Knowledge@Wharton

WIPRO
Applying Thought

July 2013

http://www.wipro.com | http://knowledge.wharton.upenn.edu

Knowledge@Wharton – Wipro Future of Industry Series: Financial Services

In a Tough Business Environment, Technology Opens New Doors of Growth for Financial Institutions

Knowledge@Wharton – Wipro Future of Industry Series: Financial Services

In a Tough Business Environment, Technology Opens New Doors of Growth for Financial Institutions

Worldwide, financial institutions are still recuperating from tighter regulations and customers continue to be wary in the aftermath of the financial crisis and the resulting economic downturn in the U.S. and Europe. However, experts wonder if they could have used smarter technologies to conform to regulations, win back consumer trust and deepen those relationships using business analytics, social and mobility platforms. In this white paper, which is part of a "Future of the Industry" series, Knowledge@Wharton and Wipro Technologies explore how technology could help financial institutions.

The year 2012 ended on a somewhat optimistic note for the financial services industry. As companies try to achieve profitable growth, they face two major challenges: catching up with rapidly increasing regulatory mandates and meeting the "new normal" customer demands. Soumitro Ghosh, senior vice president of finance solutions at Wipro Technologies and Mauro Guillen, Wharton professor of international management, analyze these challenges and the solutions that technology offers to overcome them.

Ghosh lists the areas financial institutions must focus on: One, change the cost curve through business and process simplification. Two, rebuild customer trust, by being best in class in whatever segment or geography they operate. Three, invest in analytics to not only respond to risk but also understand the new "digital customer" and use the insights to make better business decisions. Four, rethink how technology can help them deliver a better customer experience across channels and markets. Finally, all these have to be achieved in a tightening regulatory environment where there is still a lot of catching up to do on risk management and compliance. To enable these, they must create stronger governance and collaboration models with their outsourcing partners.

MANAGING TIGHTENING REGULATION

"The biggest constraint for companies in the financial services industry is the prospect of more regulation," says Guillen. "It is a very difficult issue that all banks will face." In addition to new rules, he expects banks will also face much more scrutiny from regulators in terms of dubious money flows because of terrorism, illicit trade, etc.

Guillen refers to the sweeping changes proposed recently by the U.K.'s Independent Commission on Banking, which resulted in a draft bill in October 2012 aimed at promoting financial stability and competition. The proposals require U.K.'s lenders to create separate subsidiaries for their retail operations of deposits, lending and

payment systems, and meet new capital adequacy requirements for each. The idea is to ensure that retail banking can continue undisturbed even if a bank's investment and commercial banking divisions incur losses. The new legislation is expected to be enacted by 2015 and operational by 2019. Ghosh points to the 2010 Dodd-Frank Act in the U.S. as another example of tightening regulatory regimes. Among other things, the act aims to strengthen consumer protection, tackle systemic risks, and ensure increased transparency to restore the trust that financial institutions lost in the aftermath of the crisis.

Guillen sees technology helping banks restructure their balance sheets and corporate governance processes to comply with emerging regulations. The emerging compliance environment will bring "big business opportunities for technology providers," he says. Ghosh offers examples of how technology is helping financial institutions work through the "process changes" that new regulations warrant. An Indian technology services vendor is providing the framework for a U.S.-based asset management and asset servicing company to comply with the Dodd-Frank Act. The same vendor is also helping a leading insurance company in the U.K. recast internal systems to meet new solvency regulations.

Higher capital requirements and new compliance reporting standards have eroded the discretionary budgets at many banks and insurance companies, Ghosh notes. Here, technology can help with cost efficiency and optimization. They could convert fixed costs into variable costs with tools such as cloud computing, he says. "Pay-as-you-drink" is the classical commercial model defining that trend of variabilization, he explains. "When times are good, I can direct services that can scale up. When times are not so good, I can scale down."

According to Ghosh, financial institutions need to reduce their "business-as-usual" costs so that they have money left over to spend on discretionary projects. "Most banks and insurance companies have grown through mergers and acquisitions, but they have not simplified their back offices," says Ghosh, citing undone work. Another ripe area for cost efficiency at financial institutions is IT infrastructure management, he says. Most financial institutions have so far not outsourced their IT infrastructure requirements, although they have tapped business process outsourcing services, he adds.

TAPPING UNDERSERVED MARKETS

Technology could also help in streamlining back-office operations, which have become highly concentrated thanks to the wave of mergers and acquisitions, especially in the banking industry. "The banking industry in the U.S. was so polarized that 80% of it used to be in the hands of 10 banks," says Ghosh. However, recent M&As have consolidated those top 10 banks into six: JP Morgan Chase, Bank of America, Citibank, Morgan Stanley, Goldman Sachs and Wells Fargo.

As the top six banks account for 70% to 75% of the total IT spending, most service providers gravitate towards them, says Ghosh. However, the IT spending of the Tier-2 or Tier-3 U.S. banks are also significant, but this market remains relatively untapped. Variabilization offers technology providers an opportunity to serve smaller banks, he adds. A Tier-2 or Tier-3 bank cannot compete with a Tier-1 bank, because it lacks the larger institution's scale of operations, making its cost per loan origination or loan servicing almost three times higher, he explains. By using technology for loan origination and servicing, a Tier-2 bank can slash its loan origination costs until they are equal to or lower than those at a Tier-1 bank, he adds.

Large, Tier-1 banks could also use technology to create a unified process covering investment banking, asset management and asset servicing, where many processes are typically duplicated. One emerging opportunity many financial institutions are still sizing up is cloud computing, which allows them to source technology needs from so-called clouds in a pay-as-you-use model.

NEW GEOGRAPHICAL MARKETS BECKON

Emerging economies offer big growth opportunities for financial institutions. Ghosh notes that "one big lesson" from the recent economic downturn was that most U.S. banks and insurance companies were overly dependent on mature markets. The downturn has forced many financial institutions to go global and expand their footprint in emerging economies. "To help them globalize, and globalize quickly, they have to set up their operations infrastructure fairly quickly," he adds. Much of such work involves extracting flexibility from legacy technology platforms.

Technology providers can help financial institutions set up their infrastructure on a turnkey basis in a new location. "It is like insurance-in-a-box or a bank-in-a-box," says Ghosh. While the bank focuses on sales, marketing and business development, its IT services vendor runs back-office operations. Similarly, technology providers could help set up a local insurance platform in a new market that connects "to the mother platform at headquarters," adds Ghosh.

RE-ENGAGING CONSUMERS WITH TECHNOLOGY

Unfortunately, customer satisfaction in the financial services industry in mature markets like North America is lower than that in industries like telecom and breweries. Trust and simplicity are critical for financial institutions to recapture lost customer loyalties and deepen those relationships. However, they must know when to push a product or service and when to hold back, Ghosh cautions. Here, technology such as data analytics can help them achieve a deeper understanding of customer sentiments. It also helps in providing customers a seamless experience across multiple channels. For example, a customer may start a transaction online, call into a help desk or call center for assistance and finish the process by visiting a branch. Guillen sees technology as a competitive tool, too. Increasingly, financial institutions would boost their offerings from plain vanilla products to bundled products and services, such as those that promise security or financial freedom. "It would be a powerful differentiator," he says.

Mobile platforms will be crucial in providing these differentiated services, says Ghosh. For example, insurance examiners inspecting an accident site can immediately upload photographs and their assessment to their central claims processing department, which can then expeditiously approve a claim and release the payment. Such a process makes customer service "simple, fast and agile" and reduces costs for the insurance company.

Similarly, wealth management firms could use mobile devices and tablets for marketing. An agent could visit a customer at home or office, make presentations on a tablet, design an investment portfolio, render a competitive analysis of those products or services and so forth, says Ghosh. "It's a real game changer in the way business is conducted."

Banks are already beginning to use mobile platforms imaginatively, Guillen notes. For example, many banks notify credit card customers on their cell phones each time a transaction is

put through. Unrecognized transactions could flag potential fraud, he says. In addition, "mobile wallets" will soon be core to financial services, although security issues need to be fixed for them to become mainstream, adds Ghosh.

Mobile platforms could also help financial institutions penetrate underserved markets such as in Africa and Latin America. A global bank is implementing mobile technologies in a big way across its entire South American market including Brazil, Mexico and Argentina, says Ghosh. A key requirement is the "localization" of those mobile transactions, which includes facilitating them in the local language and compliance with local banking regulations.

Social platforms such as Facebook, LinkedIn and Twitter also help banks acquire new customers and sell more products to existing customers. "On both of those fronts there could be terrific gains," says Guillen. These platforms change the very nature of business interactions internally and externally, making them richer, more personal and relevant to the parties involved. Ghosh details the gains: The increased communication improves efficiencies by reducing misunderstandings. They also increase accountability because service quality becomes more important when it is personal, and builds customer loyalty since the offerings can be tailored to specific needs.

However, Guillen advises banks to go cautiously with social media platforms. "Right now banks in particular don't have a great reputation. In addition, social networks are built on trust and acquaintances. They need to rebuild that reputation prior to using social media in a big way. Otherwise it could backfire."

ANALYTICS FOR UNDERSTANDING CUSTOMERS, RISKS BETTER

Data analytics helps financial institutions boost performance on several fronts. They can obtain a "single customer view" of their overall exposure to each customer who may have bought more than one product or service. It also allows them to understand their customers' preferences better, opening opportunities to win more business from them. Analytics improves risk management and fraud prevention, and helps in regulatory compliance. Since regulatory compliance requires spending on IT, businesses are looking to leverage those investments for multiple purposes, says Ghosh. For example, a fraud database may have value for both marketing and compliance purposes.

Fraud detection is one area that can benefit enormously from analytics. "Between 5% and 6% of a company's profit can get eroded by fraud," says Ghosh. "If you can control even half of that, you can add 3% to the bottom line." Two insurance firms – one in the U.S. and one in Europe -- have seen analytics reduce fraudulent claims by 60% and 40%, respectively, he adds.

Technology can also improve internal efficiencies by providing greater visibility of outcomes, and Ghosh explains how. For example, one bank found that simply reporting the impact of fee-waivers granted to customers across its commercial loan officer corps resulted in reducing lost fees. That transparency was sufficient to incentivize its officers to stop fee waivers. Pricing also gets more efficient. For example, an insurer armed with analytics to understand the claims patterns of its customers could decide on the appropriate premium while writing new policies.

AGENDA FOR ACTION

While technology promises gains on many fronts, financial institutions and regulators have to be cautious in some areas and perk up in others. Siloed systems still proliferate and persist in many financial institutions, says Ghosh. They need to invest more in capturing data on customer behavior and their operations. However, as they increasingly use digital media, they also have to invest in security tools to combat fraud, says Guillen. "The biggest issues with the Internet and all its applications are fraud and identity theft." In meeting compliance requirements, they need to integrate risk management into their operational processes, invest in employee training and build stronger ecosystems with vendors. According to Ghosh, regulators pushing new requirements must strike a balance between consumer protection and the need for growth and remaining competitive. "It should not become so restrictive that it actually chokes growth, because then it becomes a vicious cycle, and you will never get out of the downturn," he says.

This article was produced by Knowledge@Wharton, the online business journal of The Wharton School of the University of Pennsylvania. The project was sponsored by Wipro Technologies.

www.wipro.com http://knowledge.wharton.upenn.edu

Founded in 1881 as the first collegiate business school, the Wharton School of the University of Pennsylvania is recognized globally for intellectual leadership and ongoing innovation across every major discipline of business education. With a broad global community and one of the most published business school faculties, Wharton creates ongoing economic and social value around the world. The School has 5,000 undergraduate, MBA, executive MBA, and doctoral students; more than 9,000 annual participants in executive education programs; and a powerful alumni network of 91,000 graduates.

ABOUT KNOWLEDGE@WHARTON

Knowledge@Wharton is the online business analysis journal of the Wharton School of the University of Pennsylvania. The site, which is free, captures relevant knowledge generated at Wharton and beyond by offering articles and videos based on research, conferences, speakers, books and interviews with faculty and other experts on current business topics. The Knowledge@Wharton network — including Chinese, Spanish, Portuguese, Indian, Arabic, Israeli and High School editions — has more than 2.1 million subscribers worldwide.

For more information: http://knowledge.wharton.upenn.edu

ABOUT WIPRO LTD.

Wipro Ltd. (NYSE:WIT) is a leading Information Technology, Consulting and Outsourcing company that delivers solutions to enable its clients do business better. Wipro delivers winning business outcomes through its deep industry experience and a 360 degree view of “Business through Technology” - helping clients create successful and adaptive businesses. A company recognized globally for its comprehensive portfolio of services, a practitioner’s approach to delivering innovation, and an organization wide commitment to sustainability, Wipro has a workforce of 140,000 serving clients across 57 countries. For more information, please visit www.wipro.com.