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Driving Sustainable Ecosystems with BaaS

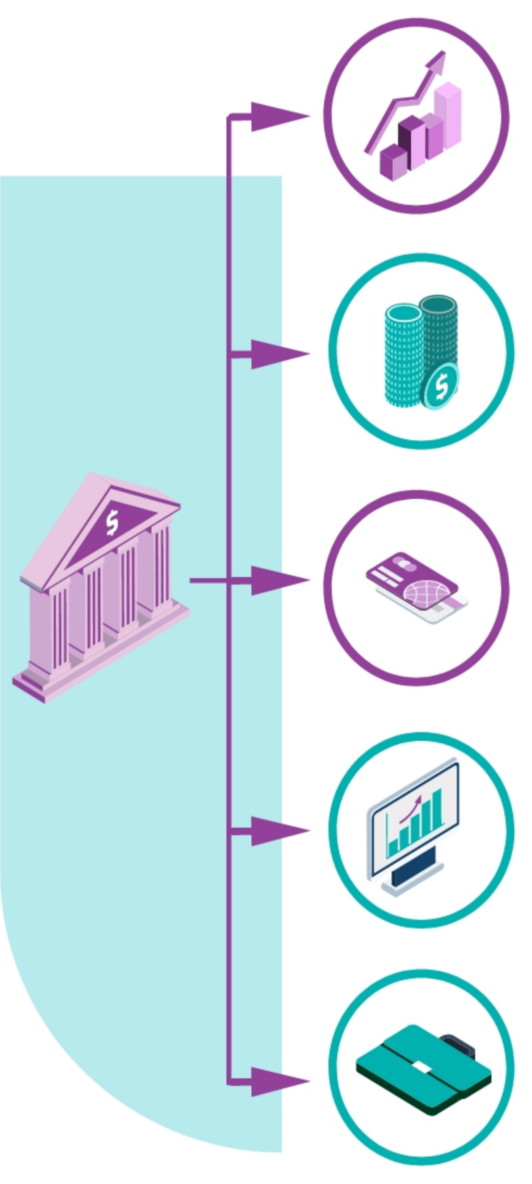
By Amit Dua, President, SunTec Business Solutions
Pat Nuzzo, Executive Vice President, Head of Commercial Liquidity Management, Citizens Commercial Banking
Likhit Wagle, Managing Partner, Financial Services, IBM Consulting EMEA
Steven Reiter, Managing Director, Ernst and Young

Changing customer expectations have had a significant impact on the banking sector. Customers want contextual, hyper-personalized, integrated banking experiences and on-demand access to banking services. In other words, they want to be able to access banking products and services at the exact moment they need it. Embedding financial services into other non-banking businesses is the latest development that puts the customer at the heart of banking. Banking-as-a-Service (BaaS) presents a new opportunity for financial institutions to acquire customers at lower costs, reach new customer demographics, grow revenues, and deliver customer satisfaction. It is a USD 25 billion opportunity and 11 percent of financial institutions have already implemented BaaS models while 20 percent are actively considering it. SunTec Confluence 2022 delved deeper into this emerging business model to understand how BaaS can help build sustainable ecosystems. Moderated by **Amit Dua**, President, SunTec Business Solutions, the panel included **Pat Nuzzo**, Executive Vice President, Head of Commercial Liquidity Management, Citizens Commercial Banking, **Likhit Wagle**, Managing Partner, Financial Services, IBM Consulting EMEA, and **Steven Reiter**, Managing Director, Ernst and Young.

BaaS – a New Phenomenon or in Action for Decades?

BaaS involved embedding banking functionalities into non-banking businesses to help customers avail themselves of financing and payment options on one comprehensive platform. But the question is, is this really a new phenomenon? The auto sector has been offering auto loans at point of purchase for decades, and the airline sector too has been offering co-branded credit cards for several years now. What differentiates BaaS from these age-old financing options? The difference, as Steven Reiter pointed out, lies in the immediacy of the services. While auto loans and airline credit cards have always been around, they could not offer loans or payment options in real time. BaaS embeds financial services into the heart of the business. Customers interested in a product can immediately avail themselves of a loan to pay for it at the point of purchase without having to leave the platform. Likhit Wagle also pointed out that thanks to technology, BaaS is now seeing wider adoption across sectors. Technology giants like Alibaba, Google, and Apple, are pursuing BaaS actively as it holds the key to solving core customer needs.

Navigating BaaS Partnerships



The entry of tech giants in the BaaS sector raises questions about who owns the customer journey or relationship. In a BaaS ecosystem operated by a fintech or a technology giant, the bank stands the risk of being relegated to the background, thus losing out on customer recall and loyalty. For example, a customer planning a holiday can use Google to identify a holiday destination, find and book hotels and flights, apply for a visa, pay for their trip and even avail themselves of travel insurance and forex without ever leaving the platform. While this situation is ideal for a Google user, the bank's brand identity may well get lost in the crowd. Therefore, many banks are now seeking to become orchestrators of comprehensive ecosystems rather than participating in one owned by another business. For example, DBS in Singapore orchestrates eight ecosystems, and this forms a core part of their offering. Pat Nuzzo said that BaaS focuses on the value chain of a particular industry, and this works well in some market segments.

As more banks get into the BaaS space, it is worth considering the kind of partnerships they want to get into. Market share, Return on Equity, customer engagement, margins, and volumes are some of the factors they must consider. For example, Deutsche Bank recently partnered with WeChat to provide banking services to WeChat's customers. This gives Deutsche Bank access to over a billion customers in China, but at low margins. Such an arrangement may not be a good idea for other banks. When getting into a BaaS partnership, banks must remember that ROE on back and mid office functions is only five percent while that on front office is 20 percent. A bank that remains in the background handling mid and back-office functions may initially gain access to a large volume of transactions and a wider customer base but will not be assured of long-term business growth and ROE.

Also, banks must not underestimate the assets they already have as they navigate the BaaS world. Larger banks especially enjoy a large customer base and despite the competition from fintechs, they also enjoy significant customer trust that they can leverage to own and orchestrate comprehensive ecosystems. SBI Yono is an example of an ecosystem orchestrated by the State Bank of India that capitalized on its wide reach and large clientele. It brought the right partners to the platform as they wanted access to the bank's 300 million customers. Some banks may also choose to focus on segments with a large market share and work with the leading solution provider for that segment. For example, a bank may consider the agriculture sector and partner with John Deere to connect with a large cross section of customers within that segment. There may also be specialist BaaS providers like Solaris in Germany or Starling in the UK that are cloud native entities with the capability of offering the right solutions at the right time at low costs.

Striving for BaaS success

The business of modern banking calls for an agility that traditional banks do not have. They must radically simplify operations to be able to succeed in a commodity intensive business. The focus must be on delivery efficiency now. Banks must accelerate their technology adoption as the traditional banking models differ significantly from BaaS ones. Most banks work with high-cost networks while BaaS platforms are virtual with no associated costs. These also work at the microlevel and hold infinite possibilities as they are flexible and scalable and capable of changing as customer behavior evolves. Partnering with the right organizations that deliver the right value is critical for organizations embarking on this journey.

The key to BaaS success lies in effective use of data. And at the same time there are regulatory hurdles to cross as well. Regulators have concerns around unregulated lending, data privacy, and the increased penetration of fintechs, but at the same time they are aware that customers want the personalized ease and value delivered by a BaaS ecosystem. They will find a way to balance both sides to ensure security, economic growth as well as customer satisfaction. More importantly, BaaS players will have to develop the capabilities of complying not only with diverse regulations across geographies but also different customer behavior trends. For example, not only does Europe require compliance with GDPR but European customers are also more reluctant to share their data, making it challenging for BaaS ecosystems to drive relationship based personalized engagement. Customers across Asian markets like India, China, Singapore on the other hand is far more open to sharing data if they perceive a value exchange.

When it comes to BaaS, fintechs and banks are not in a position of competition against each other. Banks still lack the capabilities required to handle a multi-vendor ecosystem, manage open APIs, testing, release management and more. On the other hand, fintechs have evolving regulations to contend with and lack the reach and trust enjoyed by large banks. BaaS ecosystems offer a symbiotic relationship that can benefit both parties and help deliver the best experience possible for customers. Such relationships are well established in industries like pharma where large companies tie up with universities and bio tech companies to speed up research and development. The real competition for banks will come from tech giants who have the will and the means to own ecosystems. The BFSI sector will need to focus on creating comprehensive strategies for BaaS partnerships with tech giants in the coming years.