial standpoint – and it all starts with your business case.

As banks face overwhelming regulation, more demanding customers, and increased competition, it's getting harder for their current core banking systems to swiftly respond to the increasing complexity and changing environment. Those responsible for core banking systems need to create a holistic business case, which is the first step in a core transformation project. This is the foundation that will not only help you gain support from the C-suite, but achieve an effective core banking program down the road that can enhance business performance and respond to future needs.

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