

Knowledge@Wharton – Wipro Future of Industry Series

# Moving towards the Digital, Omnipresent, Transparent and Profitable Banks of Tomorrow



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Banks across the world are facing multiple pressures on their profitability with tighter regulatory requirements, changing customer preferences and increased competition. However, technology can help them overcome those pressures. Digital tools allow banks to offer new services, grow in underserved markets, achieve omni-channel presence, automate processes to lower costs, be more transparent to customers and regulators, lower risk and combat fraud. Rajan Kohli, head of the banking & financial services business at Wipro Technologies and Mauro Guillen, Wharton professor of international management, lay out the digital road map for banks in this “Future of Industry” series white paper, produced by Knowledge@Wharton and sponsored by Wipro Technologies.



Banks are facing a “perfect storm,” says Rajan Kohli, head of the banking & financial services business at Wipro Technologies. The profile of the retail bank customer is changing, business opportunities are shifting to the emerging world and profit margins are under strain. Tighter regulatory requirements

in disclosures and capital adequacy after the 2008 financial crisis means banks derive less profit from products that previously brought high revenues and margins. At the same time, traditional bank products are becoming commoditized, further constraining profitability.

Kohli notes that competition among banks has intensified with shifting customer loyalties. The pain of shifting from one bank to another was “very high in earlier years,” when customers tended to patronize one bank for all their financial

services. Today, they have other avenues to send or receive money or get financial advice, he explains.

The cost/income ratio of banks — the ratio between operating expenses and operating income — at present averages 65. Pointing out that a lower ratio means higher profitability, Kohli says: “No bank could be profitable at that level. The best banks have the cost/income ratio closer to 40-45.”

According to Mauro Guillen, Wharton professor of international management whose research specialties include banking strategies, in the developed markets, the biggest challenge for banks is higher capital required by regulators. The other challenge he sees is the demographic shift in banks’ customer profiles. “On the one hand, more and more people are getting into the 60 or 70 age group and the population is aging. At the same time, you have these new young consumers or the millennials, and they are very difficult to keep entertained and focused. They are hyperactive and want innovation all around.”

Guillen finds emerging economies like China or Russia or Mexico becoming “very quickly like advanced markets,” with banks facing similar challenges. However, in other emerging markets like India, Brazil, Pakistan and Indonesia, the challenges are around bringing more people into the banking system and serving smaller businesses.

## TECHNOLOGY AS A PROFITABILITY LEVER

Digital technologies around mobility, cloud platforms, data analytics and others promise to change the way customers interact with banks, says Guillen. They also help banks rethink their physical branch strategy, “which has been their cornerstone for retail banking for a long time,” he adds.

Many banks are automating labor-intensive processes to cut labor costs. For example, a bank might replace live calls at its customer call centers with online chat windows. At a typical retail bank with 100 to 120 processes, automation can help eliminate the work of up to 40% of the operating staff and save 20% to 40% of wage costs, says Kohli. One top-tier retail bank in Europe was able to lower its cost/income ratio “from about 55 to the upper 40s” largely through simplification of processes over three years, he notes.

According to Kohli, many banks are also using digital tools to “embed” themselves in business processes. For example, while “mobile wallets” allow customers to pay for their purchases from their smartphones, banks are making it possible for them to receive and track loyalty rewards and store coupons. Meanwhile, technology-enabled processes help them “cross-sell” (other products) and “upsell” (more expensive products) to existing customers, he adds.

Guillen says banks still need clarity on how best to use digital tools. For instance, one debate among banks is about whether their customer

interactions should be real time or not. According to Guillen, smartphones or mobile Internet platforms hold big promises for banks, but “they cannot exist in isolation of the other channels.” He advises banks to integrate operations across different channels and “make sure different parts of the bank talk to each other and share information.”

Kohli says that such integration is occurring, and banks are working to offer customers “omni channel” experiences or seamless interactions across branches, online platforms or call centers. He notes that in earlier times, banks faced a “loss of transactions” because a customer call center was not equipped with the requisite information to continue a discussion that a customer may have begun at a branch or online.

Elsewhere, business intelligence gained from data analytics is helping banks grow their relationships with corporate customers. For example, a bank can help a corporate client reduce its employees’ travel and hotel expenses by providing analytical reports that highlight spends higher than the industry average, says Kohli.

## ENGAGING WITH EXTERNAL PARTNERS

According to Kohli, in their digital journey banks work with external partners expecting them to “co-innovate,” bring ideas and build use cases. Banks today are willing to pay for business outcomes, instead of paying for “time-and-materials,” he adds. For instance, a bank may contract with an external provider for online account origination and pay for the outcome, or for every new account opened. Kohli points to Square, a San Francisco-based firm that offers mobile payment services and uses JP Morgan Chase to process card transactions. “That is true business outcome-based pricing where JP Morgan can charge Square per transaction,” he says. Moven, a “new age, virtual bank” in the

U.S., has no branches, but uses a large banking services firm to oversee its back-end processes, paying a fee for each transaction. Such providers of external services make up the new ecosystem for banks in a digitally enabled world, Kohli adds.

Regulatory compliance is another area where technology can help banks, says Kohli. For one, it enables consistency in data reporting and real-time storage and retrieval, helping banks evaluate risks better. Secondly, it helps banks gain new insights by layering external information on internal data.

Technology also allows increased transparency of bank operations, helping with both regulatory compliance and offering customers real-time information on accounts, says Kohli. For example, if there is a dispute over online transactions, a bank could offer updates to customers on the status of their cases, thereby avoiding calls to customer support centers or branch visits. Also, analysis of customers' transaction patterns could help the bank identify potentially fraudulent activity and reduce risk.

## RETURNS ON TECHNOLOGY INVESTMENTS

Kohli cites a recent survey in which 70% of the banks said investments in such tools met or exceeded expectations. However, Guillen says banks that use mobile channels purely for informational purposes or for relatively simple transactions are seeing limited gains. The gains

can be bigger if they are also able to reduce the number of customer calls or branch visits.

According to Guillen, banks still have to figure out "what works and what doesn't work" with digital technologies. "There are some good experiences but there are also some banks that earlier poured a lot of money into these technologies and haven't been able to get a lot of mileage from them," he notes.

In some cases, the gains are about personal safety. Kohli talks of one bank that recently wanted to hold its annual shareholder meeting in the Middle East. Since the top leadership of the bank was to travel to the region, it wanted "to put a number to the risk and track it." It achieved that with a geopolitical risk model using data on external political and natural events risks in the region. (Kohli declines to identify the bank or say what it eventually decided.)

In identifying and mitigating risk, Guillen says banks will find analytics social network data useful. "You are known for the company you keep," he says, adding that banks would have to factor in privacy, security and ethics concerns. "The old banking model relied a lot on relationships to the point that 60 years ago you wouldn't be able to get a loan without somebody putting in a good word for you. In a funny way, we are going back to the roots, but in a radically different way – now we have the potential to analyze big data."

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