

Banking on the digital experience

Banking, Financial Services and Insurance



Abstract

With rising customer clamor for superior banking experience, the demand for anywhere, anytime, frictionless banking has intensified. Fintechs and challenger banks are stepping in with innovative digital offerings to deliver a delightful experience, further heightening the competition. This, in turn, is driving traditional banks to explore different options such as adding more digital capabilities to their existing armory as well as defining and delivering the right digital experience to their customers. However, designing the right digital banking experience requires financial institutions to decide on the approach they want to adopt. Banks can either bolt on digital banking capabilities incrementally to their existing technology architecture by leveraging market solutions or build a disparate digital banking platform by revamping their core infrastructure to infuse flexibility and enable new technology integration or set up a separate digital-only entity under a new brand.

While banks may initially begin with either of the first two options to quickly launch their offerings and counter fintech competition, we believe that their ultimate goal should be to progress toward a digital-only entity. This white paper discusses how financial institutions must address key aspects of business, technology, and operations to create a contemporary and highly personalized digital banking experience through the right digital banking solution. The paper also shares our perspective on the foundational pillars of designing digital banking capabilities, and presents a comparative analysis of three major approaches to setting up a digital-only bank.

Business Drivers for Adopting Digital Banking

As customers expect the same kind of digital-first experience that they get in other sectors like retail and hospitality, banks are compelled to follow through with digital investments and create digital banking capabilities.

Offering digital banking services has thus emerged as the holy grail of retaining customer mindshare and share of wallet. Well-executed digital banking platforms tend to have more efficient banking operations primarily due to automation and the adoption of newer technologies. Digital alternatives are more cost-efficient as they enable customer acquisition and servicing through a combination

of digital and immersive technologies that deliver frictionless omni- and opti-channel banking, enhanced analytics, and ecosystem integration. Our experience of implementing digital-only entities for global clients reveals that the cost per transaction reduces to less than 2.5% of the cost incurred in traditional channels. In addition, the cost of acquiring new customers reduces by around 80% when banks adopt digital banking models. Furthermore, moving toward branch-less, digital-only operations has led to a twofold increase in the number of customers that can be supported by a single employee.

Another factor that is boosting digital banking is the steps taken by governments in developing countries to drive financial inclusion. Many governments are relaxing regulations to encourage the entry of new entrants — fintechs, challenger banks, or neo banks — especially in the payments

sphere, to bring the unserved and the underserved populace into the banking fold. This, in turn, is driving traditional banks to embrace digital banking models or launch digital-only avatars to ward off competition from new entrants and retain their customer base. Needless to say, offering digital services has become an urgent imperative for incumbent financial institutions.

The first step in the digitalization journey is to define an adoption approach. There are predominantly three options for banks to enable digital banking capabilities. The first option is the proprietary development of digital capabilities (greenfield) that fit the bank’s requirements and integrate seamlessly with existing systems and applications. The second option is to leverage market solutions from the ecosystem and adopt a banking-as-a-service (BaaS) approach for accelerated go-to-market. The third option is to embrace a hybrid approach that combines the greenfield and BaaS models and incorporate customized and differentiated digital banking capabilities for core processes while leveraging third-party solutions for ancillary and non-core processes. We believe that banks should focus on a progressive transformation by embracing any of the three options, with the ultimate goal of becoming digital-only entities.

Foundational Pillars of Digital Banking Capabilities

In another decade, the term digital-only bank will most likely be phased out since all banks and financial services will be digital by default.

Getting to that state of digital nirvana, however, will entail a slew of transformation programs. Thus, identifying the business, technology, and operational imperatives that drive the creation, implementation, and maintenance of digital banking models becomes extremely crucial.

Based on our global engagement experience, we have developed a framework (see Figure 1) that sets out six key pillars to enable the right digital banking experience. Banks must incorporate these pillars into their digital banking strategy to leverage the right technology and ecosystem solutions to:

- Build bundled yet differentiated products and services
- Reach out to new customer segments through partners and channels
- Ensure intelligent and automated operations
- Remain compliant with evolving regulations

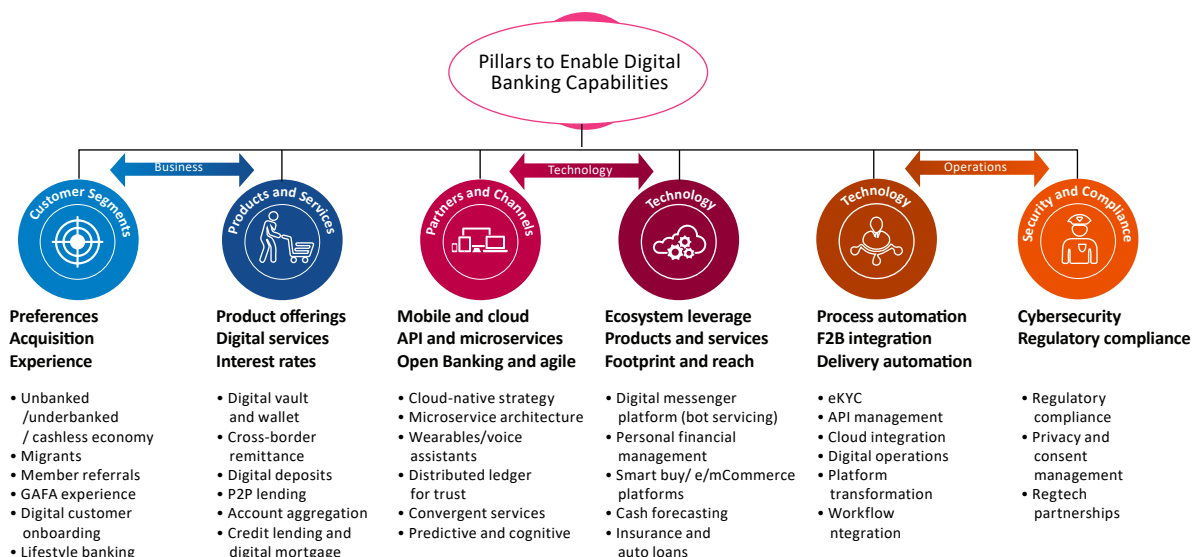


Figure 1: Foundational Pillars for Digital Banking Capabilities

Customer segments: tapping the unbanked and underbanked

Traditional offerings were typically designed for large customer segments and focused on meeting everyday banking needs, which are both costly and overwhelming. With the proliferation of technology and ever-increasing competition, banks should identify offerings that have a greater impact and generate higher revenues. One way to achieve this is to add banking products targeted at specific customer segments (unbanked, underbanked, youth, migrants, 'HENRYs' or high-earners-not-rich-yet, and millennials). This will enable banks to build the right digital experience for the target segments across touchpoints and continuously improve them.

Products and services: hyper-personalized and purpose-driven

Delivering true customer-centric offerings is key to providing a differentiated experience. These offerings should build trust, strengthen relationships, improve financial wellness, and provide advice. This would help banks transcend traditional product-centric customer experience boundaries to deliver personalized, purpose-driven, and value-based experiences. This will necessitate leveraging cognitive analytics and ecosystem partner offerings to create a mix of premium, zero-fee, low-fee, bundled products and services that are purpose-driven and offer a hyper-personalized experience to digital-native customers.

Partners and channels: exponential distribution and service outreach

With challenger banks raising expectations, the end consumer has little interest in interacting through conventional banking interfaces. Regulations like the Payment Services Directive-2 (PSD2) and Open Banking have opened up opportunities in the industry and broken barriers to the entry of non-banking players. Banks should therefore go beyond traditional services and channels and create collaborative partner ecosystems for distribution and servicing, and in turn, co-create value for end customers.

Technology options: next-gen integration fabric and business-driven architecture for a connected ecosystem

As customers increasingly demand anytime, anywhere banking services, banking applications should be always available and universally accessible across channels and interconnect various banking systems and partner solutions. Hence, the capability to integrate several technologies on a modern, scalable, and maintainable platform is crucial to the success of the digital banking model. This can be achieved by:

- Building an open, lean, and business-driven architecture (focused on the delivery of business capabilities and customer expectations) that differentiates core proprietary capabilities and leverages non-core capabilities from the ecosystem.
- Embracing application programming interfaces (API) to provide the flexibility needed to integrate with the front- and the back-office.
- Adopting cloud technologies to enhance scalability and reduce hardware, development, deployment, and maintenance costs.
- Embracing newer technologies that enable more immersive and interactive customer engagement.

Operations: contextual, automated, and cognitive

The transition to digital banking offers opportunities to improve front-, mid-, and back-office functions. Although faster and seamless processing of service requests, faster dispute resolution, and transparent status checks are fast emerging as hygiene factors in service delivery, many traditional banks are unable to meet these requirements due to legacy technology. By embedding modern technologies such as cognitive intelligence (virtual assistance for quick access to the knowledge base), machine-first automation (routine actions like data input, accessing other applications, and performing required actions) and artificial intelligence (AI) backed analytics (contextual next-best-action recommendations), banks can move toward 'zero-ops' or 'no-ops' (zero manual operational effort through extreme automation) digital banking models and deliver immersive experience.

Security and privacy: data security, access, and consent management

Recently introduced provisions enable banks to completely digitalize their customer onboarding process, removing the necessity for in-person interactions. However, this introduces increased risks in ensuring the privacy and security of sensitive financial and personally identifiable information (PII) while considering granular customer preferences as regards consent and access. With regulatory demands varying across asset size, geography, lines of business, and mergers and acquisitions, banks will need to consider the relevant regulatory implications while launching digital banking. Even though compliance comes with its own challenges, it offers banks great opportunities to leverage consent management technologies and design hyper-personalized offerings.

So, how can banks operationalize digital banking capabilities? Once the foundational pillars are in place, banks will need to take specific actions across business processes and technology, which are:

- Create an architecture with dedicated layers for specific banking function and core business capabilities
- Embrace a resilient and scalable cloud infrastructure for functional and data layers
- Rearchitect IT processes by embracing straight-through processing to make them efficient, agile, and frictionless
- Enable digital self-service capabilities and automation interventions to minimize operational inefficiencies
- Enable intuitive and anywhere, anytime banking through omni-channel interfaces
- Leverage the larger ecosystem for consuming services as well as monetizing enterprise resources

Approach to Setting up a Digital-only Bank

Establishing the foundational pillars is critical to building the digital readiness, essential for offering digital banking services. However, banks' ultimate aspiration should be to evolve into digital-only entities and establish a digital brand to differentiate themselves from their peers.

More than going branchless or moving toward limited or no physical presence, the intent to deliver immersive and enhanced experience across the customer lifecycle drives traditional banks to set up digital-only avatars or digital experience banks. In our view, banks must adopt one of three approaches to building digital-only banks (see Figure 2).

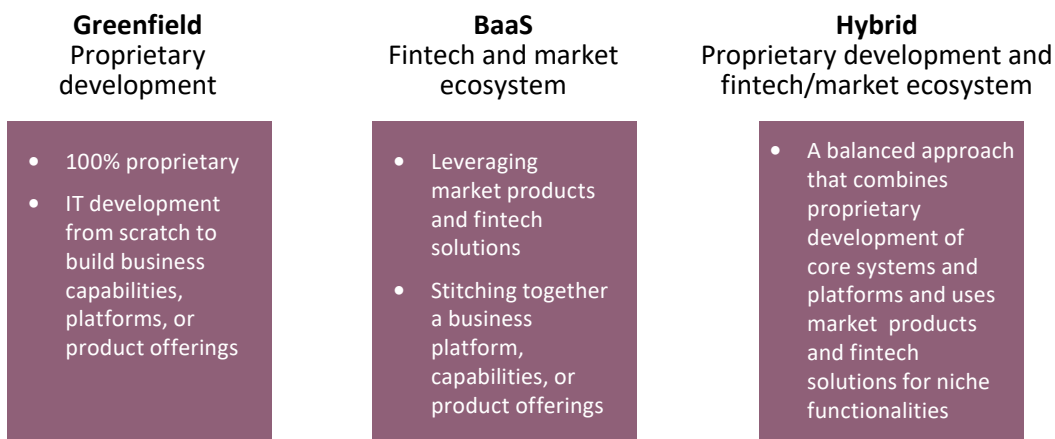


Figure 2: Approaches to Building a Digital-only Bank

Approach 1: Greenfield bank - build the banking core from scratch

Building a digital bank from scratch will maximize the chances of the new entity fitting organization-specific requirements and achieving seamless integration with systems and applications (see Table 1). Consider adopting this approach if a 100% proprietary development is crucial to gaining a competitive edge. This approach can be a preferred option for banks with strong domain and engineering resources.

Advantages	Disadvantages
100% control of code and roadmap	Time and effort intensive, especially for core functions
A unique set of capabilities across experience, functions, infrastructure, and back-end transaction systems	Longer time – three to four years – to break even
Disruptive proposition to gain market share early	Heavy investments for marketing and customer acquisition in the early years
Potential IP ownership and monetization opportunity for select business capabilities through white labeling	Limited use of partner networks for cost-efficient acquisition
	Large IT teams for ongoing enhancements and support

Table 1: Pros and Cons of the Greenfield Approach

Approach 2: Banking-as-a-service (BaaS) – create a digital ecosystem leveraging third-party technology

The BaaS approach entails assembling a digital-only bank by stitching together a banking platform using a set of third-party solutions such as commercial off-the-shelf (COTS) and fintech products. This approach is faster as it avoids reinventing the digital banking wheel. It also improves speed-to-market by leveraging tools and solutions that have been successfully launched and tested.

Advantages	Disadvantages
Easy plug-in of the most suitable fintech solutions as per market demand	Increased time consumption in evaluating the technology and establishing credibility of fintech solutions
Better control over products and service portfolio	Potential compatibility differences between the fintech's IT landscape and organizational culture
Faster extension of products and platforms into new markets	Long-term pricing risk
Faster speed-to-market	Data security and privacy regulations compliance
	Absence of exclusivity agreement with fintech players

Table 2: Pros and Cons of the BaaS Approach

Approach 3: Hybrid – adopt customized third-party fintech solutions

The hybrid approach to building a digital-only bank combines the advantages of the greenfield and BaaS approaches. In this approach, the core differentiating business capabilities can be built ground up as proprietary application systems to gain a competitive edge, while the non-core capabilities and commodity services can be sourced from industry utilities in the relevant markets. Incorporating a plug-and-play BaaS model for non-core and ancillary services will help accelerate launch and minimize 'reinventing the wheel.'

Advantages	Disadvantages
Combination of agile third-party solutions and proprietary technology	Potential scalability challenges and difficulties in customization of niche fintech solutions
Faster launch compared with greenfield development	Potential lack of synchronization for product upgrades, enhancements, and support
Easier integration with legacy systems as fintech solutions use API frameworks with componentized microservices	Out-of-the-box solutions with little or no differentiation from solutions used by peers
	Difficulties in determining business credibility and technical robustness of external solutions when defining long term technology strategy

Table 3: Pros and Cons of the Hybrid Approach

Building a Digital-only Bank: One Block at a Time

Banks will first need to analyze the brand position of the new business against the overall market when setting up a digital-only bank. Once the foundational pillars are ready, banks should evaluate and adopt the approach that best suits organization-specific requirements, and then design a strategy focusing on a few key considerations:

- Define a detailed roadmap with immediate, short- and long-term goals.
- Ensure ecosystem preparedness by considering business aspects such as customer acquisition and servicing, and identifying, selecting, and building the right digital core.
- Consider technology implications, including architecture layering considerations (vertical layering as well as horizontal), digital adoption, and delivery automation enablers.
- Consider operational aspects ranging from legal and compliance, organization change management, and customer engagement.
- Factor in risks and challenges related to loss of branding opportunities at physical locations.

In a Nutshell

Setting up a digital-only entity or a digital experience bank is a challenging yet exciting journey as it entails many firsts – an experience-first approach for customer centricity, automation-first approach for speed, efficiency, and accuracy, an agile-first approach for speed-to-market and flexibility, a cloud-first approach for reduced infrastructure costs and operational agility, and a data-first approach for insightful and outcome-based customer interactions.

Banks will need to choose their own path to digital nirvana. They can either adopt an incremental approach and ultimately evolve into a digital-only bank or take a big bang approach and establish a digital-only entity under a new brand creating a greater impact in the market.

While the first approach will yield gradual returns on investment, the latter approach will be investment-intensive but deliver immediate returns besides appealing to millennial and gen Z customers. Whatever approach banks choose, the need for delivering speed-to-value is paramount to retain market supremacy.

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