Financial Services Report

Reshaping ICT, Reshaping Business

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What does the economic crisis, Eurozone challenges and public scandals mean for the financial services industry?

The financial services industry is undergoing massive change. The global economic crisis, on-going Eurozone challenges and well-publicised banking scandals have left the sector with a severely tarnished reputation and under real scrutiny. Many household names have disappeared while those that remain have been publicly criticised and consumers left questioning how these organisation really behave.

Light touch, self-regulation has been shown to have its limitations. New regulations and stricter codes of conduct are being prepared which will change fundamentally how banks are structured, managed and controlled.

The coming years are full of tough challenges and change for the financial services industry:

- **Returns will be lower.** The high returns of the last 15 years or so are no longer attainable. The landscape has changed. The scandals that have tarnished the industry will be expensive to resolve. From the mis-selling of products to the "fixing" of LIBOR, the industry has been peppered with scandal which has damaged the industry in the eyes in investors, regulators and customers. This is resulting in a changing regulatory environment, the full effects of which have yet to be made clear. However, we do know that some businesses will be forcibly shrunk, capital requirements will be higher for all and some form of barrier will separate the higher risk, higher return investment banking operations from the lower risk and lower return retail operations. And, as if that wasn't enough, the effects of the ongoing recession and Euro zone crisis continue to stalk the industry.
- **Measuring customer expectations.** The key consequence will be that investors are now facing returns of perhaps one third to one half lower than they have grown to expect. Expectations must, therefore, be reset, but even achieving these will have their challenges. While investors understand the changes that are coming to the financial services, they will still be looking for the banks to demonstrate that they can deliver acceptable returns. They will continue to exert pressure on management teams to produce the best possible returns, but which are fully balanced against risk.
- **Adapting to change.** Financial institutions must do things differently. While they must continue to seek new ways of growing, they must also redouble their efforts to grow revenues, cut costs, and generally accelerate the delivery of benefits to the bottom line. Merger and acquisition activity is likely to grow as financial institutions reshape their balance sheets in light with the changed world that is emerging.
- **Improving customer experience through technology.** Technology is changing the banking the landscape. Customers are looking at banks more critically than ever. Not only do they expect the basic services to be offered and provided problem free, they are looking to banks to improve the entire banking experience. Doing this cost-effectively will often mean making greater and better use of new and evolving technology. Online banking is, increasingly, the norm and its appeal will only increase as it integrates with mobile technologies and other new channels. The use of social media is growing, with one bad experience being communicated to thousands in a matter of seconds. The challenge for banks is to understand such developments, manage their potential and derive the financial benefits that they offer. Harnessing the power of technology and the social enterprise is therefore the key to success.
- **Being agile to stay ahead of competition.** Financial institutions need to become far more agile than before. Long-lasting change programmes or IT projects can no longer be the norm. Projects – and their ensuing benefits – need to be delivered faster and in a more controlled and professional way, perhaps making greater use of third-party expertise to accelerate delivery.

These are just some of the insights into the changed world of banking that stem from a Fujitsu study undertaken during summer 2012.

*55 CIOs within leading UK retail, investment and wholesale banking institutions were interviewed.**

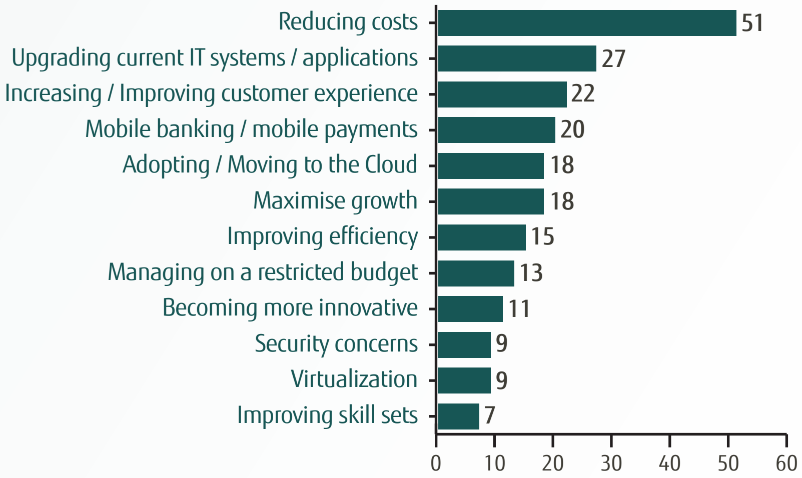
*This independent study was managed by Coleman Parkes Research on behalf of Fujitsu and set out to provide supporting evidence of the core challenges and changes taking place in the financial services industry. The study looked at the UK financial services industry's: Top business priorities for the future, issues around cost management and control, and new emerging technologies and channels and their future impact.

Top priorities until 2015

When put on the spot and asked to state the top priorities for the organisation between now and 2015, it is probably not too surprising to see that over half of the financial institutions interviewed mentioned reducing cost. This is a particularly "hot topic" for those in the retail banking sector. Key strategies by which the banks believe costs might be lowered include:

- Exploiting cloud based technologies
- Improving the overall IT landscape
- Looking to become more agile across the banking operations and streamlining core processes to improve the customer experience

Figure 1: Top 3 priorities for the next few year



However, at a time when financial institutions recognise the importance and need to cut costs, they are also well aware of upcoming pressures which will increase expenses. These include:

- **Upgrading the current IT systems and applications.** At Fujitsu, we expect banks to need better methods of gathering and reporting data. "Big data" will be a key theme, as banks grapple with the technical challenges of analysing and quickly reporting very large amounts of information, often for regulatory and risk management reasons. Similarly, we expect the 'Message Centre' – that dedicated web portal ideal for secure communication between bank and customer – to grow in popularity, primarily at the expense of e-mail. This will promote a move to new applications and maybe a removal of the reliance on all legacy systems. Applications need to change to meet both internal and external customer demand and expectation.
- **Increasing/improving the customer experience.** This is essential to the ongoing success of the banks. The move to or increased integration into exiting distribution channels of mobile banking, improved relationship management, greater branch automation and streamlined application processes underpinned by enhanced technologies, will all have a positive impact.
- **Mobile banking/ mobile payments.** This is seen to be critical to the development of the industry. Mobile is suitable for two areas in particular – fraud prevention and marketing to customers. At Fujitsu, we fully expect to see banks seek and deploy a single set of technologies which allow mobile banking solutions to be fully integrated with e-banking and payment/authentication solutions – something akin to what has been available in Japan for several years. We also think that retail banks will need to become familiar with sharing their expertise with others in the supply chain or risk being dis-intermediated.

Cloud computing as a key enabler of change

Financial institutions need to focus on delivering operational excellence. While the onus is on getting their financial houses in order after (what Americans call) the 'Great Recession', financial services organisations now have a legal requirement to boost their capital reserves to further protect themselves against risk and the possibility of their, or their competitors', future failure. Also, Basel III is reported to be considering limiting an organisation's ability to fund investment through debt. So what does this all mean in terms of practical change? Simply, that banking organisations need to become more operationally streamlined. Efficiency, and maximising the use of technology such as the cloud, is paramount in achieving returns expected by investors.

As we see later in this report, the importance of adopting the cloud should not be underestimated. This is a trend already well underway – for example, National Australia Group embarked on its cloud journey back in 2009, reportedly building an internal private cloud with an infrastructure-on-demand platform which will allow up to 30 smaller data centres to be consolidated or retired. In Spain, BBVA has enabled its 110,000 employees to use a wide range of enterprise software located in the cloud for internal communication.

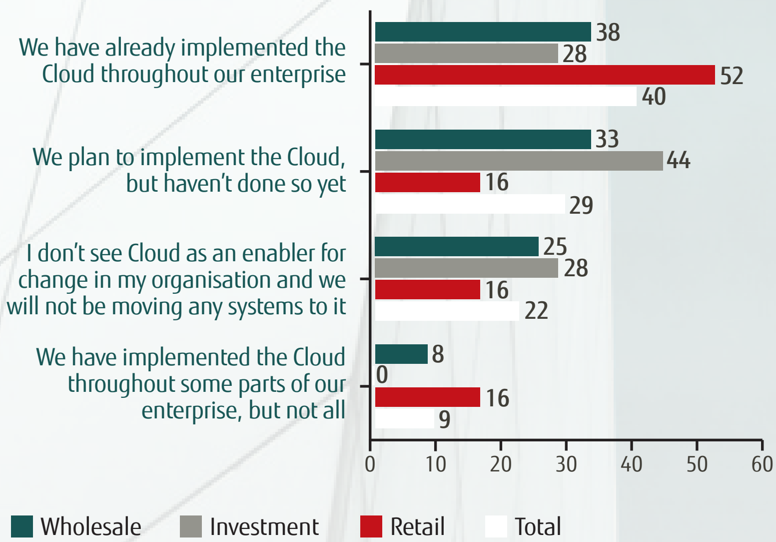
There is strong evidence that cloud based technologies will be used across all areas of the business amongst UK financial institutions. When questioned, only 29 per cent of all UK banks and only 16 per cent of retail institutions do not see the cloud as an enabler for change.

The focus for cloud computing activity will be on key marketing and core business functions to drive efficiency such as:

- Marketing processes/systems (79%)
- Internal knowledge based systems (79%) to leverage the vast amount of information circulating around the business and underpin faster decision making
- Loan processing (77%)
- Credit card processing (70%)
- Mortgage processing (64% - but with a clear and obvious focus in the retail banking sector)

The impact will be far greater in the retail banking sector, driven by the focus on marketing and loan based functions. But investment and wholesale banks will implement the cloud to drive efficiencies in core IT application and infrastructure areas.

Figure 2: Cloud computing as a key enabler of change



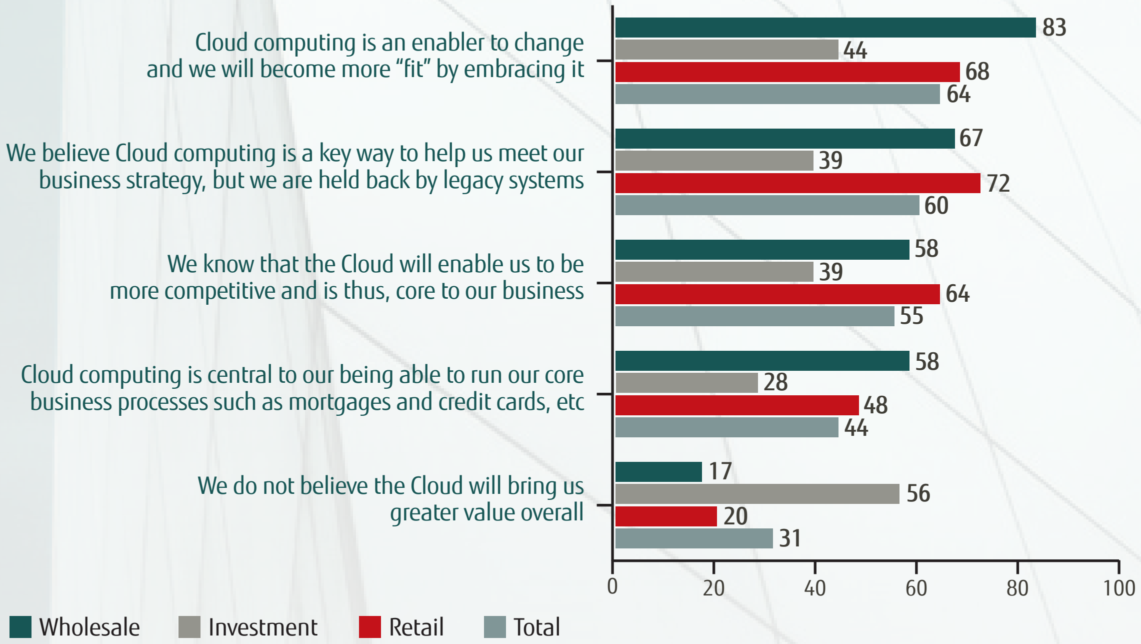
Impacts of cloud computing

The one quarter of organisations that cited the need to leverage legacy systems as a key reason not to move to the cloud need to take care. Legacy systems remain a drain on financial, technological and human resources. Few organisations will move legacy systems to the cloud rapidly, particularly those that hold customer data – by their very nature, such systems are complex, mission critical and highly integrated across the whole business value chain. But placing new applications in the cloud is where quick wins can be made. The cloud offers the most cost effective, operationally efficient way to develop and launch new applications in a secure manner. Time to market is essential, as well as operational efficiency, and the cloud has been seen to allow an organisation to bring applications and services to market much more quickly. To meet the key banking sector need of operation excellence, maintaining legacy systems in their current environment would seem sensible – but always with a longer term view to implement change. Using third-party support to manage the applications and drive economies is also a key option for many banks.

Further evidence of the impact of the cloud on operational efficiency is seen by the fact that within the survey 64 per cent of financial services organisations agree that "Cloud computing is an enabler to change and the business will become more fit by embracing it". This is of greatest importance to retail and wholesale banks . In addition, three in five firms (72 per cent in retail banking) also agreed that "they believe cloud computing is a key way for their organisation to meet its business strategy, but it is held back by legacy systems".

Retail banks look set to exploit the cloud for business efficiency far more than investment banks, reflecting the end-customer focus of the sector, and the expectations that those end customers have, regarding the level of service and channels through which to carry out their banking needs. Investment banks seem the most reticent about using the cloud, with 56 per cent saying that they do not believe that the cloud will bring greater value overall.

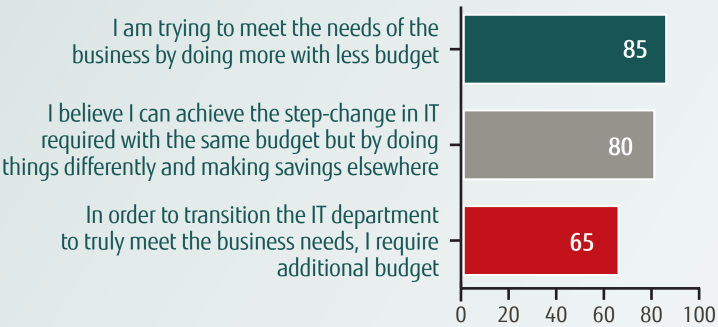
Figure 3: Impacts of cloud computing



Cost reduction and strong management is critical

Leveraging the IT budget for maximum gain is fundamental in times of austerity. The term "doing more with less" has never been more appropriate. 85 per cent of companies in the study agree that the IT team is trying to meet the needs of the business by doing more with less. So, the need to look at new cost effective technologies becomes ever more important. 80 per cent of our respondents believe they can make the step changes required in IT with the same budget but by doing things differently and creating operational savings elsewhere. Knowing what to do, when to do it and how to implement decisions efficiently will require third-party expertise as banks remain resource-constrained. This would point to a change in the way the IT infrastructure is managed and would help understand why 90 per cent of financial institutions are looking at the cloud be it internal or external for applications; 85 per cent for IT infrastructure and 79 per cent for other applications teams.

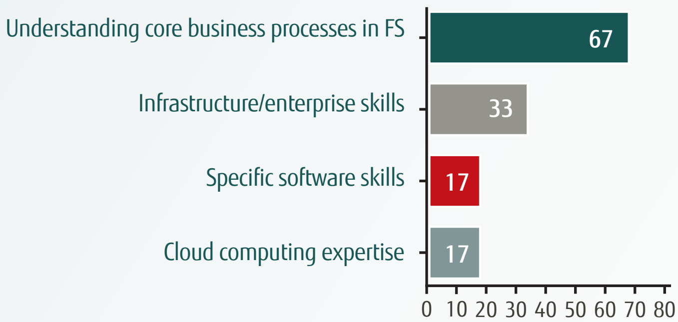
Figure 4: Agreement with key statements regarding IT Budgets. % agreeing only



Looking at alternative IT infrastructure scenarios such as cloud or utility computing will enable IT leaders to free up scarce financial and technology resource to meet the additional needs of the business. As reported in the study, to meet any skills shortfall, two thirds of financial institutions will seek resources from third party or outsource providers. Given the specialised skillsets required for truly effective mobile banking and cloud integration, it seems likely that financial services organisations will find that current skills are not adequate. Life is certainly going to get tougher and banks are going to have to do more with less. They will need to harness efficient partnerships with third-party providers to drive down costs and increase operational efficiency. Third-party partners can provide new ways of looking at IT and service delivery – all with reduced costs.

The skill most in demand from third-party providers across all of the sectors of the industry was said to be the ability to understand core processes in financial services. For any change programme to be successful and to provide rapid business impact it is essential that the skills of the team deployed are sufficient and centre on the core processes. One third of institutions seek enterprise/infrastructure skills and some specific software skills.

Figure 5: Skills most required

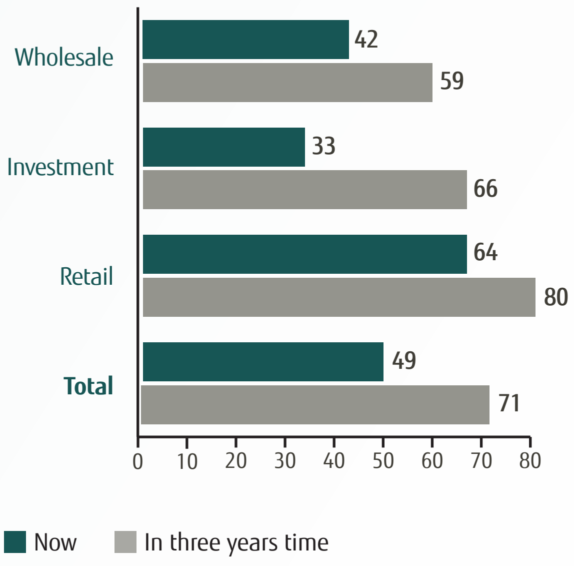


Mobile Banking - A key means to grow distribution and revenue

Mobile banking offers the financial services community, especially the retail banks, the opportunity to increase revenue, meet customers' expectations and underpin investor returns.

The crisis over the last few years and the ongoing poor external press for the financial services sector - for example, payment processing accidents, PPI mis-selling and the furore over bankers' bonuses - has meant that customer loyalty has been tested to the full. Financial services organisations need to focus on core activities that will drive and increase customer loyalty, help add new customers while also keeping acquisition costs to the minimum. There is little doubt that customers are becoming more and more demanding. They want to engage with a retail bank across multiple, integrated channels – but with a common and high quality experience. Emerging channels like online and mobile allow for instant, on-the-move banking and more and more interactions with a retail bank. Self-service is set to become the norm. Mobile banking now offers companies the most important route to customer acquisition and satisfaction since the move to online. Those organisations that embrace mobile application development will be sure to win in the long run – but speed of movement is critical, especially in the mobile arena where rapid technological development is the norm.

Figure 6: Importance of Mobile Banking now and by 2015.
Proportion Saying Important



The results from the survey clearly indicate the importance of mobile to the financial services sector. Forty-nine per cent of organisations mentioned that mobile banking is important to customers now and 71 per cent believe it will be important to customers in three years' time. 64 per cent of retail banks see mobile as important for customers now and this will grow to a very high 80 per cent in within three years. Twice as many organisations in investment banking also think mobile banking will be important in 2015 compared to now. So things are set for dramatic change as banks seek opportunities for increased growth and customer interaction/retention. Rapid change is not a common theme for the banking community, so the use of third-party expertise and services is a core opportunity to drive through the strategic change that is required in a relatively short period of time.

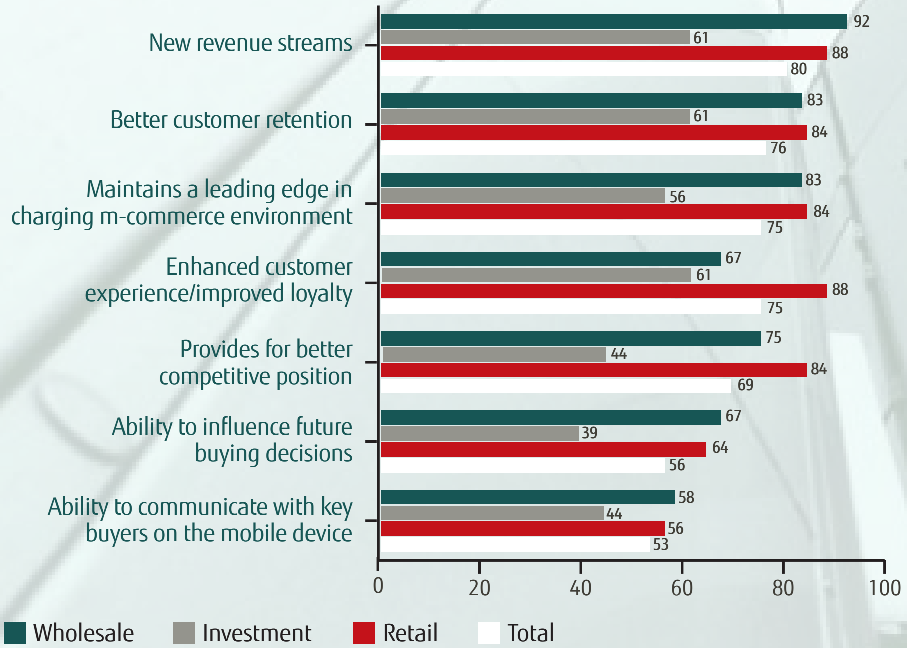
Mobile meets rapidly changing customer demand

72 per cent of retail banks, compared with only half of wholesale banks, report that they have an active, clearly defined strategy for mobile banking including mobile payments. The one quarter that have yet to move the path will find it hard to meet customer and investor demands and need to implement a change as rapidly as possible.

Mobile banking clearly affords the banking community a means to grow distribution while also meeting rapidly-changing customer demand. By way of confirmation, the survey found that a key benefit of the move to mobile banking is that new revenue streams can be opened up. 80 per cent of the financial institutions in the study said that mobile banking affords new revenue streams and a further 76 per cent said that customer retention is improved. Three quarters also cited a key mobile banking benefit as maintaining a leading edge in the changing m-commerce environment. All of these are focused on the key priorities for the sector in the short term.

A key complexity in the mobile banking arena is knowing who owns and is driving the development. Just over half of the market (55%) believes that a combination of the players in the sector - the retail banks, telecommunications service providers, retailers and network providers - are all influential in the market development. One quarter of the survey respondents firmly believe that the retail banks are the most influential in driving the development of mobile banking – wholly appropriate given that the retail banks have potentially the most to gain. What is surprising is that the figure is only one quarter.

Figure 7. The key benefits of mobile banking



Leading edge solutions, need leading edge skills often not found inhouse

A major issue for the retail banks is how they roll out the mobile applications to meet their objectives. Almost half of banks are seeking help from either current or existing partners – the rest feel they can go it alone. To create the speed of change that mobile banking demands, third-party and domain expertise would appear a prerequisite. Retail banking IT teams are already stretched to the full with legacy systems, meeting additional regulatory requirements and doing 'more with less' budget, so how they aim to realistically meet the demands of mobile banking has to be questioned.

Based on the survey, the core barriers to the successful implementation of a mobile banking solution centre on:

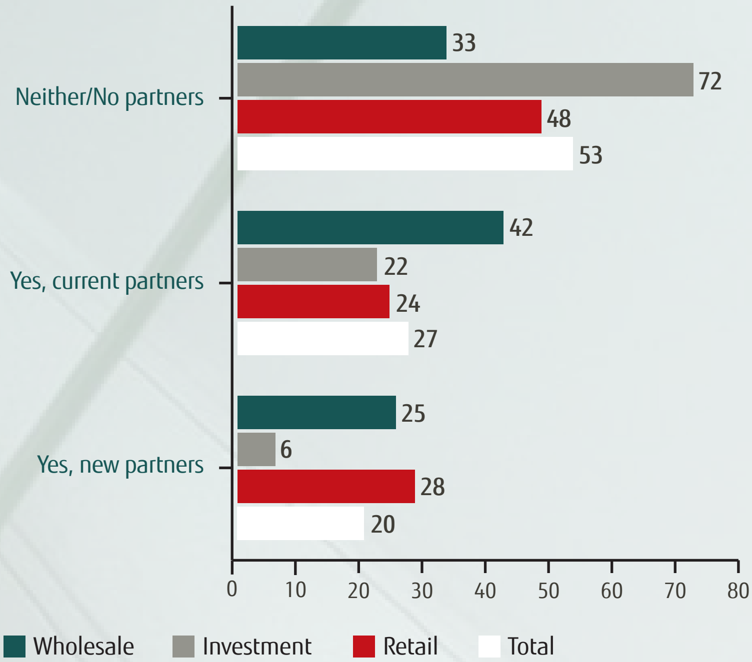
- Security (64%)
- The cost of deployment (42%)
- Retailers (35%)
- Absence of customer demand (33%)

Security will always be an issue and retail banks in particular need to focus on working with providers who help overcome this key barrier. By its very nature, mobile banking takes financial activity out of its comfort zone. Security is vital and solutions exist to ensure that operationally the activity is as secure as online banking.

Deployment costs are clearly a concern, but selection of the right partner and avoiding trying to do too much in house will help reduce those costs. History has shown that internally-developed solutions are notoriously delivered late and often with bugs. Development teams are under greater pressure to provide high quality applications faster with less budget and resource. This is where external help is important and selection of the right partner critical.

The retailer being seen as a barrier is very interesting. Mobile banking exposes retail banks to the whole retail ecosystem and drives partnerships that are quite unfamiliar to them. Ownership of the interaction is at the centre of the debate. If the retail bank is going to own the interaction, transaction and application then it needs to take the lead.

Figure 8: Assistance with the development and roll out of Mobile Banking



Agility is key to keeping up with regulatory changes and growing customer expectations

A long term goal for the financial services sector has been the desire to improve business agility. Legacy systems abound, but the move to becoming more agile is essential in order to meet changing regulatory needs and growing customer expectations. But banks are often like super tankers – not best suited to moving quickly. Regulatory needs, historic IT environments, fear around security, complex applications and fear of the unknown all conspire to prevent the agility required to meet the changing business and consumer environment.

Business agility embraces the entire organisation. What are the key priorities? How quickly can the IT team respond to changing business needs? Are the resources available and at hand to deliver the change required? And can this be done cost effectively? And with the right technology?

Over the next few years, change, the ever constant, will be more challenging to deliver. Financial institutions need to embrace technology and partnerships to generate the required agility so that IT can be scaled up and down to meet the business' needs rapidly, account applications can be processed in hours not days and loans can be provided when the customer needs them.

Conclusion

Financial institutions in the UK find themselves at a pivotal time. They need to reshape their ICT to reshape their business. New regulation coming on stream between now and 2014 will demand that retail banks and financial services organisations really get their houses in order. To meet these needs, IT will need to be fit to change. Flexibility, more analytics and better focus on the needs of the business and customers will underpin success. Solving platform complexity will be important.

The UK consumer market for financial products is changing. The basic tenants of demand are threatened. At one end of the age spectrum, many students are entering the workplace carrying debt which will limit their ability to purchase financial products while, at the other end, those planning for retirement are finding that they will have to save more, as investment returns diminish and life expectancy extends. The impact will be that we will all feel "less rich" for some years to come. And when we carry heavy commitments already, our ability to fund further borrowing or investment can only be limited. The landscape is changing and banking firms need to respond rapidly. Traditional revenue streams will change. The focus must be on the "new". New channels. New customers. New services. New technology. New ways of working. New returns.

Customer retention in light of changing customer attitudes and needs is a key area in which any financial organisation must focus. The IT team, through its own skills and resources or by way of third parties, needs to exploit the key technologies such as cloud computing, mobile banking and mobile payments to ensure that the business grows and meets the changing demands and needs of ever more demanding customers. Cloud computing will allow the speed of change as the focus will be on applications rather than infrastructure. Partnerships and third-party relationships will assist and provide well-needed skills and resources – plus the ability to change rapidly.

But fundamentally, IT departments and the financial institutions themselves need to accept that they need to change in order to ensure business success. Legacy has to be managed and controlled . The focus must move to innovation, not keeping the lights on. Scarce IT resources must be channelled effectively and efficiently into business growth areas or where costs can be saved. Financial organisations need to reshape their IT to reshape their business. Those that do stand the greatest chance of success, built on a platform of understanding the internal and external constraints, customer requirements and the technology available for success.

FUJITSU

Tel: +44 (0) 870 242 7998
Email: askfujitsu@uk.fujitsu.com
Ask Fujitsu Ref: 3399
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uk.fujitsu.com