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Digital Transformation and the Rise of the API Economy

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"If it doesn't challenge you it doesn't change you." Fred Devito. The year 2020 will go down as a tough year filled with challenges and learnings for the banking industry. While internet and mobile banking was gaining ground before the pandemic, the global crisis made digital the only way to reach out, engage and meet customer needs during lockdowns, making it more about a bank's actual survival than a box to be checked. As customers increasingly turn to digital alternatives, banks must follow to stay relevant, survive and thrive.

Another significant change connected to digitization is the rise in the API economy. Open banking, enabled by open APIs is today firmly embedded in financial services, putting customers in control of what products and services, including those of partner products, they consume; and which provider they choose to use and buy from. Which means that the purchase decision could originate at the third-party provider level and not the bank at all. In this changed context, third party service providers, big tech companies and fin-tech are all contenders to becoming customer owners.

Even amidst these very real challenges, banks still have the best starting advantage given that they have not just large amounts of customer data with customer consent to share such data but importantly, banks still have the trust of their customers, the greatest asset to winning and retaining customer loyalty.

The Changed Contexts that are Driving Banks

There are three realities that banks today have to deal with – first, a significantly changed customer expectations; second, an equally changed competitor landscape that has thrown up non-traditional, new-age and tech-led companies; and third, the enhanced power of collaborative ecosystems that use various kinds of technology to deliver better customer experience.

These changes have happened in less than two decades and with it – where earlier, customers had to go to a particular bank branch, technology and digitization enabled banks to start centralizing systems, therefore making it branch-agnostic and possible to service the customer across branches. This was the first step in what we now take for granted – the need for positive customer experiences, where an individual is a bank's customer and not just that of a certain branch.

However, banks will need to find ways to leverage the trust capital that customers place in them and find a balance between physical and digital presence. In a recent study on post-pandemic banking behaviors, Simon Kucher & Partners discovered insights that showed that today's customer wants both. 54% of respondents said they would "only" open a new account with a bank that had physical branches, 26% said they would move some or all their business to another bank if their bank branch shut down temporarily and 65% said they would take some or all of their business to a competing bank if their bank branch was to shut down permanently. But the study also found that customers are unlikely to stay with and would choose banking with institutions that offered better digital experiences.

Matching Customer Expectations – Going Beyond Functional Needs to Meet Emotional Needs

A Deloitte financial study done in 2018 had some interesting insights on customer perception of the way they transacted with their favorite brands compared to their primary banks. 67% of customers even two years ago felt that their favorite brands routinely found ways to improve their experiences and delivered greater value; only 49% felt the same about their banks.

Customer expectations have evolved where banking is an activity done while doing other things – boarding a flight, queuing-up in coffee shop, indeed just about from anywhere. The expectations are for speedy service, the best offers when compared with others on the internet, while at the same time offering unobtrusive, ubiquitous, and immersive banking.

Customers are demanding more value out of their relationships with their service providers and banking is no exception. They are also looking to control more of their banking, going beyond statements and accounts, into wanting ready access to the products and services they are subscribed to, looking at ways in which to increase benefits and value for their money. Which is the promise that open banking seeks to fulfil.

Enhancing Positive User Experiences by Developing an Experience-First Mindset

Since customer expectations will only increase with greater proliferation of technology and service provider choice, it is imperative for banks to develop an 'Experience-First Mindset', moving away from the traditional products and services mindset.

From Banking-as-a-product where the focus is on selling traditional products such as loans, credit cards and money market accounts, banks must move to banking-as-a-service in the short term where they become plug-and-play services with the adoption of APIs and move to open banking. In the long term though, banks must graduate to becoming ubiquitous, cash-free, and part of consumers' everyday lifestyles. This paradigm shift to ultimately becoming banking-as-a-lifestyle is possible when banks leverage a technology landscape defined through a customer-centric IT strategy enabled by APIs, analytics, cloud and microservices.

The picture of what the competition looks like today is something most banks would not have foreseen at all. Already in some parts of the world, small and differently positioned challenger banks are becoming household names. With the systematic unbundling of banking services, fintech companies are nibbling away at many banking services. The proliferation of payments apps, the sudden interest in the traditionally underserved SME market, the personal finance management space – all make for increasing competition for banks that are facing a double onslaught – from new, challenger banks on one side and fin-techs on the other.

The path ahead lies in banks making a conscious choice – to become utilities or innovate to become 'everyday banks.' In other words, to be low cost, high-efficiency utility providers, or evolve to becoming customer-owners, providing not just their own products but completing the customer's experience cycle with a host of partner products as well.

The Glue that Can Make It All Possible – Technology

- Most banking IT landscapes are inherently complex and continue to be challenged by legacy core technology systems that are in many cases, outdated but cannot be replaced because of the vast customer and product data they hold. This has hindered banks from being as agile as the changing world around them, leading to inadequate and unwholesome customer experience. It is certainly not for lack of understanding or trying – the Deloitte Center for Financial Services Global Outlook Survey 2020 found that 48% of banks were already implementing digital transformation of their business services, while 44% were in the process of doing so.
- What is needed is a digital core that can orchestrate customer experiences, vital for effective transformation. Such solutions are being looked at closely. Hollowing out the existing core and the setting up of a digital core, called System of Engagement vis-à-vis the System of Records in the back office is what banks require today. This digital core sits below the channel layer, which banks use to interact with their customers. This clean and effective technology architecture, which sits atop the back office and below the channel, provides the necessary intelligence to deal with the customer, allowing for prescriptive actions, forming a bridge between the top and bottom layers. This API-based layer is designed with customer centricity in mind, enabling banks to provide world-class customer experiences.
- This makes it possible for banks to rationalize their product offerings, create ecosystems that can provide value to customers across their spectrum of needs and therefore provide seamless and excellent customer experiences.

Delivering True Value

To meet customer expectations in a changed world, with increasing competition, transformation must be well thought out and not done in an ad hoc manner with short term gains in mind. For digital transformation to work in banking and financial services firms, there needs to be a focus on great customer experience and effective ecosystem management. Achieving delightful customer experiences needs a digital core and ensuring effective ecosystem management needs fair distribution of value amongst the partners within it.

For banking to reach the next level and not just match up to what the customer expects today, regardless of whether the banking is for consumers or corporates, banks need to ensure that the right solutions are put in place to make digital transformation work to offer not just products and services, but unparalleled end-to-end customer experiences.