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Swiss Banking Business Models of the future

Embarking to New Horizons

Deloitte Point of View

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Contents

The banking market in Switzerland is undergoing significant change and all current business models are under scrutiny. Among several universal trends and Switzerland-specific market factors affecting banks and their customers, 'digitisation' is the most significant. In addition upcoming new regulations will drive more changes to business models than any regulations in Switzerland have ever done before.

Deloitte has produced this report, based on extensive research and fact-finding, to assess how major trends and disruptive innovations will re-shape the business of banking in the future.

The report addresses the following questions:

- What are the key trends affecting banks and their customers?

- What are the main innovations that are being driven by these key trends?

- Which scenarios can be predicted for the banking industry of tomorrow?

- What will be the most common business models for banks in the future?

- How should banks make their strategic choice?

This report will not give you definite answers, but it should indicate how to start addressing the question: "Where do we want to position ourselves in the banking market of the future?"

Yours sincerely,

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Lead Author, Banking Innovation Leader

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Consulting Leader Financial Services

Management summary (1/3)

Digitisation as a main driver of change

Banks need to **adapt their business models to key trends and disruptive innovations** that are already having an impact on society and the economy. The **main driver of change is digitisation**. Over half the people in Switzerland now use e-commerce or e-banking, and the numbers are increasing.

Millennials getting into the focus

At the same time the **wealth of millennials** (individuals born between the 1980s and 2000s) **is expected to grow significantly** in the next few years. These are a technophile generation, and banks will need to adapt the services they offer to meet the demands of this important customer segment.

Digital disrupters becoming new competitors

Increasing numbers of so-called **'digital disruptors' are using IT platforms to enter the market for banking services,** although they do not seek to replicate the universal banking model. IT giants such as Google, Facebook, Alibaba and Twitter are developing ways of selling banking apps and services. There are also innovative opportunities in banking, using blockchain technology, robots, biometric security devices and 'gamification'.

Management summary (2/3)

Disruptive innovations will lead to fundamental changes in business and services

Five primary banking functions will be impacted:

- **Payments services** are already experiencing a shift from cash to electronic payments, and to faster and cheaper methods of making transfers.
- The traditional **deposits and lending** business of banks is now challenged by alternative lending methods, such as online platforms for person-to-person (P2P) funding, mobile banking and alternative methods of credit assessment.
- Investors will have better access to **financial advice and investment processes**, as technology develops in areas such as advanced analytics, retail algorithmic trading, social trading and automated investment advice.
- In the financial markets, new information sources and **market platforms** are improving connectivity, and automated trading is affecting market volume, liquidity, volatility and spreads.
- Alternative funding platforms are opening new opportunities for **raising capital** through crowdfunding.

Customer relationship becoming more important

As a consequence of these developments in technology and automation, **alternatives to the traditional one-stop banking model are emerging**. And with the diminishing role of banks as a counterparty in financial markets, customer relationships based on advice and speed of information provision are becoming more important.

Management summary (3/3)

Disintegration of the value chain

Banking has traditionally been an integrated business, with banks providing their services and managing their value chain in-house. With standardisation of IT interfaces for banking services, and other disruptive innovations, we can expect to see **a break-up of the value chain**, creating **opportunities for specialist firms**.

Banks will have to choose which of five business models to adopt

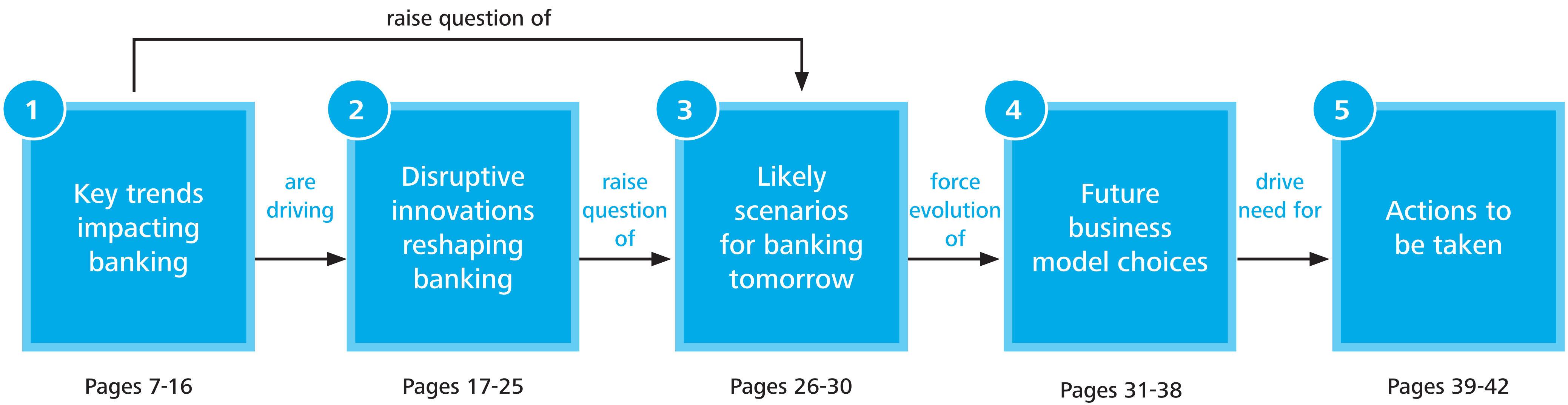
Five main business models to choose:

- The **'transaction champion'** will focus on exploiting economies of scale to deliver low-cost, standardised transactions in partnership with other banks and non-bank providers.
- The **'product leader'** will focus on gaining market share quickly for innovative products, charging premium prices.
- The **'trusted advisor'** will focus on exploiting economies of scope by offering a broad range of products and advisory services.
- The **'managed solution provider'** will focus on complementing the other business models by offering specialised back office services.
- The **universal bank** will need to achieve scale in all their business lines, to minimise costs, and will also need to allocate their resources efficiently.

Strategic choice based on assessment

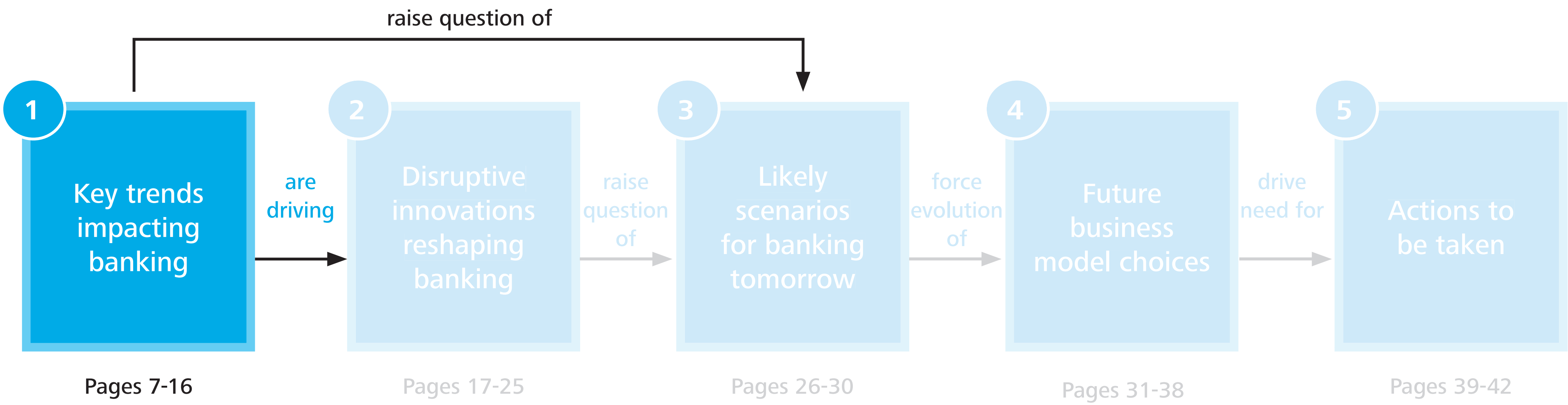
All banks will have to make a strategic choice about which business model to adopt. Their choice should be **based on external factors and internal strengths and capabilities**.

Overview of the report



Chapter 1

What are the key trends impacting the banking industry?



Key trends: Overview

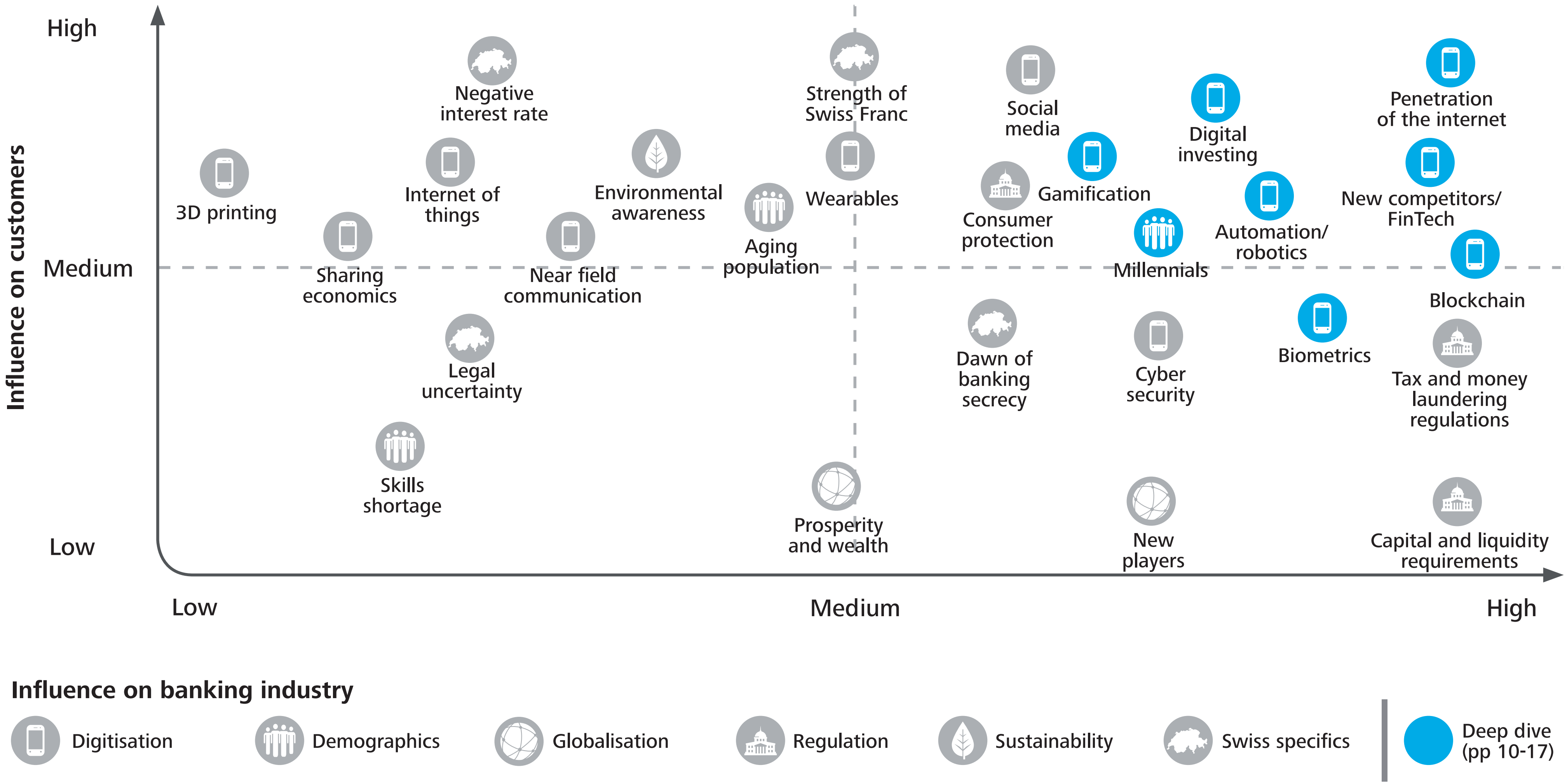
We identified six key trends that are having an impact on banks and their customers

Theme	Key trends
Digitisation	• The increasing global **penetration of the internet** brings along **new competitors** in banking (e.g. fintechs) • New technologies **(e.g. robotics, blockchain)** are changing the traditional banking business model fundamentally • **Digital investing, gamification** and **biometrics** enhance customers’ experience of banking and banking products
Demographies	• The **population growth** in developing countries creates **new markets for banks** – but also a **shift in economic power** • **Ageing of the population**, particularly in industrial countries, **affects client needs** and **saving and spending patterns** • **Millennials** are becoming the most productive generation with implications for client relationships and workforce retention
Globalisation	• **International customers** require increased levels of **advice** and **services** to cope with **cross-border complexities** • **Innovations cross national frontiers** and industry boundaries, leading to closer **convergence of industries** • Globalisation fosters the **creation of prosperity and wealth** in developing markets
Regulation	• **Implementation of regulations** introduced after the financial crisis will continue to be a priority for banks for many years • Extra-territorial application of national laws and regulations increase the **complexity of managing compliance** • Consumer protection rules impact the **cost-to-serve** of certain **client segments**, requiring banks to make strategic choices
Sustainability	• **Sustainability** and **environmental aspects** gain an increased role in the agenda of stakeholders (investors, politics, customers) • Customers become more aware of the **impact of their investment behaviours** on sustainability and the natural environment • **Scarcity of resources** impacts market prices
Swiss specifics	• An Increasing number of initiatives threaten **political stability** and **business friendliness** as competitive advantage • **Economic effects** (strength of Swiss Franc, dawn of bank secrecy, negative interest) impact Swiss banks’ **competitive position** • **Developments in the relationship with major economic jurisdictions** will influence market access for banks

Source: Deloitte research

Key trends: Overview

Digitisation is the main driver of key trends, impacting both banks and their customers

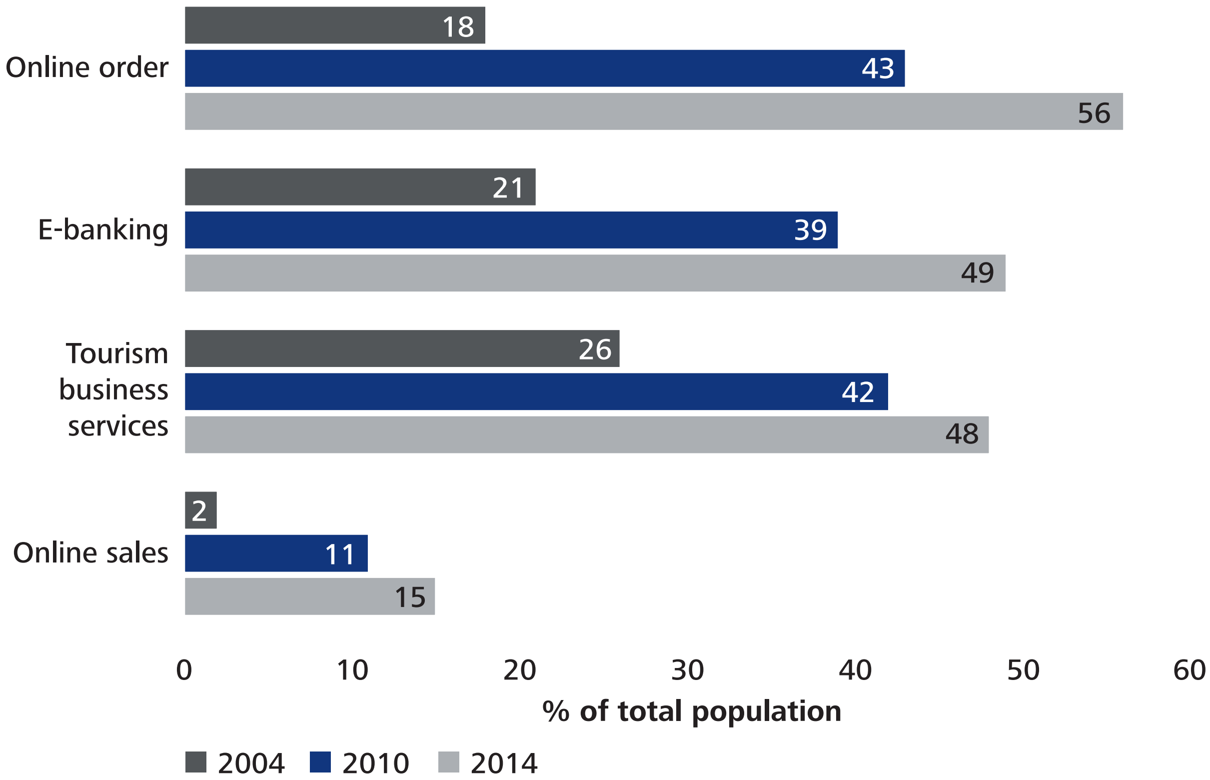


Source: Deloitte analysis, Deloitte (2015) Banking Innovation Series

Key trends: Penetration of the internet

Half the Swiss population are using e-services today, requiring banks to offer easy-to-use payment options and highly usable e-banking solutions

Development of e-commerce and e-banking in Switzerland



Conclusion

- **Over half the Swiss population** ordered at least one item online in a three-month period during 2014. **E-commerce is popular in Switzerland** and is expected to grow further in the next few years.
- A similar trend is visible in the **use of e-banking** with almost half the population making **online payments** or using **online banking services** in a three-month period in 2014.
- With the **emergence of e-commerce**, there is a demand for the **development of easy-to-use payment options**. This will offer opportunities to financial service providers with **innovative and highly integrated solutions** to **gain market share in payments**.

Source: BFS (2014) Omnibus IKT

Key trends: New competitors

Digital disruptors use digital technology to enter the market for banking services and to deliver a more seamless customer experience

Examples of how new competitors are making their way into banking

Digital Wallet Innovation

Google is on the verge of launching a payments API (Application Programme Interface) for use on Android devices that will smooth the way for Android Pay.

Payments via Twitter

Barclays UK has launched peer-to-peer Twitter payments, via its mobile application Pingit.

Smile-to-pay in E-commerce

Chinese e-commerce giant Alibaba is developing facial recognition technology that enables mobile shoppers to replace their passwords with selfies.

Payments via Facebook

Facebook is planning a mobile payments solution that will let friends send money to each other via the Facebook Messenger application.

Conclusion

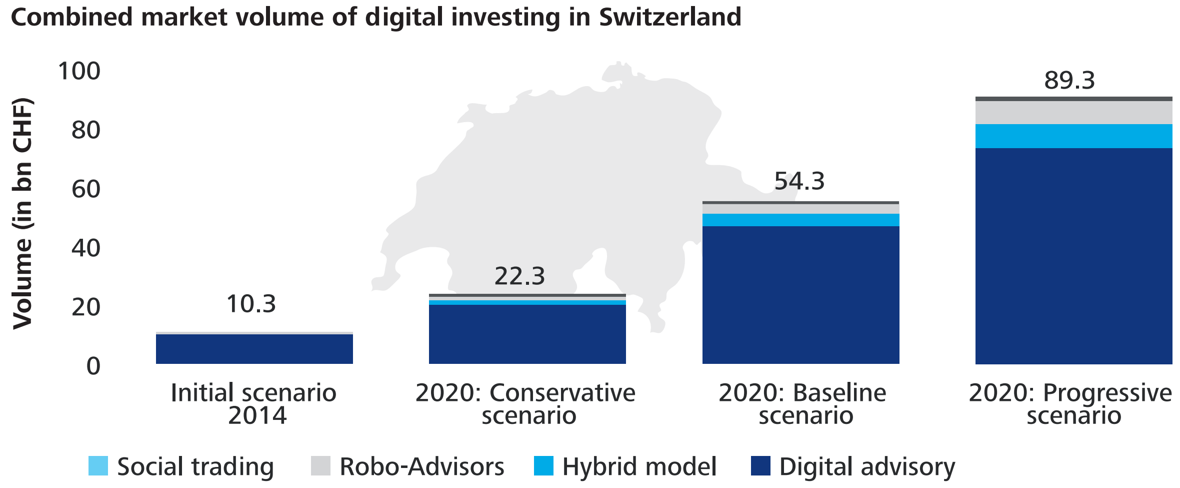
- Technology firms do not replicate the universal banking model. However they innovate around it, **undermining the traditional integrated banking business model**.
- Google, Twitter, Facebook and Alibaba do not seek to enter the banking business as such; but they are interested in selling banking products, apps and services to consumers in order to **maintain acquisition traction** and to **provide add-on services**.
- Positioning themselves across the entire **payment process** gives them an opportunity to earn high-frequency, low margin revenue as well as the ability to capture **purchase behaviour insights**.

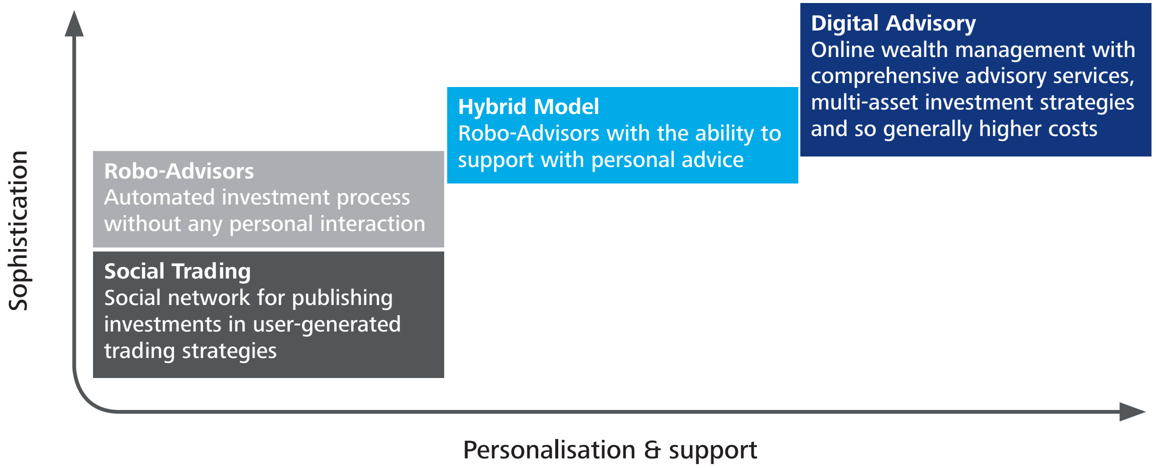
Source: Deloitte (2015) Deloitte Banking Innovation Series

Key trends: Digital investing

Digital investing via social media and robo-advisors in Switzerland is still in its infancy, nonetheless it is expected to expand considerably

Three scenarios for development of digital investing in Switzerland





Conclusion

- Based on the analysis of supply and demand for digital investing, the **forecast for market volumes looks positive for traditional financial service providers** to adjust their digital offerings.
- Even though the total market volume of digital investing is expected to increase greatly, **traditional financial service providers** should be aware that **new providers** will **enter the digital advisory market**.
- The main distinguishing features of digital advisory products will be their **simplicity of operation, transparency of costs** as well as **data security. Robo-advisors** will be attractive to customers who were previously **non-consumers of wealth management services.**

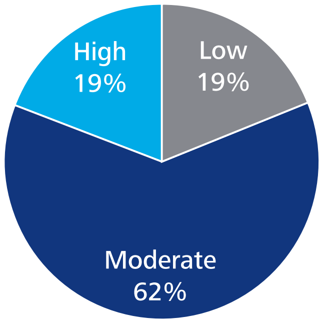
Source: IFZ and Swisscom (2015) Digital investing

Key trends: Millennials

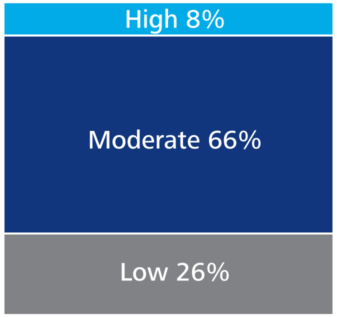
The wealth of millennials is expected to grow significantly in the next five years, making them an important banking client segment

Three types of future banking customer and how to serve them

Millennials' level of financial and investment knowledge



Millennials' level of trust in banks and financial markets



Three types of millennial banking client and how to serve them

	The Novice Low financial knowledge Your future investor	**The Loner** Self-directed Your future enthusiast	**The Cautious** Negative perception Your future referrer
Information	• Concise information • Simplistic investment data	• Detailed information • Technical investment data	• Clear information • Transparent investment data
Services	• Virtual investment portfolio • Investment learning tutorials	• Social investment clubs • Algorithmic trading solutions	• Face-to-face consultation • Case-by-case pricing
Technology	• Demo trading account • Online investor school	• Algorithmic investment tools • Mobile investment solution	• Adviser peer comparison • Benchmark my performance

Conclusion

- Most millennials possess a low-to-moderate level of **financial knowledge**. Only a few have a high level of **trust in banks and financial markets**.
- The **demands of millennials vary widely**, and banks have to address the gaps between **expectations** of the millennial generation and the **current services that banks offer**.
- Banks need to identify the **different types of next generation client**, align their offering accordingly and provide segmented services.
- Millennials are attractive as **future wealth management customers**, due to high incomes and future inheritances.

Source: Deloitte (2015) Millennials and wealth management; Merrill Lynch (2013) Millennials and Money

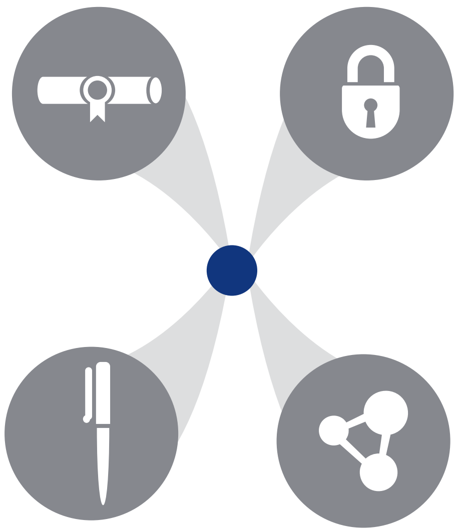
Key trends: Blockchain

As distributed ledger technology evolves, banks will have opportunities to vertically integrate new products and services

Potential implications of blockchain technology

Smart Contracts
Electronic contracts with transfer of ownership provisions coded into the contract itself eliminates the need for trusted third-parties

Intellectual Property
Blockchain technology could prove ownership of digital (intellectual) property



Anti-Counterfeiting
Identification codes stored on the blockchain can be used to track and verify the provenance of luxury goods such as wine, jewels and art

Foreign Exchange
Improved visibility of the flow of funds between parties could provide unprecedented transparency and regulatory oversight

UBS
UBS is experimenting with smart-bond and self-paying instruments using blockchain technology.

Santander
Santander reports that blockchain technology could save banks $15-20bn a year by 2022.

Goldman Sachs
In 2015 Goldman Sachs participated in Circle Inc. a US digital currency company.

Barclays
Barclays is investigating how blockchain technology could strengthen the financial sector.

Conclusion

- **Blockchain electronic records** will guarantee fair execution without insurance and administration overhead costs.
- Blockchain technology helps to answer questions such as how to get multiple computers to **agree on certain pieces of data** or how to **handle inevitable faults** in the system.
- Building **competence** and **expertise** in **cryptocurrency fundamentals** will be a key part of the further development of blockchain technology.

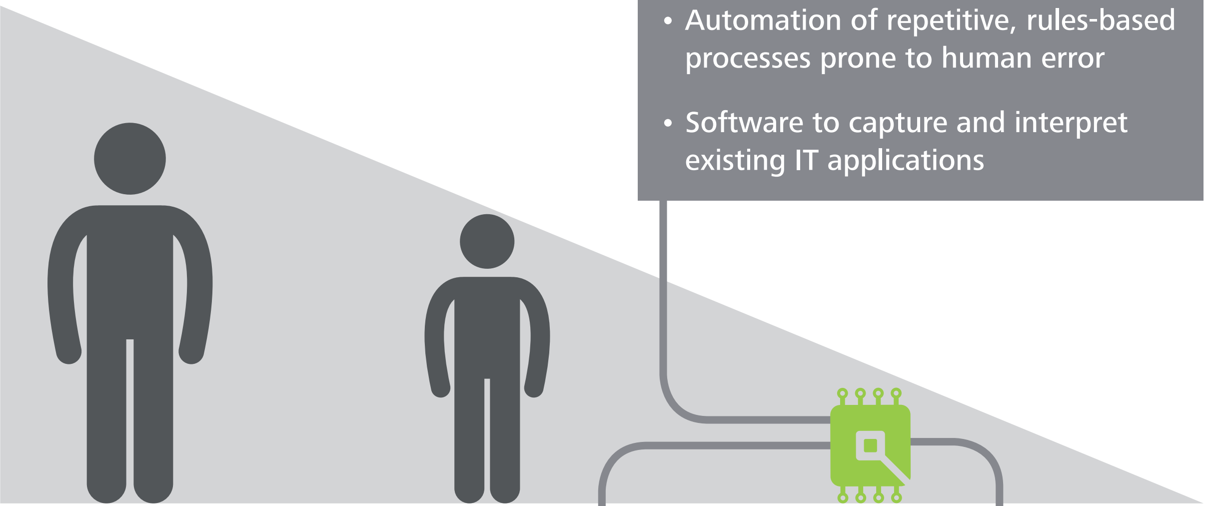
Source: Deloitte University Press (2014) Bitcoin; Deloitte research based on publicly available information (e.g. company websites)

Key trends: Automation/robotics

Robotics are computer-coded software that can achieve costs savings far greater than those achieved by relocating processes offshore

Robotic process automation

Cost of one unit of work performed by one FTE



Definition

- Automation of repetitive, rules-based processes prone to human error
- Software to capture and interpret existing IT applications

Benefits

- Efficiency
- Scalability
- Productivity
- Cost reduction
- Flexibility (e.g., 24 hours service)
- Quality/ Accuracy/ Risk mitigation

Approach

- Undertake work-in-progress analysis
- Install virtual machine and management system for record-to-report process
- Implement, test and present robot to replicate process steps

Conclusion

- Banking is becoming a **commoditised industry** heavily focused on the **front-end** and on **improving client experience**, to attract and retain clients.
- Banks have been slow to **review their procedures** and their **complex core legacy IT platforms** do not allow for quick introduction of new technologies. **Automation of back-office processes** is therefore still in its infancy.
- **Back-end operations** still require much human support, despite not being **revenue-generation areas** and not requiring direct **client interaction**.
- Therefore banks need a fresh approach for their **operations and processes. Robotics and process automation** are a critical new **delivery model** to drive **efficiency gains and analytics**.

Source: Deloitte (2015) The robots are coming

Key trends: Biometrics

Biometric security technology is continuing to develop, providing benefits beyond improved security and is resulting in competitive advantages

Biometric authentification boosts security and customer experience

Biometric authentication allows banks to improve security while enhancing customer experience.

Examples

Heartbeat-rhythm security
A bracelet on the wrist has an embedded sensor which recognises the wearer's unique electrocardiogram and communicates their identity to terminal devices using Bluetooth.

Eye-vein security
The camera on the smartphone will be used to match the customer's real-time eye vein patterns with the stored image on the phone, without any additional software or hardware.

Fingerprint security
This technology will provide customers with quicker access to their accounts when on the move, and also improve security.

Voice recognition
As an important part in banks' fraud prevention systems, voice recognition is already used in numerous call center authentication systems.

Conclusion

- With the **increasing use of the internet**, mobile devices, and cloud computing, threats from **cybercrime** and **data breach** are also greater.
- Biometrics is a **mobile device capability** that **financial services providers could use** to increase security and provide a superior client experience.
- Biometrics are, by their nature, **difficult to replicate** and **faster to process** than personal identification codes.
- In the next few years, **more advanced biometric solutions** are likely to emerge, in the form of palm-, iris-, and facial-recognition features **embedded in mobile devices**.

Source: Deloitte (2015) Banking Innovation Series

Key trends: Gamification

Banks make use of gamification to offer an enjoyable client experience, to gain a better understanding of clients and improve business numbers

Gamification educates customers and generates insights for banks

Gamification is the use of mechanics of games in non-game situations

Examples

Application description	Gamification element	Benefits for banks
DSK GAMEO Mobile savings application	Users are rewarded points for accomplishing everyday financial tasks (e.g. making savings)	• Uncover qualified sales leads. • Generate insights into customer base.
BUX Virtual trading application	Users can trade on markets with fictitious and real money and compete against each other in “BUX battles”	• Prepare clients for investing real money. • Generate insights into customer base.
WELLS FARGO Education Finances Interactive websites	Quizzes, videos and infographics that acquaint students in a playful way with managing their financials	• Interact with young client generation. • Reduce risks of bad debts.

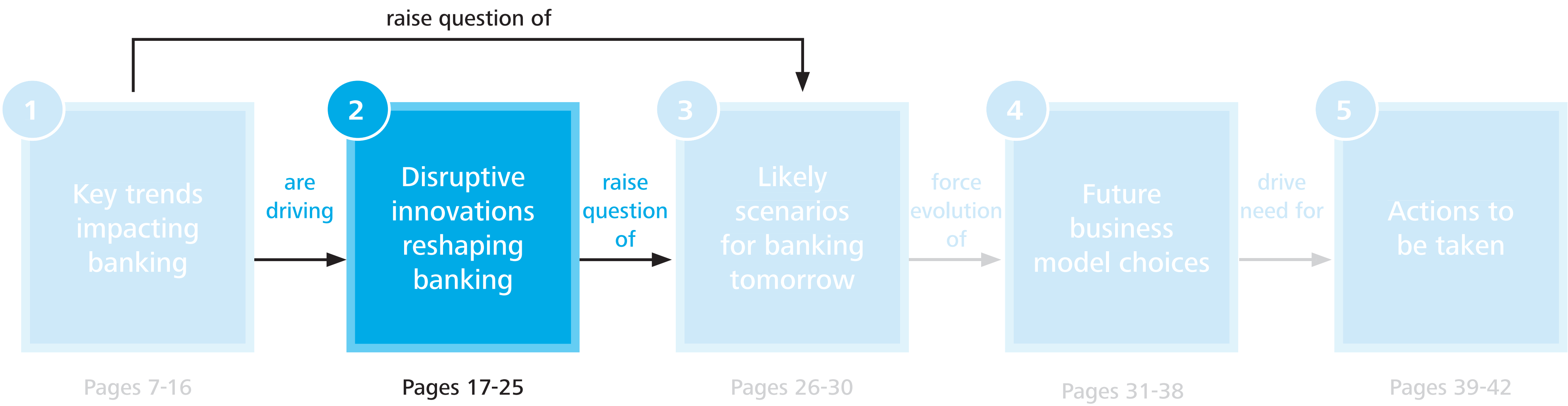
Conclusion

- Gamification can be used to **enhance customer experience**, **test new products** or **provide financial education**.
- Banks can make use of gamification to increase the ‘stickiness’ of their offerings, by **associating fun with their banking products**.
- Clients will be given the opportunity to **build up their financial knowledge** through practising in a virtual environment.
- However, most current examples of **gamification** are relatively **simple**. Better and more interesting ideas are needed to **attract clients permanently**.

Source: Deloitte (2015) Banking Innovation Series

Chapter 2

How do disruptive innovations reshape the banking industry?



Disruptive innovations: Overview

Nine drivers of innovation fundamentally impact all five primary banking functions and thereby create a great challenge to traditional banking

Banking function	Drivers of innovation	Disruptive innovations
Payments	Cashless world; New payment rails	More **integrated customer functionalities** will limit differentiation opportunities for financial service providers. **Alternative payment methods** will streamline the transfer of value and impact on the role of traditional intermediaries.
Deposits and lending	Alternative lending; Shifting customer preferences	**Alternative lending platforms** are transforming credit evaluation and sourcing of capital, and **narrowing the spread between deposits and loans.** Meeting customer demands will become more important as new entrants offer competitive and **customised services.**
Investment management	Process externalisation; Empowered investors	**Access to sophisticated financial services** will be improved through social and automated trading, and automated advisory services. Increasing **externalisation of processes** will lead to improved levels of efficiency.
Market provisioning	Smarter, faster machines; New market platforms	Algorithmic trading may offer **smarter and faster response to real-life events.** New information platforms are improving connectivity among market constituents, making the markets more liquid, accessible, and efficient.
Raising capital	Crowd-funding	**Crowdfunding platforms** are enlarging access to capital-raising activities.

Source: World Economic Forum in collaboration with Deloitte (2015) The Future of Financial Services

Disruptive innovations: Payments

As new consumer functionalities are built on to existing payment systems, transactions become faster and more integrated

Cashless World

Cash will be displaced increasingly by electronic transactions

Payments

New Payment Rails

Transfers will be more transparent, more global, faster and cheaper

Mobile Payments

Digital wallets free consumers from physical limitations of cash and cards they carry

Pay

Integrated Billing

In-app purchases within mobile apps combine purchase and payment into a single tap

UBER

Streamlined Payments

Machine-to-machine payments make the payment process more effortless

bPay

Next Generation Security

Transparent transfer histories allowing high visibility into flow of funds and low exposure to fraud

coinbase

Mobile Money

Mobile money provides alternatives to traditional transfers by streamlining intermediating processes

KOPO KOPO

P2P Transfer

P2P value transfer networks rely on a trusted central party to transfer value rapidly across geographies

M-PESA

= Example application as per WEF (2015)

Source: World Economic Forum in collaboration with Deloitte (2015) The Future of Financial Services

Disruptive innovations: Deposits and lending

New lending platforms are transforming credit evaluation and loan origination, opening up consumer lending to non-traditional sources

Alternative Lending

Saving and lending will become more transparent, faster and more available

Deposits & lending

Shifting Customer Preferences

Increase demand for mobile, flexible and alternative banking solutions

P2P Funding

Online platforms provide direct matching of funds between savers and borrowers

LendingClub

Lean, Automated Processes

Alternative platforms allow automated on-boarding and assessment of borrowers for fast, transparent processing

Zopa

Alternative Adjudication

The creditworthiness of borrowers is assessed beyond credit scores, analysing behavioural data

Lenddo

Virtual Banking 2.0

Improved technology allows virtual banks to offer value propositions other than just lower cost

fidor BANK

Banking as a Platform (API)

By standardising APIs across banks, developers can build customer-facing enhancements to offerings

YODLEE

Evolution of Mobile Banking

Rapid adoption of mobile devices has led many banks to add digital channels for transactions

popmoney

= Example application as per WEF (2015)

Source: World Economic Forum in collaboration with Deloitte (2015) The Future of Financial Services

Disruptive innovations: Investment management

Accessibility to refined financial services will be improved, reducing barriers to entry for new players and enable new levels of efficiency

Process Externalisation

The scope of externalised processes is expanding as technologies provide new levels of efficiency

Investment management

Empowered Investors

Customers can receive advanced financial advice and participate more closely in the investment process

Advanced Analytics

Advanced computing power, algorithms and analytical models lead to higher levels of automation and service sophistication

AYASDI

Process as a Service

The notion of core internal processes changes as external providers offer full externalisation of an entire capability as a service

FUNDAPPS

Capability Sharing

Banks working together to share capabilities or easily integrate with new providers, by constructing legal and technical standards

eCo Financial Technology

Social Trading

Platforms enable individual investors to build and share investment strategies and portfolios with others

eToro Your Social Investment Network

Automated Advice & Wealth Management

High-value advisory services on portfolio allocation at low cost, based on automated analysis

wealthfront

Retail Algorithmic Trading

Platforms enabling investors to build, test and execute algorithms with limited know-how and infrastructure

Quantopian

○ = Example application as per WEF (2015)

Source: World Economic Forum in collaboration with Deloitte (2015) The Future of Financial Services

Disruptive innovations: Market provisioning

New platforms are improving connectivity and automated trading is becoming more powerful, resulting in more liquid and accessible markets

Smarter, Faster Machines

Automated trading affects the market structure in terms of volume, liquidity, volatility and spread

Market provisioning

New market platforms

New platforms increase efficiency of intermediation between buyers and sellers

Big Data	**Artificial Intelligence/Machine Learning**	**Machine Accessible Data**
Access to extensive real-time data sets through specialised databases and uncovers market insights	Machine learning and prescriptive analytics improve trading strategies without human intermediation	Machines process news feeds through algorithms in real time, without human intermediation
Palantir	NeuroDimension	SNTMNT
Social	**Standardisation**	**Automation**
Platforms embed elements of social networks to host interactions among buyers, sellers and intermediaries	Platforms enable buyers to evaluate sellers more critically through standardised data points	Platforms automatically collect and analyse data to help buyers and sellers make informed decisions
ClauseMatch	LIQUITY	NOVUS

= Example application as per WEF (2015)

Source: World Economic Forum in collaboration with Deloitte (2015) The Future of Financial Services

Disruptive innovations: Capital raising

Alternative platforms for crowdfunding allow individual investors to play a more important role in providing capital for investment opportunities

Crowd-funding

Enterprises will increasingly interact with individual investors to widen options for raising capital

Raising Capital

Crowd Based	Customisation	Empowering individuals
Platforms provide a market place for individual investors to discover investment opportunities and invest directly and in common	Platforms provide a number of customised parameters for businesses to adjust and easily design funding options	Funding platforms leverage the expertise of lead investors by providing them with opportunities to gain additional income
SEEDRS	crowdcube	AngelList

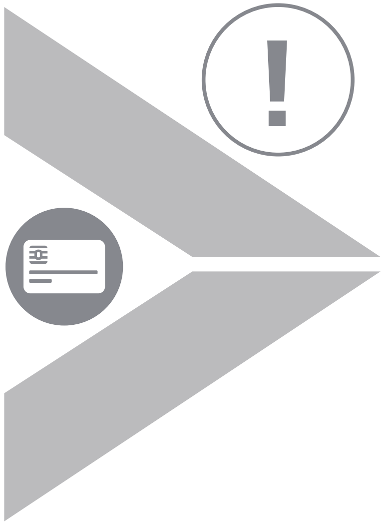
= Example application as per WEF (2015)

Source: World Economic Forum in collaboration with Deloitte (2015) The Future of Financial Services

Disruptive innovations: Implications

The traditional one-stop banking model will erode as technology and automation fundamentally change processes and customer interactions

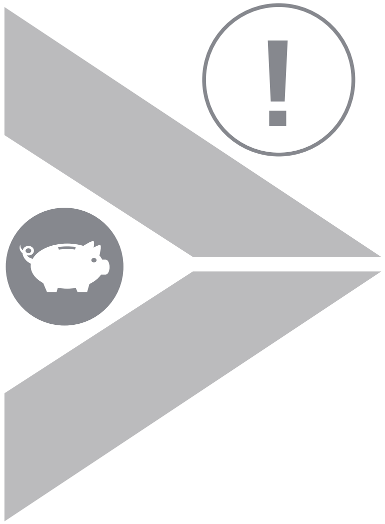
Payments



… become more independent of banks reducing touch points and driving partnerships.

- Banks lose control over **customers' transaction experience** as digital wallets **consolidate digital payment platforms**.
- The **role of traditional banks** diminishes, and **margins** on current payment transactions will need to be **restructured** as competitive pressure grows from **alternative payment rails**.
- Banks' ability to leverage **data on specific client segments** and to **partner with merchants** will become critical to gaining a dominant share of wallets.

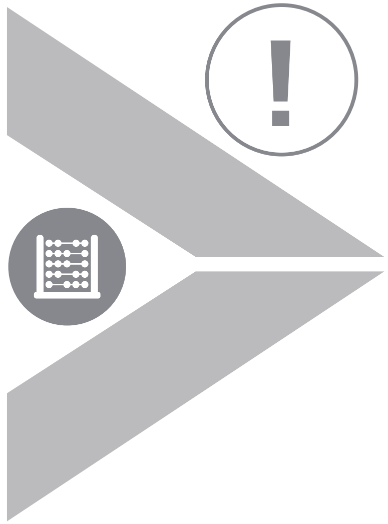
Deposits and lending



… become more widely spread across different platforms and offered on a stand-alone basis.

- Customers' savings and credit portfolios become **distributed** over a large number of **alternative platforms. Partnering with non-traditional players** will be key to remaining competitive.
- Lenders will **leverage lending platforms** as short and medium-term investment vehicles, reducing the demand for traditional deposits and investment products.
- Financial products and services will be offered increasingly on a **stand-alone basis**, limiting banks' ability to **cross-subsidise** competitively.

Investment management



… becomes increasingly driven by external providers, eroding the one-stop banking model.

- **Advisory services and products** will decouple as more customers switch to automated advisors for a more cost-effective service.
- As more processes are **externalised** banks will become more **dependent on third parties** and eventually lose the ability to develop a holistic view of operations.
- Standardisation and virtualisation by **new entrants** will make **more services** less profitable for traditional banks and **intensify competition**.

Source: World Economic Forum in collaboration with Deloitte (2015) The Future of Financial Services

Disruptive innovations: Implications

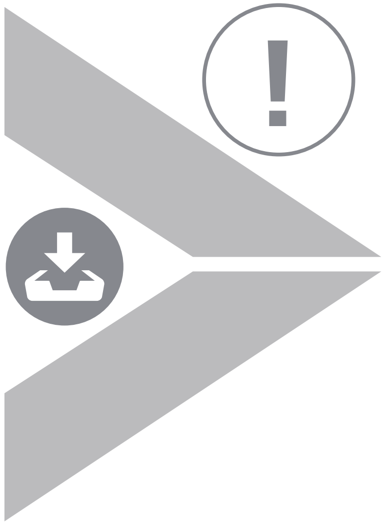
Capital raising and market provisioning become more automated and transparent, leading to easier access and a more active customer

Capital raising

… becomes easier to access through platforms that give customers a more active role.

- Traditional banks will need to compete for investments against **distributed platforms** where investors can play **more active roles**.
- As individuals gain access to investment products better aligned with their **needs** and with a potential for higher returns, banks need to adjust their **traditional investment product mix**.
- With **access to more diverse funding options**, companies will be able to grow at a quicker pace, forcing banks to **streamline their funding processes**.

Market provisioning



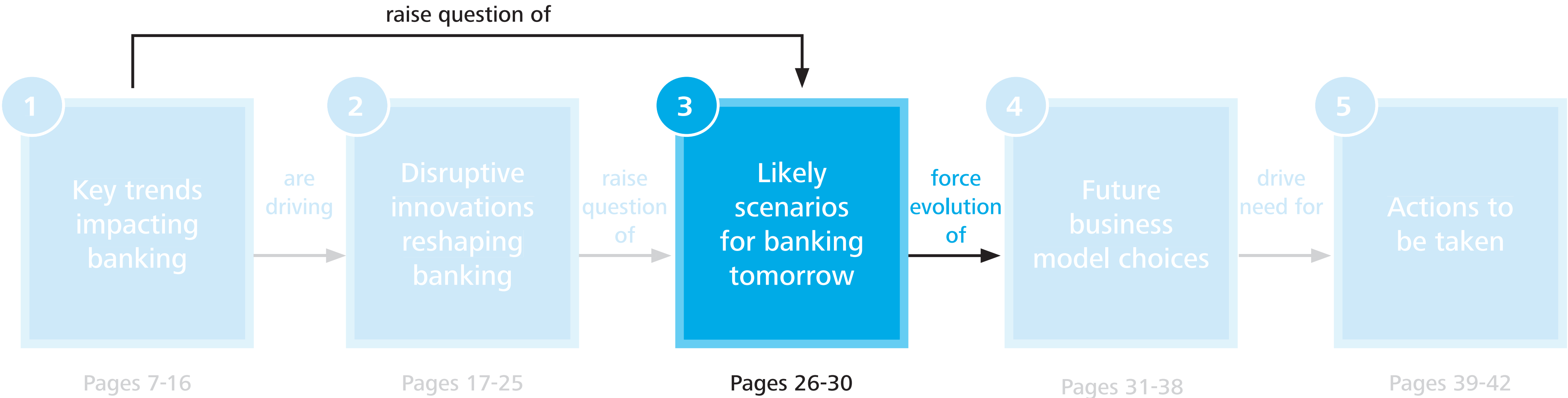
… becomes more automated, reducing the role of humans; new platforms improve transparency

- As banks' role as counterparties diminishes, **customer relationships based on advice** becomes more important.
- Banks need to adapt their business models as the **competition for speed** in gathering, analysing and acting on data increases and **the role of humans diminishes**.
- With customers gaining improved **visibility into market demand and supply**, banks' negotiating power will change, causing **more efficient pricing**.

Source: World Economic Forum in collaboration with Deloitte (2015) The Future of Financial Services

Chapter 3

Which are the likely scenarios for the banking of tomorrow?



Likely scenarios: Overview

Three different scenarios of banking tomorrow can be identified, reflecting different ways in which disruptive innovations can have an impact

Banks domination

1

Existing players will manage to protect their business model, supported by strict regulations and timely adoption of new technologies

Banking reinvented

2

Banks that fail to adopt new technologies will be overtaken by new banks leveraging Finance 2.0* ideas and building on lean modern platforms

Banking ecosystem

3

Disruptive entrants gain significant market share in some market segments and create an 'ecosystem' similar to the App-Store for iPhones

* Finance 2.0 is the next generation of financial services and the resulting changes in customer behaviour triggered by technological innovations

Source: Deloitte scenario analysis

Likely scenarios: Details

The three scenarios can be analysed into sub-scenarios, showing how areas of banking might change for each of the main banking functions

	1 Banks domination	2 Banking reinvented	3 Banking ecosystem
Payments	• Customers prefer **payment solutions** that seamlessly link to their bank accounts. • Incumbent institutions provide **leaner, faster payment options** within the existing network.	• **One-click solutions** favour a default card, driving consolidation of the payment market. • **Incumbent institutions** launch products connected to **alternative payment schemes**.	• **Digital wallets** remove the limitation of large numbers of cards. • Incumbent institutions compete with an **alternative network** of financial providers.
Deposits and lending	• Traditional institutions absorb **alternative platforms** and build upon their trust. • Banks strengthen **customer relationships** beyond needs-based transactions.	• **Traditional institutions and alternative platforms cater** to different customers. • New banks focus on account management and **partner with alternative networks**.	• **Alternative platforms** successfully move upstream to replace traditional players. • Traditional players become product providers as **new entrants** own customer relationships.
Investment management	• Wealth managers focus on HNW clients. • **Online tools** serve mass affluent clients. • With the externalisation of core capabilities, human factors become differentiators.	• High-value services become **commoditised** and banks focus on **bespoke services**. • Centralising compliance increases speed at which banks can react to regulatory change.	• **Retail and social trading platforms** compete directly with traditional wealth managers. • External service providers give smaller players access to sophisticated capabilities.
Market provisioning	• Large players develop **platforms to improve connectivity and efficiency** between them.	• **New platforms** make **counterparty selection** more objective, **empowering smaller institutions** with less developed networks.	• **Platforms** extend **connections to individual** investors and can act as market for specific assets.
Capital raising	• **Peer-based funding platforms** focus on investors with motives beyond financial return.	• **Peer-based funding platforms** focus on higher risk **seed-stage companies**, while banks provide later stage **venture capital financing.**	• **Peer-based platforms** develop into **alternative channels** for larger companies to raise capital.

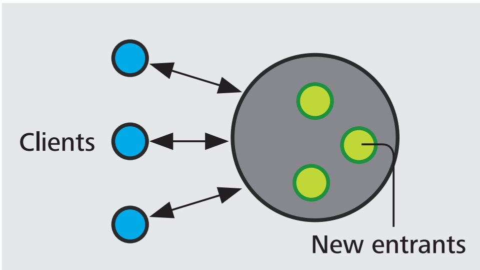
Source: Deloitte scenario analysis based on World Economic Forum in collaboration with Deloitte (2015) The Future of Financial Services

Likely scenarios: Implications

Key opportunities and threats cut across the five banking functions and influence the three scenarios from the perspective of a traditional bank

Scenario 1: Banks domination

Illustration



Opportunities

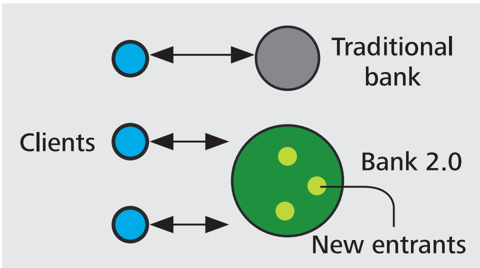
- Established banks are becoming more active in **investing, implementing and acquiring** market connection platforms to stabilise the current market.
- New financial products and services are creating uncertainty, fuelling **regulators' concerns** and increasing **entry barriers** for disruptive entrants.
- In competing against disruptive entrants, new technologies will improve the efficiency of established banks tin meeting customers financial and non-financial needs, i.e., **bionomic advisors**.

Threats

- **Losing the 'one-stop-shop' market position** and being reduced to 'core banking platforms' as **implementation of new technologies becomes unaffordable.**
- Losing the innovation race against disruptive entrants due to the **shortage and rising costs of well-educated IT employees**.
- Underestimation of the **power of networks** while the **digital revolution** largely ignores well-established rules and boundaries.

Scenario 2: Banking reinvented

Illustration



Opportunities

- Emerging innovations leverage computing power to **automate activities**, allowing them to offer **cheaper, faster** and **more scalable** alternative products.
- **Externalisation of processes** will make it easier for new banking players to enter the market without significant infrastructure.
- **Consumer functionalities** built on existing systems will result in meaningful changes to **consumer behaviours** and **business models.**

Threats

- Emerging innovations allow banks to **access new data sets**, such as social data, that enable new ways of **understanding customers and markets**.
- As customers consume services on a **a-la-carte basis**, banks will no longer own the majority of individuals' financial data **limiting their influence.**
- As banks evolve their offerings to stay more relevant to customers, they expand to **less-defined areas**. This creates **risk and compliance issues.**

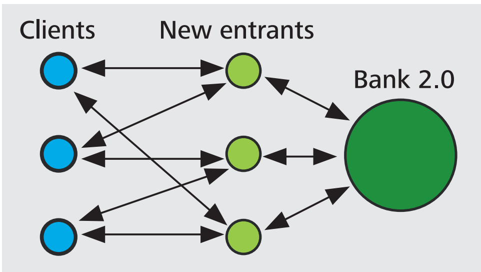
Clients · Traditional banks · New banks · Disruptive entrants

Likely scenarios: Implications

Key opportunities and threats cut across the five banking functions and influence the three scenarios from the perspective of a traditional bank

Scenario

Illustration



Clients
Traditional banks
New banks
Disruptive entrants

Opportunities

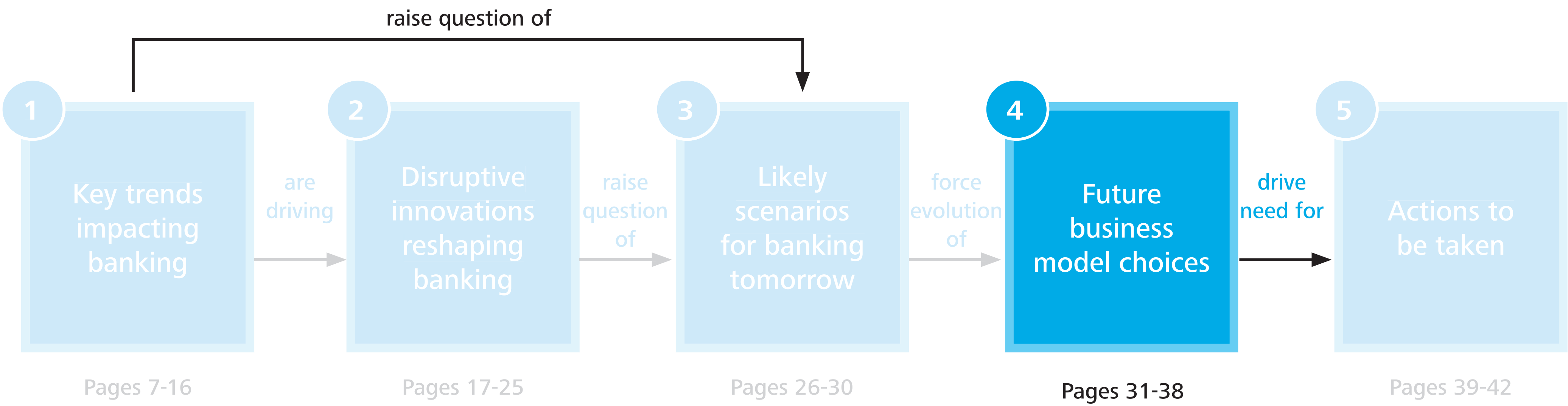
- Disruptive entrants are unable to develop a 'killer app' while traditional banks are able to **develop** and rapidly **deploy new customer solutions**, e.g. new skills, suppliers and partners.
- Early **co-operations with specialised product and service providers** will provide new ways to aggregate data, **improving connectivity** and reducing **costs of participation** in financial activities.

Threats

- **Agility** of new entrants becomes critical for reacting in a timely way to the uncertainties generated by regulators, amidst the shift towards **automation and efficiency**.
- Banks will **participate actively** in creating, funding, and acquiring **innovative externalisation** providers to **sustain scale-driven advantages**.
- The role of **in-person advisers** will become more critical as competition intensifies and services become more **digital and automated**.

Chapter 4

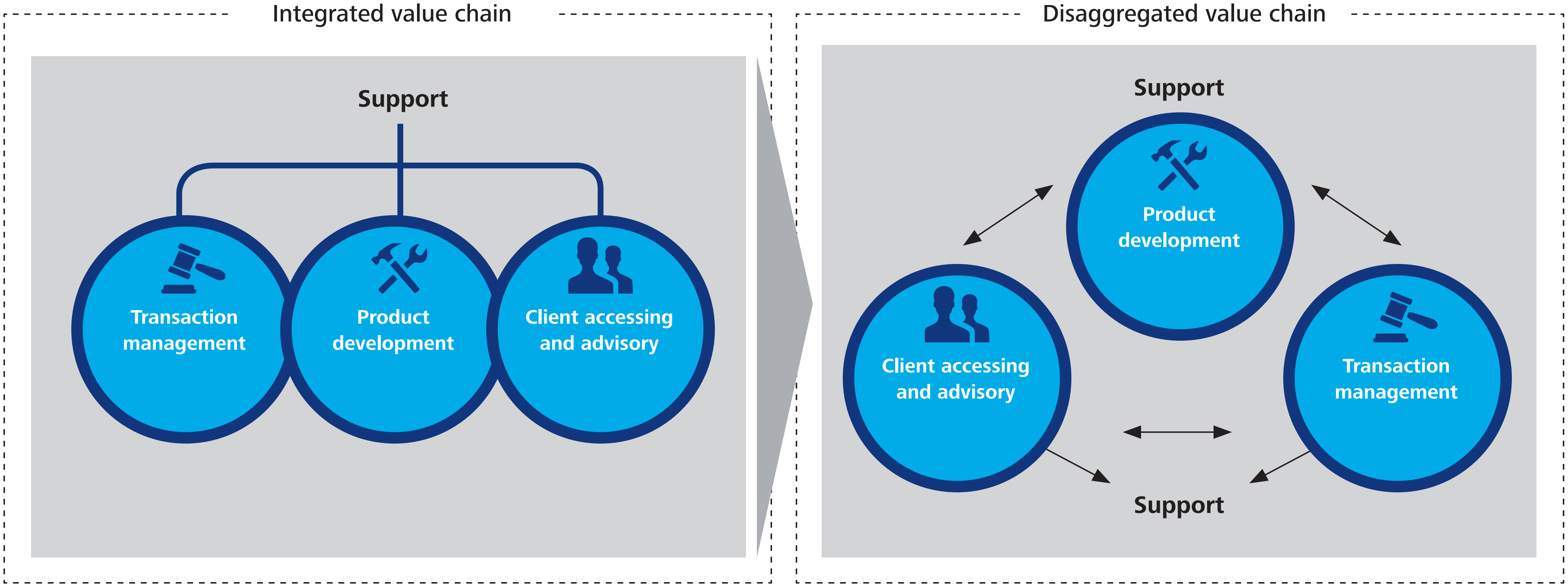
What is the impact on banks' business models?



Business models: Disaggregation of value chain

Key trends and disruptive innovations drive the disaggregation of the value chain through greater standardisation

Evolution of the value chain



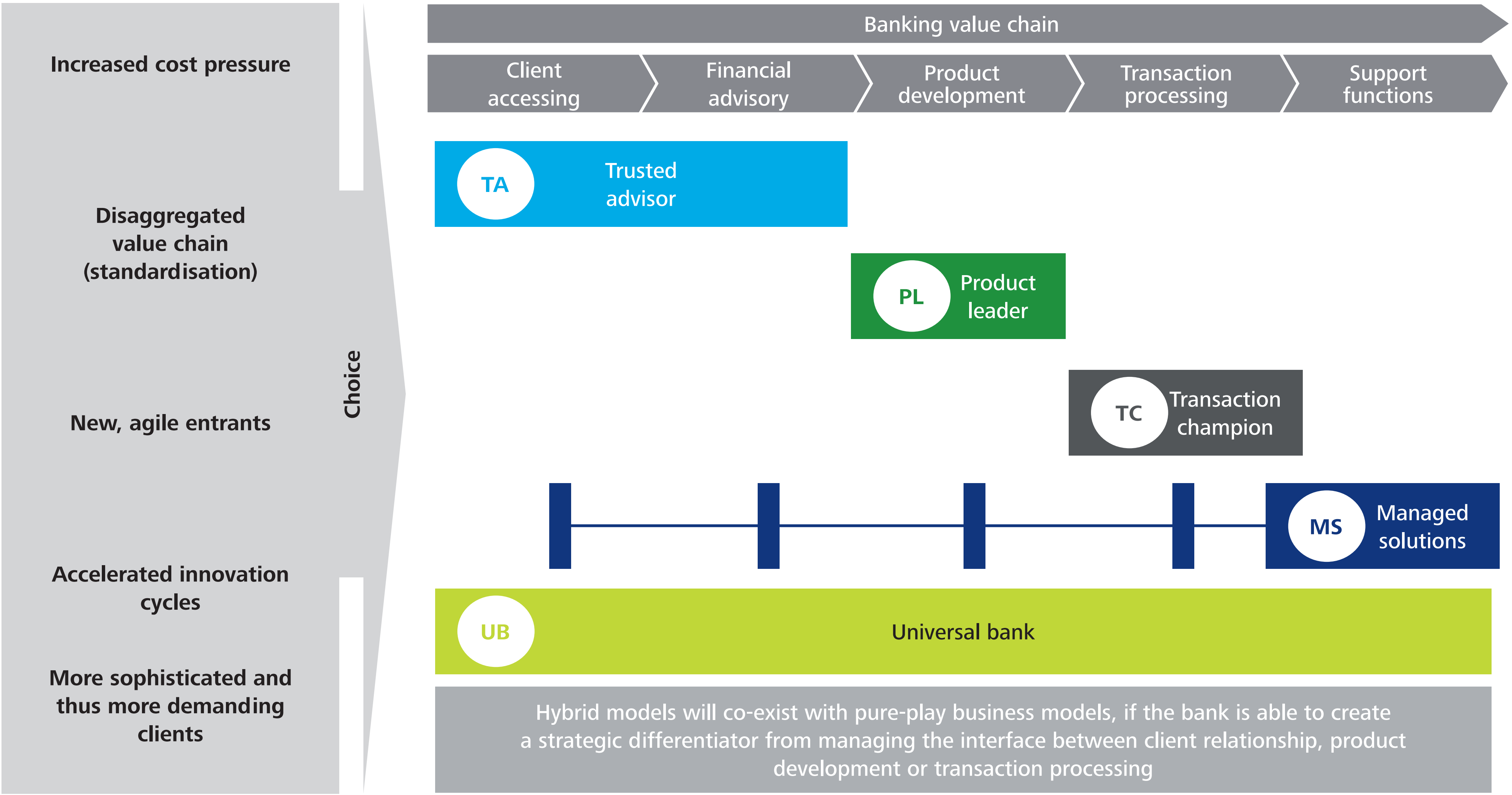
- Banking has **traditionally been an integrated business**, where financial institutions have distributed self-developed products through **proprietary channels** and have fulfilled all transaction and **support services in-house**.
- The value chain components each follows a different **economic logic** and has different technological and procedural requirements. Thus disaggregation is a natural progression if **interfaces** are sufficiently **standardised**.
- **Disruptive innovations** combined with standardisation of processes and services facilitate the trend towards **value chain disaggregation**, creating benefits of scale or scope to the specialised firms.

Business models: Overview

Banks need to consider their internal capabilities and external factors, and choose between pure play business models or hybrid ones

Challenges

Business models



Business models: Trusted Advisor (TA)

Banks becoming a 'trusted advisor' will focus on exploiting economies of scope through gaining a high share of their client's wallet

Value proposition

- Trust-based holistic advisory services in financial related (and complementary) matters for end-clients (going beyond pure investment or transaction advisory services but including value-add services).
- Tailored service offering based on extensive understanding of client needs and behaviours.
- Product portfolio encompasses a broad range of own and third party products and services (open architecture).
- Service offering beyond pure financial need, e.g. concierge services, financial education.

Customer segment	• Clients with limited time or financial know-how • Clients who seek high end professional financial advice (investment, tax, financing)	Key activities	• Tailoring services and products to individual client needs • Investing in customer experience and adjacent services • Conducting smart omni-channel management
Customer relationship	• Building long lasting client relationships based on institution's trust and reputation • Maintaining personal networks	Key resources	• Client specialists (with strong networks) and product experts • Open product architecture platform • Advanced analytics for risk-/need-based proposal generation
Channels	• Integrated and seamless omni-channel approach across branches, web, mobile and phone • Offering direct access to client advisor and product specialists	Key partners	• Service providers adjacent to banking services (e.g. tax experts, lawyers, concierge services) • Specialist product providers
Revenue streams	• Advisory fees (asset based/time based/fixed fees) • Net interest income	Cost structure	• Higher operating costs (less standardised services and salary costs with high success-based component for relationship managers)

Strengths	• Superior client experience (customer-comes-first focus) • Trusted advisor for clients • Pool of specialists/experts	Weaknesses	• High customer acquisition costs • Limited in-house processing and product development know-how

Business models: Product leader (PL)

Banks choosing to become a 'product leader' will focus on developing innovative products to gain market share quickly and at premium prices

Value proposition

- Development and offering of attractive new products and services for existing and new clients.
- Rapid time-to-market for innovative products and services, seeking first mover advantage.
- Superior insights into technological and/ or financial engineering developments.
- Capability to translate client needs into new products.

Customer segment	• Own or third party financial services provider clients • Professional investment firms (e.g. insurances, pension funds, external asset managers)	**Key activities**	• Research and product development • Trend spotting/identification of end-client needs • Recruiting and retention of specialist talents
Customer relationship	• Maintaining B2B partnerships (tailored product development) • Leveraging brand, reputation and performance as quality certificate to gain new clients	**Key resources**	• Creative product experts and proficient research department • Strong marketing department • Agile multi-purpose processing system
Channels	• Third party distribution channels (e.g. EAMs, other banks eChannel • Standardised interfaces with B2B partners	**Key partners**	• FinTech providers • Research boutiques and innovative think tanks • Transaction champions
Revenue streams	• Management fees (via product) • Transaction fees • Advisory fees/subscription fees	**Cost structure**	• High fixed costs (agile multi-purpose technology) • High operating costs (non-scalable product development and research costs)

Strengths	• Innovation driven model • Ability to generate a premium price • Agility (short time to market)	**Weaknesses**	• Limited efficiency • Low barriers to entry (competition) • Dependence on key talents

Business models: Transaction champion (TC)

Banks choosing the business model 'transaction champion' will focus on exploiting economies of scale through partnering with other providers

Value proposition

- Standardised offering at low cost to end-clients and third party banks and non-banks.
- Offering white label solutions.
- Acting as consolidator of transactions and/or custodian for deposits and securities (leveraging economies of scale).
- Providing access to financial network (correspondent bank).
- Outsourcing provider for services which require a banking licence or specialist knowledge which pure-play outsourcing providers cannot offer (e.g. acting as banking platform for non-traditional financial services providers).

Customer segment	• Corporate or private clients seeking cost-efficient offerings • Clients of non-traditional financial services provider • Banks lacking the scale to maintain cost-efficient operations	**Key activities**	• Acquisition of new clients/ business volume to achieve scale • Continuous industrialisation of own offering • Agile adoption of new banking services/standards
Customer relationship	• Partnering with smaller banks and non-traditional financial services providers as a processing expert • Seamless integration of own services into clients' offering	**Key resources**	• Efficient and agile processing system • Banking processing, industry and technology experts • Key account managers
Channels	• Standardised interfaces (e.g. APIs) • Self service web, mobile applications, call centres • Key account management	**Key partners**	• 3rd party financial services providers requiring banking partner • Global correspondent banks • Product leaders
Revenue streams	• Transaction fees; or • Revenue-based fees (percentage of partner's revenue); or • Fixed service fees	**Cost structure**	• High fixed costs (heavy investment in technology and processing capabilities) • Low variable (operating) costs due to scalable processing

Strengths	• Superior and efficient, integrated processing capabilities • Economies of scale	**Weaknesses**	• Risk of commoditising own offerings • Limited brand awareness of end-clients • Limited ability to offer customised solutions

Business models: Managed Solution provider (MS)

Banks becoming a 'managed solution provider' will focus on building economies of scale through providing banking solutions to other providers

Value proposition

- Specialist offering to banks and non-bank providers allowing them to break up their internal value chain.
- Acting as expert within specific areas allowing clients to source capabilities rather than building them in-house.
- Offering white label solutions.
- Enabling institutions to source complete solutions rather than single services.
- Solutions can range from regulatory insights, specialised investment advice as well as non-core processes, e.g. KYC, Tax, Payment.

Customer segment	• Banks or other third party financial services provider clients • Professional investment firms (e.g. insurances, pension funds, external asset managers)	Key activities	• Acquisition of new clients/business volume to achieve scale • Continuous industrialisation of own offering • Identification of client as well as end-client needs
Customer relationship	• Maintaining B2B partnerships • Leveraging reputation as well as potential efficiency gains to expand client base	Key resources	• Deep specialised experts • Banking industry and technology experts • Key account managers
Channels	• Standardised interfaces with B2B partners • Key account management	Key partners	• Providers of specialist expertise • Transaction champion
Revenue streams	• Transaction fees; or • Revenue-based fees (percentage of partner's revenue); or • Fixed service fees	Cost structure	• High fixed costs (heavy investment in technology and processing capabilities) • Low variable (operating) costs due to scalable processing

Strengths	• Transforming upcoming client needs into intelligent solutions • Economies of scale within a specific area of expertise	Weaknesses	• Risk of commoditising own offerings • Limited brand awareness of end-clients • Dependence on specialised experts

Business models: Universal bank (UB)

Banks choosing to become a 'universal bank' must achieve scale in all their business lines to achieve low cost levels and overall efficiency

Value proposition

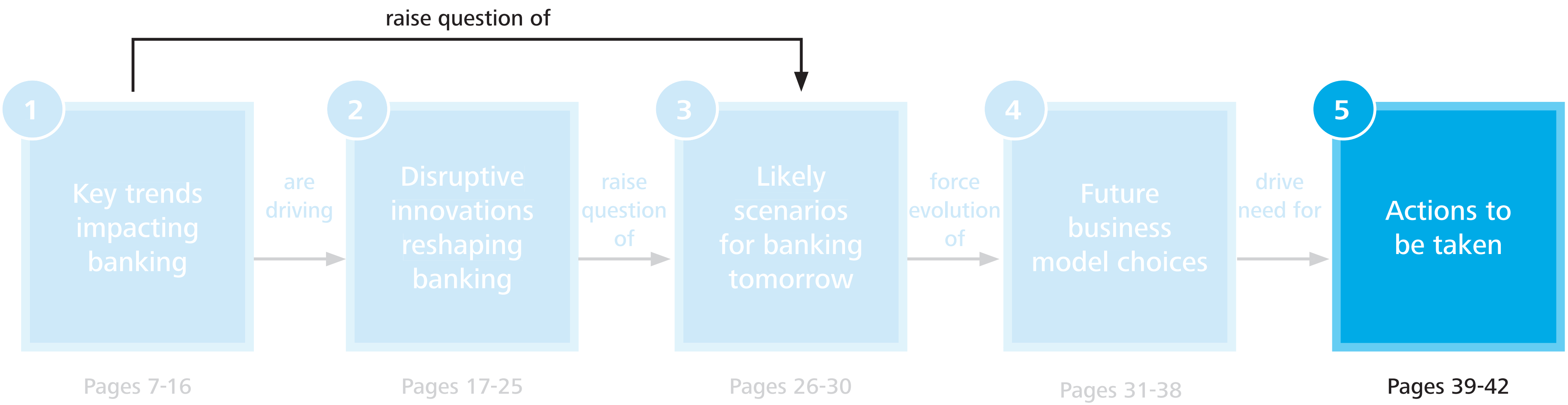
- Full product offering across several industry sectors, i.e. retail, private, corporate and investment banking as well as asset management.
- Seamless control over front-to-back processes (integrated value chain) providing greater flexibility to tailor to client needs.
- Diversified business mix in principle will reduce volatility of earnings.
- Offering sophisticated products and services, leveraging capabilities across business divisions.

Customer segment	• End-clients across client segments including private clients institutional and corporate clients • Third party banks	Key activities	• Allocation of resources • Advisory, transaction processing and product development • Commercialisation of own capabilities
Customer relationship	• Being 'one-stop-shop' for clients • Brand and reputation (stability)	Key resources	• Client relationship managers • Banking processing experts
Channels	• All channels	Key partners	• Third party product providers • Outsourcing providers/transaction champion • Network with similar provider
Revenue streams	• Net interest income • Transaction fees • Advisory fees	Cost structure	• Very high fixed costs due to branch structure and technology (if not outsourced)

Strengths	• Control over a large part of the value chain • High share of customers' wallets (insights into clients' needs) • Opportunity to optimise use of balance sheet	Weaknesses	• Sufficient scale required to meet acceptable cost margins • Lack of focus, competing priorities and conflicts of interests • Capital-intense

Chapter 5

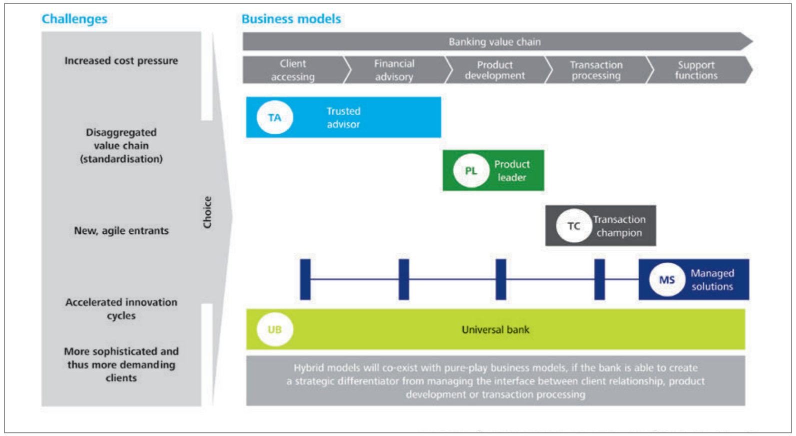
Which actions should banks take now to prepare for the future?



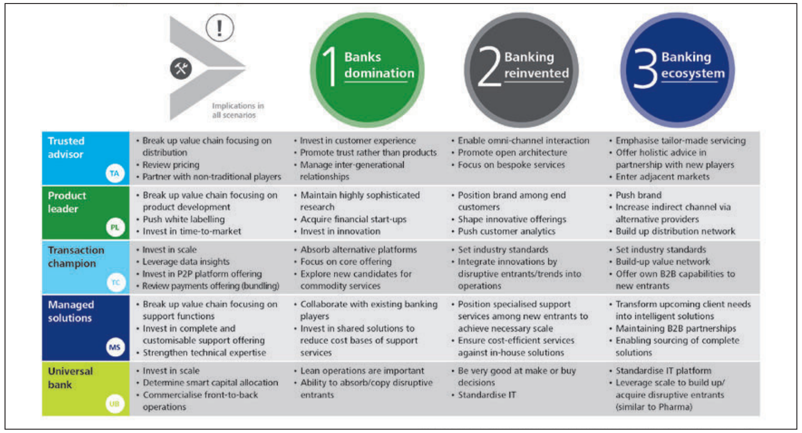
Actions: Approach

Each scenario may impact the business model differently. Strategic choices should leverage strengths and address weaknesses

What business model is aspired to?

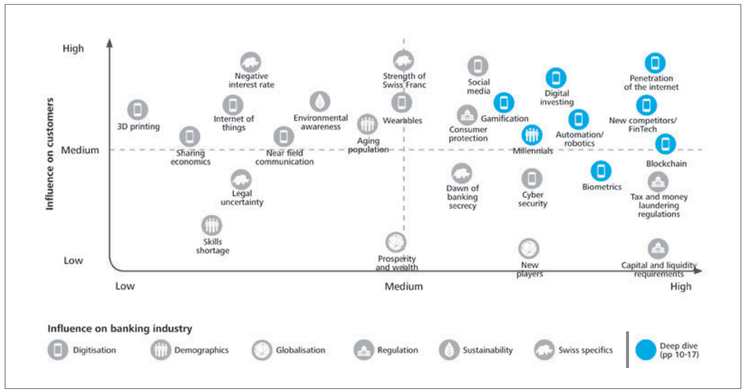


What are the strategic choices?



	Implications in all scenarios	1 Banks domination	2 Banking reinvented	3 Banking ecosystem
Trusted advisor (TA)	• Break up value chain focusing on distribution • Review pricing • Partner with non-traditional players	• Invest in customer experience • Promote trust rather than products • Manage inter-generational relationships	• Enable omni-channel interaction • Promote open architecture • Focus on bespoke services	• Emphasise tailor-made servicing • Offer holistic advice in partnership with new players • Enter adjacent markets
Product leader (PL)	• Break up value chain focusing on product development • Push white labelling • Invest in time-to-market	• Maintain highly sophisticated research • Acquire financial start-ups • Invest in innovation	• Position brand among end customers • Shape innovative offerings • Push customer analytics	• Push brand • Increase indirect channel via alternative providers • Build up distribution network
Transaction champion (TC)	• Invest in scale • Leverage data insights • Invest in P2P platform offering • Review payments offering (bundling)	• Absorb alternative platforms • Focus on core offering • Explore new candidates for commodity services	• Set industry standards • Integrate innovations by disruptive entrants/trends into operations	• Set industry standards • Build-up value network • Offer own B2B capabilities to new entrants
Managed solutions (MS)	• Break up value chain focusing on support functions • Invest in complete and customisable support offering • Strengthen technical expertise	• Collaborate with existing banking players • Invest in shared solutions to reduce cost bases of support services	• Position specialised support services among new entrants to achieve necessary scale • Ensure cost-efficient services against in-house solutions	• Transform upcoming client needs into intelligent solutions • Maintaining B2B partnerships • Enabling sourcing of complete solutions
Universal bank (UB)	• Invest in scale • Determine smart capital allocation • Commercialise front-to-back operations	• Lean operations are important • Ability to absorb/copy disruptive entrants	• Be very good at make or buy decisions • Standardise IT	• Standardise IT platform • Leverage scale to build up/acquire disruptive entrants (similar to Pharma)

What are the influencing factors?



Decide which components of the disaggregated value chain can be divested, based on internal capabilities

Assess the influence of each scenario on the chosen business model

Actions: Strategic options

Depending on the chosen business model, banks have different strategic options to choose from today in order to prepare for tomorrow

	Implications in all scenarios	1 Banks domination	2 Banking reinvented	3 Banking ecosystem
Trusted advisor TA	• Break up value chain focusing on distribution • Review pricing • Partner with non-traditional players	• Invest in customer experience • Promote trust rather than products • Manage inter-generational relationships	• Enable omni-channel interaction • Promote open architecture • Focus on bespoke services	• Emphasise tailor-made servicing • Offer holistic advice in partnership with new players • Enter adjacent markets
Product leader PL	• Break up value chain focusing on product development • Push white labelling • Invest in time-to-market	• Maintain highly sophisticated research • Acquire financial start-ups • Invest in innovation	• Position brand among end customers • Shape innovative offerings • Push customer analytics	• Push brand • Increase indirect channel via alternative providers • Build up distribution network
Transaction champion TC	• Invest in scale • Leverage data insights • Invest in P2P platform offering • Review payments offering (bundling)	• Absorb alternative platforms • Focus on core offering • Explore new candidates for commodity services	• Set industry standards • Integrate innovations by disruptive entrants/trends into operations	• Set industry standards • Build-up value network • Offer own B2B capabilities to new entrants
Managed solutions MS	• Break up value chain focusing on support functions • Invest in complete and customisable support offering • Strengthen technical expertise	• Collaborate with existing banking players • Invest in shared solutions to reduce cost bases of support services	• Position specialised support services among new entrants to achieve necessary scale • Ensure cost-efficient services against in-house solutions	• Transform upcoming client needs into intelligent solutions • Maintaining B2B partnerships • Enabling sourcing of complete solutions
Universal bank UB	• Invest in scale • Determine smart capital allocation • Commercialise front-to-back operations	• Lean operations are important • Ability to absorb/copy disruptive entrants	• Be very good at make or buy decisions • Standardise IT	• Standardise IT platform • Leverage scale to build up/ acquire disruptive entrants (similar to Pharma)

Actions: Next steps

Assessing own capabilities, preparing for the unavoidable changes and defining the future business model are the next steps ahead of banks

01/

Assess your bank's internal capabilities against competitors' capabilities

How do your bank's capabilities compare against capabilities of your peers?
What are your bank's strengths and weaknesses?

02/

Prepare for the unavoidable (scenario-independent) implications

Which changes in the financial services industry will impact your bank the most?
What measures can your bank take to be prepared?

03/

Define your future business model and tailor to the likeliest scenario

Considering your bank's capabilities and the likeliest scenario, which business model is most promising for your bank?

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