FinSights from the FinLabs

Episode 1: Innovation and Commoditization in Banking

Transcript:

0:05 - Natalia Zurowski:
Hi, everyone, live from our virtual FinLabs, I'm your host, Natalia Zurowski, Marketing Lead, UK and APAC at Synechron and welcome to FinSights from the FinLabs - your podcast for the latest in innovation and transformation from our FinLabs experts.
Today, I'm joined by a very special guest, Tim Coates, Head of Digital, APAC at Synechron. Tim, thanks for joining us.

0:29 - Tim Coates:
Thank you for having me Nat, I've been looking forward to this.

0:32 - Natalia Zurowski:
Excellent. Before we dive in to get the latest and greatest views on innovation trends in banking, can you please give a quick introduction to our listeners about yourself?

0:49 - Tim Coates:
Sure, I'm the head of digital at APAC. I've been with Synechron for about seven years, working out of our London, New York and now in our Singapore offices. I had a great benefit of growing with the firm at that time, I think we're three or four times larger than we were when I joined. I lead the digital practice in APAC working with a lot of smart folk here, and other locations to sort of design and build technology enabled solutions that change the bank's operating model or business model. Previously, I led our blockchain Centre of Excellence, and I've been working in AI in more recent times. To be honest, my passion lies in identifying the trend lines of how new digital solutions or capabilities will help to align to the bank's strategic goals. And just really keep aware and abreast of the headwinds facing an industry and work for solutions and use whatever technology helps me get my solutions to market in the easiest way possible.

1:42 - Natalia Zurowski:
That's great. Thanks, Tim. For today's show, we're looking at innovation and financial services, something you've been leading the way on for Synechron for a few years now, as you said, the work that you did with the blockchain CoE and now some of the work that you're currently doing on the client side as well. What do your experiences tell you about how to drive digital transformation? What does success look like in the future?

2:02 - Tim Coates:
The Synechron sweet spot is in digital transformation and digital innovation in financial services. Our whole company's operating model deliberately lends itself to applying that strong banking domain knowledge to major high-end technology challenges. In the context of that role, I've had the benefit of seeing a lot and hearing a lot about big, cool digital projects around the world, transforming banks, insurers, asset managers, but at the same time, I would say in the last seven years of my career, at Synechron, maybe even go back to the last financial crisis, the banking business has got a lot tougher. The return on equity, the number of banks used to be around 20%, back in 2008. And these days, particularly in Europe, you'll see banks barely exceeding their cost of capital, so like 6 or 7%. I think

more and more we're seeing, well, I guess the challenge that we have here is to reconcile that digital is this great, amazing thing for banks to invest in but at the same time, the last decade of digital

investment has seen banks' profits, rapidly decline. And so is that because no one knows how to deliver these digital things successfully, obviously not. But I think you'd be pretty warm if you point to API's and the upcoming shifts, and how they and digitalization really supporting a trend line of commoditization banking, and that's been going at a pace for some time now. And commoditization, that's the erosion of any unique competitive advantage that a bank might have a particular area. So that the service offering they give is less sticky, easy to swap out and it's easy to price compare against another bank. And so, in that world where commoditization is really taking a hold, these digital investments are critical, you have to do it to survive. But at the same time, it's table stakes, and it's making everyone the same. And so, the place for relationship banking as a differentiator is certainly changing, I believe dying out, or at least the human subjective nature of it is, and so we're seeing digital transformation, to answer your question, as being, really looking for that next level challenge now. How do I build something proprietary and sustainable advantages with what I've got and how I leverage my incumbency advantages?

4:24 - Natalia Zurowski:
Right. So just going back to then, the commoditization that you were speaking of. This isn't entirely new; this is something that has been discussed for the last 10 years. But as you said, banks are doing it as a survival play. But surely there's different routes for banks to take here. I'm not saying commoditization is the only future for banks, can one bank not be better off as a result of its advantages and operations in the back end? Surely, the commoditization route works out just fine for them. Or on the flip side, if a bank is more focused on say, digital experiences, relationships, smart products and is better at building a brand, then they'll defeat commoditization of their business model.

5:03 - Tim Coates:
Yeah, so I can't give you a one cookie cutter answer for all segments of all banks. I tend to believe that those advantages that you speak to that in the long run, they're all going to even out to a zero-sum game. And digital transformations have, certainly looking back a few years were very rules based. And I don't think rules based digital processes or digital platforms, are creating any particular sustainable advantages. For sure there is that race to be the most efficient organisation to fast track that heritage, modernization journey, be more flexible, adaptable, as a bank. But ultimately, if everyone plans the same self-service, fully automated real time platform, and that will be the case across big areas of transactional banking, that all we've achieved is a zero0sum game ecosystem and banks probably have less look forward to there. Banks would prefer to strengthen and rely upon a relationship banking model. That's obviously just in the past. But I think these days, it's better to call that relationship banking to be more of a human plus machine relationship with an emphasis on the growth emphasis on the machine path going forward. And I think there's one exception to the rule of breaking out of commoditization and that's the ability for a bank to use its data assets, to offer solutions that are driven by analytics or data science. That's really getting us towards the database decision making that I mentioned earlier, going beyond rules based and that's the differentiator I see thanks to seeing long term and reorganising themselves around offering that. Data is an asset that will not even out over time, either you have the historical transactional data and portfolio data of your clients or don't. And so, you'll see more and more banks trying to strengthen their data holding around their existing clients. And as a bank strategist, I'm just looking for more and more ways to capture more and more data about clients. And that is how I'll compete in the long run: use my data assets to be a firm that stays in the value creation business, as opposed to just saying, add value capturers, which I think a lot of banks do today.

7:29 - Natalia Zurowski:
Let's just elaborate on that point a little bit further there on the value creation business. So of course, it's about creating and adding value, but just expand on that point a little bit more. Who from the banks is doing this well in the market today in terms of value creation, versus just capturing value?

7:47 - Tim Coates:
In any industry ecosystem, beyond banking as well and particularly where there's two sides to a market if it's a transactional nature, I like to look at every firm in that ecosystem, as either a value creator or value capturer. The value creators are the two ends on transacting with the buyer and seller, they are creating value for each other and exchanging value. And then you have, particularly in banking, you have a lot of value captures, less firms in the middle that are capturing fees in between those two sides in order to facilitate the safe and sound exchange value between them. In the case of banking, if these firms or the custodians and the market exchanges and the risk analytics platforms, for example, that are helping to exist to grease the wheels of a financial exchange and risk management, but if I'm a bank, what I'm looking to do or recognise that the most sustainable companies, etc., the value creators, the value capturers are always the ones that are being squeezed on margins. And you want to be a value creator. Value capturers is probably where banks have existed heavily in the past, because that business model is able to thrive and there's lots of information asymmetries and the ability to have a lot of extremely valuable data locked up in closed data stores in a bank has always helped them no more than their competitors, no more than their counterpart and find arbitrage opportunities that they make money off. Banks play both sides, but it needs to be prioritising areas where there are value creators.

9:38 - Natalia Zurowski:
Which one is the back then? Is a bank value capturer or is it a value creator?

9:44 - Tim Coates:
They're both. It's probably best to think of it as a spectrum, different banks in different segments in different markets will be somewhere on that spectrum. But particularly with banks no longer being able to hold a great deal of risk on their balance sheet, thanks to Basel and the other capital charges, more and more banks are not able to be a value creator, they aren't able to be one of the counterparts on the transaction. Or it's just prohibitively expensive for them to be that, and they'd rather just be the facilitator or create the exchange. But as I mentioned, it's very important to recognise that banks, their advantage over time came from that knowledge superiority of the market. And that superiority, that information asymmetry, that existed for many reasons, they always see as bank more trades, because you see, you have lots more counterparts. And so, you know where to find the arbitrage but for me, the number one factor is that now we are moving away from these flow datasets, where banking with whole golden source data, or a market infrastructure plan with whole gold source data and make it hard to get to, and that gold source data is telling me what the current bank balances for individual or corporate, saying what their positions are, for their past transactions. That's now made a battle by open API's, then we've really ripped out a big deal of friction that protected those firms that were holding that data store. I think an analogy that I always like to give on this topic is around the taxi industry, it's the same story that's happening in taxi issues, we have value creators here. You might have a driver and a passenger; the driver wants to make money as it's their time in a car and wants to make money and a passenger has somewhere to go and will exchange money to get there. In the past, we have these taxi companies that manually expense and perform the function to connect those buyers and sellers, you have to call up and, and they would find a cab for you and it'll come 30 minutes and you pay extra for that, because the taxi company will take a clip. And then the driver would take a clip and the drivers also paying extra lump sums to get their taxi medallion. But that's all ripped up because we now contract the real time GPS location of both the taxi driver and a passenger. And we can connect them via an app. And all of that friction that was previously sold by humans and taxi

companies is now solved by a platform; an app on your phone and Uber, Grab, Lyft, they all exist for that reason, because they are enabled by incredible transparency, and they create an efficient market where we did not have an efficient market before. Extend that analogy back to banking, we see all this investment from the banks, from the market infrastructure players, exchanges, building out real time API capabilities, so you have access to core infrastructure, and you can see real time data stores - that

is the exact same thing as a real time GPS, and so it's coming. And this is going to rip up that world we have today where we try to treat cheap delivery versus payment between two sides, using swift messages, using post rate processes, using lots of intermediaries, custodians etc. API's are going to allow a much more real time swap and that's going to eliminate massive amounts of that value capture and all the middle ups and backups that existed, capturing fees to help facilitate two sides that just want to swap positions in something. And all that money that goes into value capturing is money that's taken directly out of the pockets of the value creators, the corporate or the individual, that's where the opportunity is. It's quite exciting as a customer but for banks, they have to keep rethinking about where the long-term opportunity is to create value.

13:43 - Natalia Zurowski:
So just as an example, if I go to a restaurant, I get the food and I pay at the end, the restaurant takes the risks that I will do a runner and not pay.

13:53 - Tim Coates:
Yeah, exactly right. So that's why in banking, because we're talking about multimillion-dollar trades, we can't take that risk. A restaurant will accept the risk, that if you order a $20 meal, and you run it's not the end of the world to them. But if you're a $20 billion FX swap, I'm going to hire a tonne of organisations sitting between us to manage the risk that ensures that neither of us get caught up in that trade. And to facilitate, effectively there's an atomic swap between the asset and the cash that it's working for. It's pretty transformative stuff that's going on.

14:34 - Natalia Zurowski:
It definitely is and does sound exciting, but on the flip side, do you think this is a sort of a slow, relentless march to the end of banking? I understand from a digital perspective, the uniqueness between banks to a degree is dissipating. For example, I don't want to get started on my interest rates, now versus when I was 18 years old now but surely this creates room for something else? I have a viewpoint and I'll pass it to you first but how can banks thrive in today's current global climate and seemingly sort of, you know, that relentless push towards a, quote on quote, digital first agenda?

15:14 - Tim Coates:
I think there are segments of banking that I think are relatively doom and gloom with regard to the old way of doing things in the sexy jobs in a bank, perhaps some more on that digital strategist or the technology architecture side, and less on the front office relationship manager side. Call that doom and gloom or not, depends what your romanticism of banking is but I think there's, a few different ways to combat this. If I'm a bank strategy lead, and I'd see this decline coming and I'm looking and saying, well, for my particular bank, with this inevitable train charging towards commoditization that I highlighted earlier, what are the advantages that we have as a bank? What can we always do that someone else can't do? And what are the inevitabilities that are coming that we should just accept now because you might say, "We could plough billions into a digital transformation of a segment, that is the best it's ever going to give us as a 10% return on equity because it's going to become commoditized, then maybe we should just be pulling back from that segment." That's how banks have to think about what are the areas that will remain exciting and compelling to them long term, and where are they fighting a forever losing battle.

16:38 - Natalia Zurowski:
Absolutely. Just touching back on commoditization, as we were discussing before, it's a topic that's been around for quite some time already, as is. But what really is the difference between before commoditization now vs, then? Is it just technology has become more advanced or that it's actually become a leveller for banks, as you were saying before? Is it because there's more experts coming into the fore, competition from your challengers, of course, your Monzo's and Starling's of this world? Or can it be attributed to a combination of those things?

17:10 - Tim Coates:
I think it's probably that API story and the ubiquitous nature of and the support behind open API banking that's enabled by regulators or otherwise, or what that means going forward is to the point I've made a few times here is that data accumulation that an organisation has is their ultimate differentiator. If I look at a Monzo or a Starling, that is an area that they're going to struggle. They're going to compete on digital experiences for sure and that is what they have been doing, but they are having to offer digital experience that are so amazing that they cannot overcome an incumbent's advantages on data and network effects. To give an example, if Coca Cola and banks such as HSBC known around the world, and Monzo is going to try to compete against that, when Monzo has none of Coca Cola's historical data on trade, portfolios and how it moves when the market moves, then Monzo is never going to be able to offer anything like what Coca Cola can get from HSBC - same in the retail world. It's the same thing at a much bigger, massive scale. Monzo is competing for my personal business, when my incumbent bank that I already bank with knows a lot more about me, and what my preferences are, and what activity is fraud or not, for me. My point here is that, for me digital experiences are very replicable - data is not. And that's my bet is on the incumbent banks too often went out. Your incumbents have a lot of other advantages too. I'm just highlighting, the key thesis, from a digital strategist perspective, but clearly a universal bank also can make massive savings from the net interest income of those deposits and a Monzo or a Starling, they cannot- they offer a narrower offering. They don't have that diversification of revenue streams, the different cycles, and they don't have the deep enough pockets to play with universal banks as in cyclical markets. I continue to bet on incumbent banks coming through that particular challenge.

19:43 - Natalia Zurowski:
I love the point you made how you can't replicate data, but digital experiences are replicable. For me personally, I think customer experiences and relationships along with the data that you're describing is where I feel banks can have the biggest value add for their customers instead of looking at a product focus, banks should focus on their customers financial health. So even say in terms of offers, it's going away from what's the next best offer to say what's the next best action. So just as an example, the action can be advice or encouragement, just rewarding the consumer if they put in a certain amount of their savings account or if they reach savings milestones, and most people also don't really care about a bank creating a new product and I appreciate that might be a bit controversial, but people hate to be sold to as is. 50% of millennials don't even think their banks offer anything different. In a study I read recently, in Viacom, it was 53% - the number is quite staggering. And I was reading another article from Paul Rowan, a cloud consultant at Google Cloud, and he made a great point when he said a bank's brand should be supported by the best possible customer experience delivered to the customer's preferred digital interfaces, taking into consideration a country in which they reside in, the popular digital interface they use, sort of going back to the ecosystems model that you were speaking of earlier, as well. I think that's really the sweet spot, especially in a world of API's and banks. As I mentioned, going the ecosystem route, that's how banks will differentiate themselves but in order to do that, and understand their customers, as you said, data remains key, which is exactly what you highlighted and how your big banks, have years and years of data over the challengers. You could argue they're still definitely not harnessing it to its full power, but I think that's what you were alluding

to as well before that, once they do, that is the advantage that they have over the challenger banks. So just going back to then, what I was saying earlier about customer experience. Where for you, does the customer experience fit in all of this? In my mind, this is where banks are able to make a massive impact and that's what the unique relationships they have with their clients and developing not just digital products, apps, but providing them really with tailored customised experiences that will give them incentive to want to work with those banks or rather bank with those banks.

22:07 - Tim Coates:
I think that's my experience with many things. And you know, maybe immaturely enough, maybe 6, 7, 8 years ago, we might have thought customer experience being more of an interface led conversation and that battleground definitely happened. And then it was a conversation around jobs to be done, let's say and that sort of focus on personal financial management apps or financial health, you mentioned earlier. Those are definitely big battlegrounds and I think that more and more, you can't really see great difference between what your bank does what any other bank might do. But another part of that customer experience is the experience of being predictive and receiving predictive and timely and useful guidance from my bank as something I need to know what's happening. And that's that next best action piece that you mentioned, and that's again, controller database decision support. That's my key takeaway here is that, moving customer experience to go beyond robust processes into data driven processes, or decisions or support is a client experience play. As much as that maybe is getting into going beyond the realm of the traditional UI designer that people used to think owned customer experience, I think the customer experience is now owned by a very senior business lead rather than functional units horizontal.

23:39 - Natalia Zurowski:
A lot of what we really just been discussing now is really just innovation customised to the client. A solution and approach to a problem is different based on the incumbent power of that bank. This goes back to your point at the start around digital solutions that align to a bank’s strategic problems. Where do you find inspiration for ideation? You were working with Synechron's Blockchain Centre of Excellence, you've been working with multiple clients across the US and now Asia as well. How does a bank innovate its way out of a commodity trap, what is really important here?

24:14 - Tim Coates:
I think if you're an innovation practitioner, you have your favourite mind models, and favourite patterns that you like to apply to every problem, and I'm no different. People want to talk about jobs to be done or other well-known frameworks. For me, I like to get into the analysis that are underpinned by a lot of domain knowledge. And for me, I'll often look at market structure to find opportunity. We mentioned before value creators and value capturers, looking at every firm that exists in the ecosystem for a particular solution or segment and find inspiration and looking at circumstances where the value capturer for example is the one making outsized gains, and taking huge flips to the ticket. And so that's in those scenarios, you might find opportunities to create new network solutions, benches. Other circumstances where that's not the case, you might be looking more towards digital transformation in house to do it a little bit more efficiently because you're in a margin race. That's an area that I like to think about a lot. And when you're going through that value capture or value creator conversation, you're thinking about what are the industry blockers that are stopping or allowing that value capturer to capture so much, hold the market or hold a monopoly. I like to look into niche segmentation as well. Are there ways to divvy up the customers in a particular market? Maybe one type of customer is subsidising another type of customer, in that, if you have an alcoholic person who may be subsidised by somebody who looks after their body all the time, in the insurance and in car insurance for example or health insurance, is there a way we can divvy up this pool market to offer more customised and bespoke offerings that are better than these mass market offerings? There are so many different parallel trends you can be following within banking or beyond banking and what's the next possibility back to them. You see huge advancement in data availability through API's, but also a

huge investment in data quality. If data is higher quality and it's more available via API's, then what can I do? And that's where Stripe, Plaid and a few others found huge successes by building on top of that API centricity, and looking for the next big thing, and it's very clever. So as a practitioner, that's where your mind goes, where do I fit on these different mind models/frameworks?

27:13 - Natalia Zurowski:
Yeah, that's great. I was actually just going to say that we are just at the end of time. Thank you so much Tim for joining us today. It was great to just pick your brains on the sources of innovation that you see ahead in our future, the commoditization we're seeing in banking, what it means for the industry, the importance of data and the advantage incumbents have with it and more. Are there any final comments you'd like to leave our listeners with?

27:35 - Tim Coates:
Well firstly, thanks Nat, I enjoyed speaking with you today. I think these stories and experiences are all born from projects on the ground in all sectors of banking and we see patterns, so I'm happy to speak with any of the listeners today if you want to get in touch and talk about any of them.

27:57 - Natalia Zurowski:
Perfect, thank you Tim and thank you to our listeners for tuning in. If you're interested to find out more about Synechron and what we do, please visit www.synechron.com and if you like what you heard, please like and subscribe. Catch you next time.