TATA CONSULTANCY SERVICES

Building on belief

Reviving UK building societies: Digitalization to aid sustained growth

Abstract

Building societies bring diversity to the mortgage lending market. Unlike traditional banks that cater to mass markets, societies target unserved or underserved segments of the home-buying population. Despite strong community relations and a solid capital foundation, building societies have been struggling to sustainably grow in the last few years. Increasing competition within the segment and entry of new-age, technology-driven digital firms targeting the same niche markets are challenging the existence of building societies. As a result, the number of building societies in the UK has declined from 55 in 2008 to 43 in 2021.[1]

However, on the positive side, building societies are well-positioned to weather the storm, provided they leverage cutting-edge technologies, including cloud-based platforms, artificial intelligence (AI), and machine learning (ML). This paper explores some of the challenges that building societies face, how they are responding to these challenges, and the key drivers that will aid the growth of building societies in the future. The paper also details how technology adoption can be accelerated with a cloud-first strategy, which will help societies grow their businesses without the overheads of optimizing legacy systems.

Serving members of local communities

Building societies in the UK have existed since the 19th century and typically offer mortgage and savings products. Some societies also provide other retail banking services, including current accounts, personal finance, and credit cards. As of 2021, building societies in the UK held £342.5 billion in residential mortgages amounting to 23% of the market.[2]

Though building societies and banks work within the same industry, the main differentiator is the ownership model. Unlike banks, building societies are entirely owned by their members. Every member meeting the minimum requirements of an individual society gets one vote. As these societies are owned and controlled by their internal stakeholders, they work for the benefit of the members and local communities. On the other hand, banks are generally listed on the stock exchanges and are answerable to external shareholders.

---

[1] Investopedia, Building Society, March 2021, Accessed June 2021, *https://www.investopedia.com/terms/b/building-society.asp#:~:text=The%20number%20of%20building%20societies, in%20the%20form%20of%20collateral.*

[2] Building Societies Association, Lending up: Savings figures mask differences across society, May 2021, Accessed June 2021, *https://www.bsa.org.uk/media-centre/press-releases/lending-up-savings-figures-mask-differences-across*

Striving to stay relevant

After serving local communities for over 200 years, building societies are now caught in a tricky conundrum - some of their strengths are also their debilitating weaknesses. Their focus on local communities, specifically targeting the mortgage industry, has resulted in undiversified business models and low profit margins. In addition, we observe that building societies are constrained by limited pricing power and increasing investment spends. These challenges have had a direct negative impact on their core products of mortgages and savings. Recent statistics published by the Building Societies Association (BSA) show a continuous, steep drop in net lending (see Figure 1) and net saving receipts over the last five years (see Figure 2).

UK BUILDING SOCIETIES - NET LENDING (£MILLION)

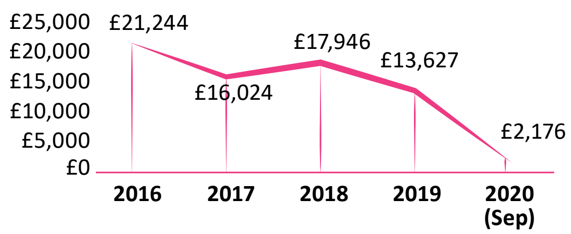

Figure 1: UK Building Societies Registered about 90% Decrease in Net Lending Over Five Years Ending September 2020

UK BUILDING SOCIETIES - NET SAVING RECEIPTS (£MILLION)

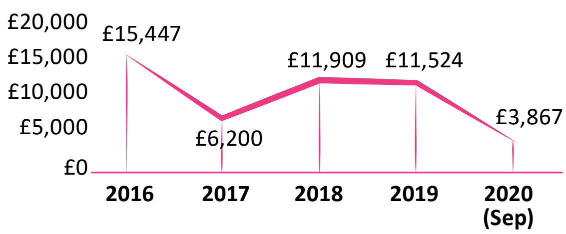

Figure 2: Net Saving Receipts Dropped over 66% to their Lowest in Five Years by September 2020

Some specific challenges facing UK building societies include:

- **Strict regulations:** Societies are struggling to comply with the statutory timeframes of regulations such as the Payment Service Directive 2 (PSD2), General Data Protection Regulation (GDPR), and ISO20022. This can be attributed to the associated overheads and costs.

- **Increased competition:** Building societies compete with each other to capture niche and specialized lending markets. Emerging banks backed by cutting-edge financial technologies and specialist lenders also target the same market segments. Fintech firms equipped with digital capabilities have lower operating costs and are able to offer more competitive interest rates, which is impacting the traditional business model of societies.

- **Changing member expectations:** Technology disruption in the financial services industry has resulted in better customer experience at reduced costs. Challenger banks and fintech lenders are ahead of societies in technology adoption. Existing members of societies are gradually moving to new-age banks for a better service experience. The lending business of societies has also seen similar disruptions.

- **Increase in cyber-crime:** Cyber-crime is increasingly becoming a challenge for societies. They need to establish remedial measures to address this issue to safeguard member privacy and keep the brand value intact.

How are societies responding to challenges?

Building societies have come to realize that leveraging technologies is the solution to overcome the roadblocks that they face. Most of them have automated the customer onboarding processes and significantly reduced the time taken to provide a mortgage offer letter.

A similar trend is seen in member servicing as well. The COVID-19 pandemic created an unprecedented situation for building societies as members and brokers were unable to visit branches. The societies had to rely on their contact centers to serve their members and began enabling digital channels as an immediate solution. Through the better part of 2020, most building societies embarked on a digital journey and gradually enabled web chat, mobile banking, and cloud-based services to effectively serve their members and brokers. According to BSA, recent digital adoption trends in building societies include the introduction of mobile apps, enabling cloud platforms, and the transformation of mortgage and saving services. Societies have also enabled scalable and agile platforms leveraging microservices and application programming interfaces (APIs).

Key drivers for future growth of UK building societies

Emerging trends reveal that building societies are taking action to solve immediate challenges as well as future issues. The adoption of advanced digital technology, AI, ML, and cloud would help to address the urgent imperatives of resilience and adaptability. This would also drive long-term growth by equipping UK building societies to:

- **Leverage existing ecosystems:** In a digital era, branches may seem redundant, but customers feel secure when dealing with people in a physical building as opposed to bots in the virtual world. Members of the younger generation also prefer to visit branches for account inquiry and one-to-one professional advice on complex products. Though building societies are in the process of restructuring their branches, it would be prudent to retain systems that have been working in their favor.

- **Personalize at scale:** Though customers prefer a human touch, they want the facilities to be accessible at a time and place that suit them. Technologies such as IoT (internet of things) and AI can digitally modernize branches to provide solutions, including video banking kiosks, that can help personalize experiences at all stages of banking.

- **Enhance customer experience:** There is a direct correlation between digital services offered by building societies and the loyalty of their members. Most members would consider leaving their building society if they are unable to conveniently manage their accounts online. Those building societies that fail to deliver an accessible and frictionless digital banking experience face the prospect of losing members. Societies are adopting intelligent automation, machine-first techniques, and software-as-a-service (SaaS) offerings with a cloud-first policy to cater to the needs of the next generation.

- **Provide secure services:** Like any other financial institution, building societies are also vulnerable to security threats. Building societies are at a critical juncture given the pressure to survive market headwinds, be sustainable, and provide better service while ensuring security and privacy to customer data. To ensure lower costs of maintenance and flexibility to change, societies should look at DevSecOps (the process of making security a fundamental part of development and operations) measures and adopt an agile business technology operating model.

The way forward

The core strength of building societies lies in their community connections. They operate at lower profits because of their mutual nature. Now is the time for building societies to not only offer niche products to the communities they serve but also look at tailoring products to new-age buyers. For example, borrowers are struggling to repay their mortgages because of financial challenges due to the ongoing pandemic. Coincidentally, first-time buyers are also looking for affordable mortgage products during the market downturn. This offers building societies opportunities to craft lending products with flexible pricing options for both sets of customers.

On the other hand, digital adoption is essential for the future readiness of building societies. Traditionally, these organizations have differentiated themselves from larger banks by establishing close relationships with members. Building societies are now well-placed to onboard new members, subject to embracing digital technologies effectively. Rapid digitalization and partnerships with fintechs will be key for building societies to strengthen the community connect, retain the existing member base, increase membership, and drive sustainable growth in this highly competitive segment.

About the author

Sandeep Mishra

Sandeep Mishra is a client partner as well as a director of the Fintech business segment, with the Banking, Financial Services, and Insurance (BFSI) business unit at TCS. He has about 20 years of experience in management, business solutions, strategy, consulting, and sales and has worked for various clients across the UK, Europe, and Asia. He works closely with several leading building societies in the UK. His focus areas include evolving business and technology platforms, cloud and fintech. Mishra has a Bachelor's in Mechanical Engineering from the Institute of Engineering and Technology, Lucknow, India.

Contact

For more information on TCS' Banking, Financial Services, and Insurance unit, visit

https://www.tcs.com/banking-financial-services or https://www.tcs.com/insurance

Email: bfsi.marketing@tcs.com

About Tata Consultancy Services Ltd (TCS)

Tata Consultancy Services is a purpose-led transformation partner to many of the world's largest businesses. For more than 50 years, it has been collaborating with clients and communities to build a greater future through innovation and collective knowledge. TCS offers an integrated portfolio of cognitive powered business, technology, and engineering services and solutions. The company's 469,000 consultants in 46 countries help empower individuals, enterprises, and societies to build on belief.

Visit **www.tcs.com** and follow TCS news **@TCS_News**.

Corporate Marketing | Design Services | M | 06 | 21