Digital transformation meets regulation 4.0 in 2030: How incumbents can keep up (3/3)

How can incumbents win?

In this series "Digital transformation meets regulation 4.0 in 2030: How incumbents can succeed", we present how incumbents could play and win to hedge the value of their digital transformation against regulatory change.

How should incumbents approach their digital transformation to win? In this publication we explore how incumbents can secure the value of their digital transformation through a three-pronged approach.

Introduction

As incumbent retail and commercial banks continue to shape their vision of the future and their capacity for achieving digital transformation, the opportunities and risks are increasing. In our previous publication "Where should incumbents play?" we explored where incumbents should play to hedge against regulatory risk by assessing their digital transformation target and their geographic footprint. In light of this, how should incumbents play to win? In this publication, we explore how incumbents can secure the value of their digital transformation through a three-pronged approach.

Trend

Through their digital transformation, incumbents want to become more agile, efficient and customer-centric. To achieve these objectives, in "Digital transformation in financial services" Deloitte defines the attributes of a strong digital DNA: agility, collaborative work culture, distributed organizational culture and bold risk appetite.

Where incumbents fall short in achieving their objectives, it is typically for one of two reasons. One is internal, and relates to the digital DNA attributes outlined above. The other is external and relates to the future of regulation (that is, regulatory risk), as explored in our previous publications. Whilst incumbents are starting to tackle the internal hurdle, in our view they have yet to prepare themselves to face the external hurdle.

Introduction

Trend

Implication

Implication

As Figure 1 outlines how incumbents can evaluate and secure the value of their digital transformation by factoring in commercial objectives and regulatory risk. In doing so, it shows the indicators that incumbents must assess alongside the levers they can deploy.

The commercial objectives that incumbents want to achieve through their digital transformation are assessed against the three key indicators: agility, efficiency and customer-centricity. To achieve these commercial objectives, incumbents need to factor in regulatory risk (which, as introduced in our previous publication "Where should incumbents play?" is assessed against: risk management, regulatory design and architecture and regulatory convergence).

To secure the value behind each of these key indicators, incumbents can deploy one of the following levers:

- scenario analysis;
- trust culture; and
- regulatory engagement.

Figure 1: Evaluating digital transformation value

External hurdle	**Indicator:** risk management **Lever:** scenario analysis	**Indicator:** regulatory design and architecture **Lever**: scenario analysis & regulatory engagement	**Indicator:** regulatory convergence **Lever:** trust culture
Commercial objective	**Indicator:** agility **Lever:** scenario analysis	**Indicator:** efficiency **Lever:** scenario analysis	**Indicator**: customer-centricity **Lever:** trust culture

As part of "Lever: scenario analysis" incumbents should think about how their planned digital transformation can take multiple futures – based on its vulnerability to future regulatory scenarios – and identify how they would respond were each potential outcome to occur. As a result of these multiple futures, incumbents can make decisions now about how to make fewer and better sequenced investments in their digital transformation. In the past incumbents have excelled at performing sophisticated quantitative scenario analysis. Incumbents should now build the same level of excellence in scenario analysis – with financial regulation as a core critical uncertainty – perform it on a bi-annual basis, and embed it as part of their broader strategic management system. The value creation of scenario analysis is clearly established and for leading practices, incumbents could think about borrowing from the oil and gas industry, which has used scenario analysis for over 45 years whilst also grappling with regulatory risk.

Introduction

Trend

Implication

Implication (continued)

As part of "Lever: trust culture" incumbents should articulate a clear link between culture and customer-centricity by putting trust at the core of their culture so as to retain their current relative advantage over BigTechs and FinTechs. Indeed, BigTechs are currently challenged over their customer data use, resulting in some erosion of customer trust. Incumbents can take advantage of the current customer sentiment by establishing themselves as data custodians. In doing so, incumbents will need to face a number of challenges, including building the adequate IT infrastructure, whilst also showing how they can best handle a number of risks, including rising operational risk (and new ways of thinking about how to perform customer due diligence). Incumbents will also need to prove that they can be trusted with providing unbiased, high quality advice and services to customers. A relatively low bar in terms of customer satisfaction on the incumbents' side may still prompt customers to switch loyalties towards BigTechs. The provisions in Open Banking requiring banks to participate in a consumer benchmarking exercise, of which results are available in the public domain on behalf of the regulator, will further put pressure on incumbents to prove that they walk the talk in terms of putting trust at the core of their culture. For now, the average customer satisfaction score for the top five UK banks is no more than 58.4% for personal banking service.

Finally, as part of "Lever: regulatory engagement", incumbents should establish a constructive engagement for an effective partnership with regulators. The capacity of incumbents to establish a trust-based relationship with regulatory authorities plays a critical role for their economic and brand value. As the regulatory environment is becoming more uncertain – and customer sentiment is becoming more influential – the importance of regulatory engagement is ever more critical. Incumbents should assess the extent to which their perceptions of regulators can impede a more constructive engagement with them. Regulators need to be considered as important stakeholders who can act as key facilitators for a successful digital transformation investment agenda. As such, incumbents should try to understand the array of organisations to which regulators formally and informally report, alongside their power and influence, so as to understand how this may affect the regulators' agenda and approach. In addition, the need for incumbents to revisit their existing organisational design models to remain relevant in the market further prompts the need to think about the role, structure and talent profile of regulatory engagement.

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