pointofview

Digital Innovation in Banking: **Outsource and Let the Tech Pros Take the Reins**

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Summary

Today's banks are feeling the squeeze from Silicon Valley's fast-moving Financial Technology pioneers. Whether it's investing directly, staging special events or supporting promising start-ups and idea incubators, banks can stay ahead in the race to please customers, grow accounts and operate seamlessly by outsourcing innovation processes. Farming out innovation gives banks access to all the cutting edge customer-centric digital technology, bells, whistles and tools without sacrificing focus on their top priorities: security, regulation and integration of legacy systems.

Ipsos insight: Banking executives know their business best, and they say it doesn't make solid financial sense to pour dollars into risky innovation in-house. The best solution: outsource it.

Innovating to stay competitive

We were in a top bank branch yesterday, waiting for a colleague to do some quick banking before lunch. He had just remotely deposited a check from our office and had to make a $1,200 withdrawal in person to pay a freelance employee. As he was waiting, a staff person pulled him out of the teller line, letting him know he could now make the large withdrawal using an advanced ATM machine. The banker showed him how to dispense the cash in denominations of his choice and reminded him he could use his phone if he needed to transfer money to cover the withdrawal amount. He could've even done this without a card since the new machine accepts Apple Pay, and customers only need an iPhone for that transaction.

Our group was very pleasantly surprised by these combined innovations—remote deposit, mobile account management, automated cash handling and cardless payments—all supported by a helpful, engaging banker in an attractively renovated branch office. This represented improvement at its best—a clear example of how banks are finding new ways to deliver "digital innovation," a term from Forrester research analyst Oliwia Berdak, with a common theme of "relentless focus on delivering new value to customers."

Upon closer examination, however, we realized none of this is internally developed. Not one service is unique to that bank brand (mobile banking, advanced ATMs, retail-style customer engagement); all are common to major banks and none are homegrown. The whole experience is the result of outsourcing on some level. We see this trend as the wave of the banking industry's future: developing new tactics to externalize their innovation process.

There are many factors causing banks to go outside their organizations. As classic examples of "operate and maintain" institutions with goals that continue forward momentum in core businesses, banks must grow customer accounts, keep consumers happy and make no mistakes. New types of financial services have to tie in with current accounts, underwriting, providing capital, enabling payments and writing loans. While past innovations, such as ATMs, online banking, reloadable prepaid cards and mobile banking, made retail banking more convenient, none strayed far from basic banking services. Banks are not places where "blue-sky" development teams focus on outflanking potential disruptors: they're just not built that way.

Can’t beat Financial Tech? Join forces.

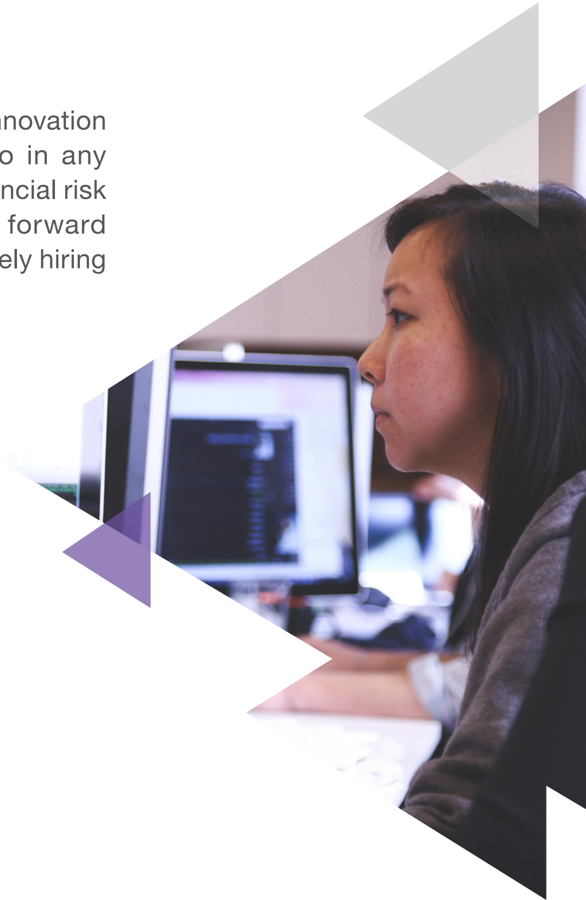
In today’s tech-dominated global marketplace, fear is a big driver of banking innovations. The vast majority of traditional financial institutions (83%) believes part of their business is at risk of being lost to standalone Financial Technology (FinTech) companies, according to a Price Waterhouse Coopers survey of global financial executives. Among bank executives, that figure reaches 95%. This threat of disruption, and disintermediation, is palpable. When Chase CEO Jamie Dimon warned “Silicon Valley is coming,” he wasn’t talking plate tectonics. He knows FinTechs are faster at responding to changing consumer needs, finding new ways of doing things more simply and quickly with less “friction” from some process obstacles banks put in their way.

And although financial service companies are staffing “innovation” positions (there are more than 100 bank executives with that word in their job title), that does not necessarily mean the institution can or will keep pace. In fact, innovation is seldom listed as a priority in polls of Chief Information Officers. Instead, CIOs more frequently mention legacy systems integration, new compliance regulations or upgrading security. “We are not big believers… in innovation for innovation’s sake and the idea of one success for every ten tries,” one top bank operations and tech executive said. “Banking is a thinly margined business…the whole idea that we would devote a tremendous amount of money to something with a 10% hit rate is not, in my view, economically viable.”

How then should banks respond to the FinTech challenge while facing cultural, structural and regulatory headwinds? The growing trend, and best approach, is to outsource their innovation process.

What does innovation outsourcing look like?

To be fair, we are stretching the definition of outsourcing a bit. Innovation outsourcing takes many different forms. But what it does do in any construction is consistently reduce costs for staff and mitigate financial risk while maintaining positive brand connections to novelty and forward thinking. Bankers can take diverse tactics that go well beyond merely hiring an offshore tech team to upgrade a mobile banking app.



Direct investment

The first, and perhaps the most common, approach is investing directly in FinTech. In an if-you-can't-beat-'em-join-'em strategy, banks place a financial bet on a firm's concept while testing its viability on customer segments. Here are a few examples:

- JPM Chase is collaborating with OnDeck Capital, a small-business lending platform aimed at disrupting traditional bank lending. Chase hopes that by using OnDeck's processes, it will reach more of its own small business borrowers faster and improve on its 8% market share, according to Barlow Research.
- Super regional bank Fifth Third made a direct investment in Zipscene, a data analytics company, without an immediate product application such as with Chase and OnDeck. Fifth Third's CEO Greg Carmichael, the former CIO, made the move knowing that data science is crucial for Fifth Third to keep pace with its rivals in merchant services and payments.
- Spain's BBVA went one step further acquiring Simple, an established mobile banking app. In a single move, the bank says it rolled out a mobile app to its customer base and now uptake is growing 10% a year.

Hackathons

The second tactic involves a bit more fanfare, mixing the publicity and buzz of a contest with a review of emerging and qualified developers. Generally called "Hackathons," companies build these events around a challenge and force participants into time-limited development contests.

Bank of the West and its parent BNP Paribas sponsored a two stage Hackathon early this year at which participating tech teams focused on customer experiences in "Click & Mortar" and "Financial Literacy & Empowerment." The event cast a wide net for contestants working simultaneously in five cities—San Francisco, Paris, Brussels, Istanbul and Rome—to demonstrate new ideas and solutions. Bank of the West invited winners to a "digital boot camp" where BNP tech leaders shared guidelines and mentored teams in product development. This is also a way to outsource tech talent acquisition: for the cost of a special event, BNP Paribas in this instance gets to review a worldwide talent pool while selecting the best new ideas generated in the heat of competition.

Start-up/innovation support

In ways similar to the digital boot camp, we envision banks investing in support for incubators and accelerators for start-ups, taking a page out of the venture capitalist's playbook. The simple act of paying for a workspace, for example, and providing some coaching and business model development, gives banks a chance to shop for new ideas without making big financial bets.

One of the largest incubator programs is Lab of America's QC FinTech program in Charlotte, NC. Lab of America accepts up to 70 applicants and chooses six for the three-month program. A team of mentors from Lab's sponsor, Bank of America, and others from top technology and finance organizations, help each start-up get its product off the ground. Level39, a similar effort in London, is centered around a space made available by the owners of the Canary Wharf complex. But Level39 shows its prospects to Barclays, HSBC, Lloyds and Royal Bank of Scotland through its *Innovate Finance* events.

More and more banks will also start showcasing innovation labs. The common tropes are ultra-modern, playful spaces where relaxed staffers can bounce around new ideas animated by their creative environs. Capital One has built three of them: "design thinking" sets the tone for "building the products and experiences that our customers need," according to the company's press statements. In Australia, Commonwealth Bank CEO Ian Narev invested $3 million to build a facility inspired by a trip to Silicon Valley. Commonwealth made its Innovation Lab to "replicate a lot of the conditions and opportunities" in product development by bringing people into a special place for blue-sky thinking.

Most of these spaces are fun and can effectively host product-testing environments while simultaneously showcasing the sponsor's progressive brand. Here, too, the outsourcing technique focuses on interior design with the greatest impact on testing branch designs and color schemes.

Is this a wave of the future?

Is this where it's all going in banking? We say, yes. Our research indicates this pattern will persist for the next few years because economists expect underlying conditions to remain the same. Consumers will likely continue to find frustration with banking processes. People will keep searching for new ways to use their increasingly powerful mobile devices to make their financial lives easier. And banks will need to keep pace by digitizing all of the services they offer. Former rivals will become partners—and all, including the customers, will benefit.

While innovation demand stays constant, banks can take a diverse outsourcing approach by making measured, limited moves with those very same FinTech companies they used to fear. In fact, direct investments in FinTech shows off banks' greatest strength: their enrolled customers. Banks can use that leverage to bring customers to product trials even faster than FinTechs could on their own.

We also expect banks to continue spotlighting their internal product development capabilities with Hackathons and incubator investments. This obscures the underlying outsourcing of new ideas, while presenting brand promotion and hiring opportunities at the same time: a win-win. Banks need to attract new talent, and demonstrate they can provide aspirational career opportunities. Outsourcing innovation in many diverse ways will be the key for banks to thrive as we move farther into our rapidly evolving, always-on digital future.

About the Authors

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