WHITE PAPER

Key Success Factors for Digital Transformation in the Banking Industry

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In 2015, IDC conducted in-depth interviews with business and IT executives to understand the digital transformation strategies at retail banks and credit unions. Digital transformation is the continuous process of employing digital technologies, namely mobile, cloud, social business, and big data and analytics (BDA), coupled with organizational, operational, and business model innovation, to create new ways of operating and growing the business.

Why go through such a transformation? In a word, survival. Today's customers are fundamentally different from customers of past years in that they are harder to acquire, retain, and delight because of the explosion in digital technologies consumers use day to day. These new digital experiences are forcing banks to play catch-up and match the innovative and engaging interactions and products — such as mobile payments — that nonbanks are offering to those same customers. The new digital environment is also rewriting the book on branch banking. IDC surveys have shown that consumers, including the important millennial generation, are still visiting the branch, so the branch experience itself is perforce becoming part of the omni-channel banking experience.

This threat of disruption, along with a need to keep costs down, is driving digital transformation in retail banking worldwide. Ultimately, digital transformation will also unite the disparate and siloed systems and create seamless "customer journeys" that will attract and retain tomorrow's customers.

Digital Transformation Within Banking Is Happening at a Slow But Steady Pace

Banking normally changes at a glacial pace. The need to react to market pressures, particularly after consumer trust in financial services plummeted in 2008, has never been more urgent. However, the regulatory responses to the same event and the current risk environment in which banking operates have forced a slow evolution. Nonetheless, there are foreseeable events in the adoption of 3rd Platform technologies that will undeniably affect retail banking. Innovation and digital transformation are necessary to add value to both banks and customers. This innovation is happening in all aspects of the 3rd Platform, including:

- **Cloud.** IDC research has found that 50% of new applications launched by financial institutions will be implemented on private cloud — some institutions are already implementing aggressive "cloud first" policies for all new applications. Many of these cloud platforms are being built on the heels of virtualization and converged infrastructure initiatives. And although public cloud remains an almost taboo subject at most banks, some report that public cloud is appropriate for some workloads, particularly where sensitive customer data is not involved, such as mortgage appraisal services, credit reporting, and compliance.

- **Mobile.** Over 50% of customer-facing and enterprise staff applications will be deployed in a mobile-first model in the next five years. Both enterprise mobility and consumer mobility (beyond simple mobile banking) in particular will be of primary importance for lines of business such as lending, wealth management, and collaboration within the institution as well as key to becoming an integral partner in the consumer journey.
- **Analytics.** Enhanced analytics capabilities will offer any institution the ability to understand its customer base and make personalized offers based on individual, household, risk, and/or business relationships — improving share of wallet with existing customers and attracting new customers through product and service differentiation. Predictive analytics will further enable real-time decisioning to consumers who already benefit from instant gratification at retail stores, for instance, a perfect example of playing a role in the customer journey. First movers in deploying predictive analytics have a competitive edge in the market.

Legacy systems and siloed data are major roadblocks to the progress in analytics that can enable digital transformation. One tier 2 banking executive explained the challenges: "The push to replace legacy systems is customer driven. Customers often make requests that we are unable to meet, so we are finding it necessary to update to meet their demands and keep up with competitors." The challenge that banks face is that the shift from legacy systems to newer digital technologies is a long one, taking years. The elongated process can be a disadvantage for banks, and thus it is common for banks to look to external solutions to help augment and expedite their internal transformational efforts.

Data Analytics Is Top Priority in the Transformation to Digital Because Analytics Is Critical to Growing the Business

In the 2015 *Vertical IT and Communications Survey* conducted by IDC, 35.5% of institutions identified big data and analytics as their number 1 priority in the coming year — higher than any other 3rd Platform initiative. The primary BDA objective of banks is to understand their customers in order to drive revenue and growth. In addition, analytics can uncover opportunities to monetize internal and external customer data to drive competitive differentiation. According to a tier 3 bank, "Business users need to have access to data to analyze customer behaviors to upsell, cross-sell, and gain new customers. We are in a competitive environment, and our long-term goal is to differentiate ourselves using data and analytics."

Understanding the customer, reducing churn, and upselling are essential to business performance, but interviews with bank executives indicated that today most banks are leveraging analytics more for what they have to do (i.e., regulatory compliance and risk management) versus what they want to do (i.e., understanding customers to grow business and differentiate in the market).

Most institutions are already using some basic data/analytics for regulatory compliance, mostly for financial reporting, managing risk by analyzing each customer's situation as well as analyzing the overall portfolio. Risk analytics, data aggregation, and regulation (RADAR) initiatives will dominate the CRO agenda and will support accelerated business demands in 2015, with initiatives focusing on compliance, cybersecurity, and risk as well as relationship profitability and new product development. The focus now is moving from analytics for compliance to analytics for customer and product growth. One of the local banks interviewed explained, "[We want] to be able to see and analyze our performance for all aspects of our company to monitor growth and learn from successes and mistakes to ensure future growth."

Despite Business Priorities, Analytics Continues to Lack Sophistication at Most Banks, Inhibiting Banks' Ability to Monetize on Customer Data to Drive Revenue

Interviews confirmed that although data analytics is a top priority, it continues to lack sophistication at most banks. Data analytics remains a somewhat immature capability at all but the top 10 banks in the United States. This immaturity is primarily due to:

- **The lack of data integration across lines of business (silos) that would otherwise enable a 360-degree view of the customer and open opportunities for cross-sell and upsell.** This is the natural result of decades of system implementations based on point solutions to satisfy line-of-business requirements, with only secondary concern for enterprise management or leveraging infrastructures and the largest hurdle to overcome in digital transformation.
- **Challenges with data quality.** One of the biggest issues in data management today is the proliferation of data copies, residing all over the enterprise, often with no clear owner responsible for the "official" version. This lack of governance makes it very difficult to ensure data quality.
- **A lack of technical and/or governance skills in big data and analytics.** Data scientists are in hot demand, and there are not always enough of them to fill the necessary positions in banks. Skills such as governance and third-party partnership management are becoming critical in BDA, and there are no indications that this challenge will be met by the labor market in the short term. Prepackaged banking solutions with prebuilt platforms to run custom analytics can help solve this problem. Though such solutions are relatively new to the market, they can allow banks, especially midtier banks for which bespoke solutions are out of reach, to efficiently customize analytics and algorithms without the need for teams of data scientists.

The vast majority of banks — across all sizes — have yet to specifically master predictive analytics. As described by a marketing executive of a tier 1 bank: "Our bank has insufficient predictive analytics for our business due to lack of complete and accurate data. [The bank] is working on a large initiative to correct data at the source and put it into a format that we can easily manipulate and analyze." In particular, tier 2 and tier 3 banks lack predictive customer analytics capabilities — integrated across product systems and into their back-office systems — to create a holistic understanding of their customers' needs and behaviors, reduce attrition, and create upsell and cross-sell opportunities.

Some top-tier banks anecdotally report that data architecture (data integration, quality, and security) is one of the first areas of digital transformation. This in itself can be a lengthy process, particularly if the bank is running legacy systems or has recently merged with or acquired another bank. However, once data lakes and analytics are deployed to better understand the customer, banks will uncover opportunities to monetize internal and external customer data to drive new sources of revenue — a significant driver for transformation reported by the banks that were surveyed.

Options for deploying analytics are varied, and most banks use third-party resources or deploy packaged solutions at least in some capacity, but there is no magic solution to enabling analytics capabilities rapidly in order to monetize customer data and gain competitive advantage. To observe and analyze customer behavior across silos, productized customer analytics solutions, delivered as a cloud service (using tokenized data), can be appealing to midsize institutions with sophisticated business needs but short on internal IT resources.

Essential Guidance for Banks

The drivers for digital transformation — and specifically the role of data analytics — were clearly echoed throughout the interviews with bank executives; banks need to engage customers, monetize the data available from internal and external sources to create revenue opportunities through cross-sell and upsell, and support the compliance initiatives important to the enterprise.

There is no single approach to digital transformation that works for all. The variety of technologies, the age of systems, institutional focus (consumer versus small business versus corporate), and even the management style of the executives mean every digital transformation project will be different. Yet, wherever banks are on their digital transformation journey, they should consider the following keys to success based on IDC research and recent interviews with banking executives:

- Within the most successful institutions, organizational transformation is part of digital transformation. It is difficult to execute on digital transformation without addressing the challenges in the siloed organizations themselves. The most innovative banks, for instance, addressed and tackled organizational transformation before the first technology was implemented. These organizational changes must begin with leadership and eventually affect all IT staff.
- Data analytics is one of the first areas being addressed by banks today. All the institutions we spoke with agree that a sound enterprisewide data strategy and architecture is the foundation upon which the business will stay healthy (compliance) and grow (revenue). It is also the link between IT as builders and the lines of business as users. Nowhere else is this partnership more closely tied together than at the data level.

  Analytics projects don't have to be large, but with every data initiative, business value must be proven, integrate with enterprise strategy, and enable the next step. Ultimately, every subsequent implementation of a project based on, or that uses, data analytics should become cheaper and faster and provide more value.
- Partnerships are more important now than ever for two reasons. First, it is becoming more and more challenging to find (and retain) the expertise needed to build and maintain a critical data and analytics environment. Second, most institutions will admit that third-party technology partners can provide specific areas of expertise, which the institutions cannot bring to bear, because of the focus they have in those areas. For this reason, external partners will be key to digital transformation efforts.

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