

Author:
Spencer Izard
RESEARCH DIRECTOR
sizard@teknology.com

Deconstructing banking complexity through a 'greenfield on top' approach

How banks can evolve past the limits of their legacy banking systems to transform into an ever-green digital bank.

Expert View level: Strategic

Sectors concerned: Banking

Topics covered: Cloud Platforms, Fintech Eco-system, Core Banking

Priority: ●●●

How digital banks continue to shape the future of the industry

Over the past decade, the financial services industry has experienced significant digital disruption led by changing customer behaviour, regulatory change, and the rise of Fintech companies. These factors created the perfect environment for the rise of neo-banks that operate more like tech start-ups than traditional banks and offer online-only digital banking capabilities at a pace and sophistication that incumbent banks could not initially compete with. The typical start-up pattern for Fintech-based neo-banks has been to collaborate with a licensed bank to meet regulatory demands before a neo-bank acquires its banking license.

The initial wave of successful neo-banks disrupted the industry by focusing on the needs of the following types of clients:

- Digital native and fluent customers who wanted a seamless banking experience akin to the likes of Amazon and Uber delivered through easy-to-use mobile app experiences on smartphones.
- Customers not yet served by incumbent banks, including younger generations.
- Small to medium businesses (SMEs) and independent contractors.

Providing a modern digitally led banking service to customers required neo-banks to focus on the following areas:

- Removing friction from the customer experience by making every type of banking activity as streamlined and easy to use as possible through a mobile app accessible twenty-four hours a day and seven days a week.
- Providing a clear value proposition focused on service convenience, equal access to banking

services, no hidden or complicated fee models, and ethical banking.

- By not being hindered by existing/legacy, often monolithic, banking technologies, the use of cloud-based internally developed or externally sourced Fintech solutions for the rapid onboarding of new, or alternative, financial products and services delivered at scale through APIs and a seamless mobile app experience.
- The adoption of open banking to drive smart onboarding of new customers, providing SMEs finance data to support their business demands, and improved personal finance data and smart reporting for individuals.

The financial services industry had for decades been very conservative in nature with its operating model remaining relatively the same. The combined disruption of Fintech companies and neo-banks though showed incumbent banks that customer attitudes were not only changing but doing so rapidly. Exposing incumbent banks to erosion in their customer base if not addressed. The challenges of operating model rigidity and legacy banking systems have impeded the ability of incumbent banks to deliver services in the same manner as neo-banks. From conversations PAC has had with banks it is often raised that being popular with customers does not always equate to sustained profitability. However, the shift in customer expectation has led to incumbent banks realising that the banking world has changed and they must evolve to meet demand.

Continuous and seamless banking evolution through a fintech ecosystem

The industry disruption caused by neo-banks has led to incumbent banks considering many options to address customers' new expectations. In recent years

PAC has spoken with many incumbent banks, and one of the common themes is the understanding that historic core banking systems are not equipped to handle the evolution needed. During the same conversations, leaders told PAC that the onset of open banking has irreversibly altered the course of the industry. PAC agrees wholeheartedly with this sentiment, which will only evolve further with the onset of open finance as the next evolution of open banking.

However, all this change has occurred in relatively rapid succession for a historically slow-moving industry. Many incumbent banks are struggling to adapt but attempting to do so by establishing their own neo-bank or creating a mobile app experience atop a legacy banking system. In addition, the Fintech sector continues to grow and diversify at pace year-on-year with an ever-increasing breadth and depth of companies providing a range of sophisticated core banking capabilities. When speaking with PAC, banking leaders have indicated that they struggle to keep pace with the number of Fintech companies but see them as providing critical innovation points for a modern core banking cloud-based system often referred to as Banking-as-a-Platform (BaaP).

PAC considers the following to be the core benefits for incumbent banks in moving to the cloud as part of their digital banking strategy:

Reduced operating costs: Moving to a cloud-based core banking platform eliminates on-premises legacy systems and staffing costs that often require costly specialist knowledge, resources, and maintenance.

Cloud-connected Fintech eco-system: The API-driven nature of cloud services provides banks with a means to build a cloud-connected Fintech eco-system to create and adapt customer services to meet demand rapidly and at scale.

Real-time and accurate data insight: The cloud provides the opportunity to pivot from the lag of legacy batch-processing and data silos to a real-time and unified view of customer behaviour to drive new banking products and promptly respond to risk and fraud issues.

Why does 'greenfield on top' support the full spectrum of digital banking demands

When PAC speaks with incumbent banks, not digital challengers, it is still evident that legacy core banking systems are a heavy burden to carry. All too often, the pressure on IT functions within banks is to deploy a solution to meet the demand for a new banking product/service and then move on to the next new

goal. Addressing the value, relevance, and inefficiencies of long-established core banking systems are often not of high priority and are deferred to a later point. In such situations, incumbent banks have typically sought to either re-platform and migrate data or re-engineer and maintain legacy technology to try and make it behave like a cloud-based digital banking solution. From PAC's experience, both approaches typically require a multi-year transformation where value, at best, is only realised upon completion. These approaches inhibit an incumbent bank's ability to react to current and evolving market forces from customers and competitors.

However, hyperscale public cloud-based solutions allow serverless and containerised IT architecture approaches to devolve banking technology monoliths into component elements. Such solutions lower the barrier to entry for incumbent banks to leverage the growing eco-system of Fintech solutions through open API integrations. This provides incumbent banks with 'greenfield' access to new modern core banking services and products atop existing 'brownfield' legacy and potentially monolithic core banking services. By operating both in parallel, the incumbent banks are placed on an equal footing with neo-banks in delivering digital banking services whilst decommissioning or refactoring legacy banking services without losing the value they provide by maintaining integrations into the modern banking platform.

Recommendation

As highlighted above, PAC considers 'greenfield on top' to be the optimal approach when defining a digital bank strategy that competes on equal footing with neo-banks' capabilities. However, deconstructing legacy banking systems is a complicated task whilst establishing a modern digital banking platform at the same time and navigating the Fintech eco-system for relevant products and services. This is where PAC considers PwC a proven partner in the financial services sector that combines a depth and breadth of accelerator and eco-system capabilities delivered through its Infinite Financial Solutions (IFS) offering. Identifying the right transformation partner is essential to accelerate the transition at pace and scale. Each month PAC speaks with people in the banking industry who express challenges in finding the right talent to aid in their transformation. PAC strongly recommends that banks consider a co-creation relationship with PwC to reduce their transformation window, drive innovation, and reduce costs.