Impact of digital transformation on Banking Operating Models

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‘Digital’ has been a common buzzword for several years now, but subject to a wide range of interpretations in terms of impact and debate regarding the ways of developing a so-called digital strategy in banks.

While digital disruption has an increasing impact for all industries, digital native generations are set to invade the professional world, and thus add to the volume and variety of digital habits and behaviour. When combined with the booming use of internet and smartphones in emerging countries, there is a lever effect, which consequences are difficult to anticipate for traditional financial institutions who are not ready or agile enough to adapt.

“Up to half of the world's banks will disappear through the cracks opened up by digital disruption of the industry” forecasts BBVA Chairman and CEO Francisco Gonzalez. Banks now need to define which operating model to adopt in order to benefit from digital disruption and convert the potential threats into opportunities.

Banks had different kinds of answers to the global digital disruption

Banks are now feeling the full force of digital disruption, which made its presence known a few years ago. The implications of such a revolution were unknown and there was no clear direction about the changes required to efficiently weather the transition into the digital world. Nevertheless, many banks tried to keep one step ahead and launched various initiatives of differing scales. A few years later, we are able to identify which initiatives can be deemed successful and explain some of the reasons why the others trailed behind.

In several cases, we observed that banks made massive investment in channels and mobile technologies to offer more client self-servicing functionality. The overall aim has obviously been to reduce the internal workload for recurring requests and to empower increasingly connected generations of clients, but this could be achieved only at high cost. Whereas the potential of smaller scale initiatives to improve their internal operational efficiency has been too often neglected.

Furthermore, the operations and processes impacted by the implementation of digital features have not been properly adapted to support and promote the related services and new functionality. This requires a deep review of Operating model in most of the cases, and since there is no single unique way of preparing for digital transformation, we will therefore explore the different options COOs should consider when setting up their digitally enabled organisations or transitioning towards the next level of maturity.

Finally, measuring the return on investments will soon become a critical issue for COOs in order to justify their budget and the expected return on investment in digital spend. They will have to use an increasing number of global cross-industry benchmarks and KPIs in order to evaluate their efficiency, alongside the need to ensure their organisation is more flexible and agile.
This short review of the current state of affairs will identify the main challenges that banks will have to overcome in the future to become leading actors of the digital revolution rather than its victims.

Outcomes and lessons learned from the first digital movers

Many banks may feel uncomfortable when confronted by a constantly moving and exponentially growing digital world, which brings together a universe of new consumer habits, competitors, technologies and solutions that would require a complete overhaul of their organisation to ensure it would be suitably flexible and agile to face this new paradigm. Among them, several were hesitating and slowed the pace of their digital transformation, while others who embraced a specific path are now assessing the results and taking stock of the first lessons learned. COOs need to be reassured; there are various ways of embarking on this journey of transformation with specific and focused initiatives adapted to their existing structure, internal organisation, customers and markets. Thus they must select the most appropriate path in light of their current level of digital maturity.

The difficulty of banking groups in recent years has been to understand the extent of the digital impact on their business, how they should adapt and what should be driving their transformation. Many of them first invested in new digital channels (e.g. customer portals, cockpits, online access to advisers and mobile apps) because these were visible on the market.
They addressed customers' growing need to have constant access to their data and to perform certain basic operations, and they ultimately were supposed to relieve the workload for relationship managers to free time for prospection and added-value sales activities. Only some years later, these have proved to be not entirely successful and the business case not wholly straightforward. Some major players have achieved great results through massive investment and making 'digital' the main focus for development in their business model.

For others, some time after their first initiatives went live, they now realise that not every digital move is the right and best move for their organisation or their market. Many are also beginning to understand that their organisation was not prepared for all of these changes to be introduced in one fell swoop, and far-reaching transformation of their culture and DNA was first required.

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In the case of major transformation programmes, as for any other transformation, the human factor could well be one of the main reasons for failure. This is particularly true when those projects are introducing new technology, calling for changes to users' habits and processes and widening access to data previously restricted to the 'happy few', thus rebalancing powers within the organisation. Some recent examples include major investment in omni-channel strategy and tooling. However, there has been low return on investment owing to a lack of uptake of those new means—both internally and externally.

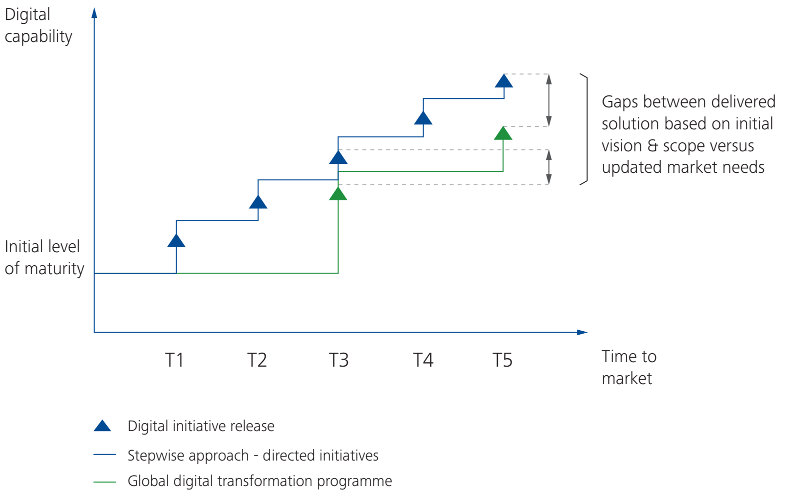
The crux of the matter is changing the way employees think and work in order to leverage new technology and become more efficient. It is also important to demonstrate that customers still need to be supported through their adoption of digital means, especially in the case of older generations. Indeed, they are keen to benefit from new online services, but they must be convinced that they can offer them added value yet with limited risk.

In both cases, the decorrelation between new 'best of breed' digital solutions, which require constant change and flexibility to adapt to new trends, and the existing format of highly administrative organisations will lead to inefficiencies and friction unless we are able to massively boost manpower and new expertise to have them working together. The truth for traditional banks is that previous organisational models are no longer suitably adapted or flexible enough to keep up with the incredible pace of the digital disruption.

The first challenge in this revolution is not providing existing customers with new innovative services and solutions, but rather convincing younger generations that a bank will be able to provide them with best-in-class services, while offering other additional features that could set them apart from other (non-banking) players. This means banks are currently up against global internet giants such as Amazon, Alibaba and Paypal, etc. and need to propose relevant offerings to ensure they do not lose their market share to them.

Agility a key ability

Where there was successful transformation on the market, those examples were led by strong sponsorship and underpinned by a dedicated organisation focusing on isolated capabilities. Traditional ways of driving multi-year programmes become obsolete from the kick-off date if there is no plan to deliver intermediary releases and build digital capabilities in an incremental way. Institutions need to put in place agile structures supporting those changes, with an ability to realign their priorities along the way and foster a spirit of innovation across the organisation.



Building and investing in a transversal digital strategy department might be one option if an organisation's business lines and functions require that kind of central body and are ready to welcome new initiatives and projects, which otherwise may not be initiated by their direct needs and teams. This entity would then act as market watcher, keeping banks abreast of new trends and competition moves and adjusting the digital strategy accordingly. This is also a great opportunity to generate synergies and set up a central digital governance body that will ensure overall consistency of the solution and data architecture.

In some cases, digital initiatives have been the most successful for organisations working in 'silo mode', meaning that they were originated from the floor, managed by their own teams, progressively building their expertise and monitoring their success. This strategy could be applied to end-to-end core banking processes for instance, such as loan origination with online capability aimed at reducing paperwork and overall time to market. Having a clear scope and measurable objectives is the safest path to success and allows other business lines to subsequently be 'evangelised' and for shared service centres to be built across departments.

For digitally more mature companies, however, this last scenario could rapidly lead to a myriad of small initiatives, technologies, expertise and best practices, lacking central coordination and governance. In this last case, banks should envisage building a central digital competence centre responsible for defining and governing an overall strategy.

Digital operating models for different bank structures and maturity levels

Undeniably, depending on the bank's organisation, services, markets, business lines and maturity, not all operating models are appropriate when a bank wishes to implement its own digital strategy. We will outline four models suited to different bank organisations, ranging from a lower level of digital enablement to a higher level:

1. **Federated model:** this type of model mainly applies to larger organisations starting their digital transition in different areas, but not in a top-down synchronised way; i.e. every business line/department may engage in digital initiatives to a minor extent and they manage their own project, related costs and resources, build their competencies and invest in required technology. This can be applied to many different cases and is the best way to garner employee involvement and commitment, thus making them the key actors of their organisation's digital transformation. Implementing a paperless process for customer acquisition and account creation would be a good example in such a context. Moreover, it could be rolled out progressively to other business lines and entities as they see the benefits of the change for their peers

2. **Shared services centre model:** when a firm has reached a minimal level of maturity with regard to its digital transformation and built up some internal skills and competencies, it is a good time to start sharing best practices across the organisation. This could be carried out for a specific field in order to benefit from past experience and existing in-house knowledge, as well as to leverage existing solutions and technology. At a certain point, this sharing even becomes mandatory for the sake of cost containment, as it would be illogical for each business line to select a different vendor, negotiate separately and contract, while another fitting solution is already in place. The aim of a shared service centre is therefore to capitalise on available know-how, harmonise methodologies, foster internal communication of service proposals to other departments and promote expansion within the company
3. **Strategic competence centre model:** as soon as the organisation has reached a certain degree of maturity, the different business and IT lines will demand more guidance on which digital priorities they have to implement and how. Having a central dedicated strategy body therefore becomes essential for supporting the application of the digital strategy across the organisation as a whole. It will leverage shared service centres that might already be in place and enhance central coordination among them, in addition to defining the strategic development priorities and tactical measures with regard to digital transformation. This central unit will identify the need for bringing in and developing new capabilities within the organisation to anticipate future market trends and position the bank as a leading actor in related fields. It will also facilitate the exchange among the various shared services. It could, for instance, provide recommendations and technology guidelines with regard to dematerialisation of processes, which should then be applied by the shared service centres through the whole organisation in various functional areas
4. **Core digital model:** this kind of organisation is suitable for fully digital companies (i.e. pure players) and/or profit centres that are organised around their digital core platform. The latter is their main differentiator and advantage over competitors, irrespective of whether they are also digital companies or more traditional players providing the same services and products. This is characteristically the case of pure online banks or mobile payment companies. In the course of their digital transformation, traditional banks will have to become efficient enough to compete with this kind of player. This will become essential for attracting the new generations of customers that will be less and less convinced they need a bank to perform most of their daily cash operations

Depending on the type of operating model selected, new functions and roles will also have to be created and assigned. It could be beneficial for instance to create the Chief Digital Officer (CDO) and Chief Innovation Officer (CInO) functions if the organisation is planning to implement one of the new operating models and run them efficiently. It also means that banks may have to attract and bring in new talent if it cannot be found internally.

Business case considerations for digital in the new global economy

When building a business case around a digital initiative, one must also consider which operating model would be the most appropriate for the related transformation and what the costs and prerequisites will be. The new operating model should be the driver of digital projects, not the other way around. In terms of costs, it is therefore crucial to identify the pre-required investments and agree on impacted budgets before project launch to avoid further discussion down the line.

During the development phase and once the project goes live, most of the typical industry KPIs may be considered for assessing efficiency and the return on investment in digital initiatives. In the context of the implementation of a new web application, it could be relevant to monitor the adoption rate of those new channels by clients or the increase in the number of new client account openings with the corresponding growth of assets under management. However, the referential and corresponding benchmarks have drastically changed.

As banks are now competing against new entrants from other industries and pure players, they will need to set their sights on being just as highly performing as them. Client onboarding, for instance, should take less than 30 minutes—as in the case for some online players—instead of several days in the traditional banking industry. Firstly, banks will likely need to measure the number of FTEs needed to manage one similar process (an easily quantifiable indicator) and make related benefits simple to evaluate. But this kind of improvement also represents a way to demonstrate to younger generations that banks can be just as competitive as the internet industry; yet, this changing perception will be difficult to evaluate. This is especially important in the context of an increasing number of young people that will not see the bank of their parents as a necessary intermediary for their day-to-day operations in the future.

By focusing on isolated processes/capabilities and directed investments, along with short time-to-market, banks will facilitate the assessment of projects' success and demonstrate the advantages of investing heavily in their digital transformation. This will nurture innovation and further push digital adoption among their staff, thus sharing new ideas and possible applications with other entities in the group.

A phased and incremental path towards digital transition success

When embracing the digital transformation challenge—supposing a global digital strategy has been developed—banks should first consider the current maturity of their own organisation. This will strongly influence the main areas in which they first choose to invest, or at least guide the changes they need to perform straightaway on their internal operating model. As demonstrated earlier, not all operating models are appropriate for all digital transformation initiatives.

Once the current state of maturity for digital enablement has been determined, banks will have two main options to execute their digital transformation,

which could also be performed in parallel:

1. Leveraging existing capabilities and operating model to implement the possible digital initiatives wherever it makes sense and starting to promote the related achievements across the organisation. This should likely be performed in contained areas for less mature organisations, with the aim of starting to expand their successes in a second stage. Some examples may include the implementation of paperless processes for client on-boarding, loan origination and evaluation, which could easily be rolled out to other departments or key principles and corresponding tools re-used for other processes
2. Starting to move towards the next operating model stage to enable enhanced organisational agility to implement major digital transformation projects. This can be performed through a Business Process Modelling exercise to restructure the operating model around the target digital capabilities. For example, when the bank is opening more channels with 24/7 access, they also need to provide the required level of support to customers, which would require the restructuring of several teams, the reorganisation of their duties and the implementation of new Service Level Agreements. Investing in front technologies and features might be worthwhile in terms of sales and revenue growth, but only if the organisation is ready to support it and cope with higher volumes of data and increased interaction with clients

Considering both options and the required level of investment and effort for each of them, COOs will see more tangible results with faster time to market if their bank start with smaller projects aimed at improving internal efficiency and consequently reducing costs. Moreover, the business case will be easier to demonstrate and will contribute to further vouching for the competitive advantage digital transformation can offer banks.

Thus, COOs will have evidence to support the development of larger programmes as soon as the maturity of the organisation allows. The Executive Committee will then start thinking about digital for achieving both efficiency and cost-reduction enablement, while positioning the bank well for the future, i.e. preserving their typical market shares by offering value-added, minimising the competitive advantage of new players and remaining attractive for younger generations.

Banks definitely need to push forward with their digital strategy, but they must do so wisely, supported by a reliable and scalable digitally enabled organisation, in order to be part of the of the leading banks having turned the digital revolution into a market opportunity.

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