Digital Disruption: Embracing an Integrated Digital Ecosystem

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Investment banking firms are under pressure from all sides. Non-traditional competitors are entering high-margin areas, such as capital raising and advisory services, while other services face continued commoditization and competitive threats from lower-cost providers. The recent era of cost-cutting, using traditional approaches, has reached the point of diminishing returns, and many established firms still carry the burden of complex, often inflexible operating and technology platforms that make innovation difficult (see Challenge 2: Investment Banking Technology: Jettisoning Legacy Architectures).

Investment banking was once characterized by high barriers to entry, but many of these hurdles have been lowered. As the consumerization of technology continues, flexible sourcing of people, infrastructure, software and information—through the use of cloud computing and “everything as a service” (XaaS)—has converged with new design, development and deployment approaches and tools. Once estimated at $5 million, the cost of launching a tech startup has been dropping steadily to just $5,000 in 2011—and is likely even lower today (see graph below). A recent MIT/NBER study noted that organizations that support regional accelerator programs can now provide meaningful funding and assistance to their startup portfolio companies with a seed investment or stipend as low as $15,000.¹

In Short

The Cost of Launching a Tech Startup Has Dropped Dramatically

$5 million

$5,000

Number of FinTech Deals in New York

33

85

2010

2014

Specific Steps for Investment Banks

Redefine clients, value propositions and roles in the ecosystem

Embrace modern architectural principles and concepts

Establish a renewed focus on talent

Encourage and institutionalize innovation

Cost to launch a tech startup over time

Source: https://www.cbinsights.com/fintech-trends-overview
The "digital revolution" presents opportunities for capital markets firms

<table>
<thead>
<tr>
<th>Change how work is done</th>
<th>Enhance efficiency</th>
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<tr>
<td>Change role/value of processes, data and infrastructure</td>
<td>Exploit data</td>
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<tr>
<td>Change the nature of customer interactions</td>
<td>Engage customers (products, segments &amp; channels)</td>
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<td>Shift value within or across industries</td>
<td>Evaluate operating model boundaries</td>
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<td>Create or destroy industries</td>
<td>Experiment with new business models</td>
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Other players—such as asset managers and hedge funds— that have their own platforms and the desire to expand into investment banking also face reduced costs. The lowering of these barriers is helping to fuel a resurgence in innovation, with client emphasis driving new thinking and the biggest ideas originating from unexpected places.

Cost and complexity—once sources of competitive advantage—now serve as encumbrances, making traditional players seem antiquated and arbitrarily complex. Scale and global reach have become de facto commodities, and information and liquidity are no longer constrained. The central investment banking concept is changing and a new digital ecosystem is emerging. Innovative firms are rushing to capitalize on opportunities to better serve clients and partnering to better manage cost and risk.

The innovation imperative

Investment banking used to be a highly innovative industry, but cost reduction, compliance and restructuring have trumped the development of new client-centric ideas in recent years. Years of cost-cutting have weakened the structures and the culture that once encouraged innovation. Technological and entrepreneurial talent have recognized this stagnation and begun turning to other industries. Continued regulatory pressure and the massive sunk costs of legacy systems also serve as barriers to innovation.
Innovation in financial services is proliferating, but investment banks are less often at the forefront of new ideas. Accenture research indicates that banks are devoting three times as much money to maintaining legacy systems as they are to building new platforms needed for growth. Meanwhile, venture capitalists are pouring money into innovative FinTech startups to fill the void.

Companies such as Google, Facebook and Uber are attracting top talent (see Challenge 1: Workforce of the Future: Dealing with Business Change and the Millennial Challenge) and entering new businesses. Similarly, financial services firms outside the investment banking realm, including Vanguard and BlackRock, are gaining a reputation for developing innovative products, both on their own and in partnership with others. Investment banks must either shape the emerging digital ecosystem, or risk being shaped by it.

Investment banks can therefore no longer afford to operate from behind fortress walls. Their future success will depend upon external collaborations that improve business operations, particularly those that introduce systems to support new products and better customer service. Eventually, investment banking firms should be in a position to not only participate in their clients’ digital ecosystems, but also manage and direct their own—drawing on skills and resources that would be impossible to replicate internally in a cost-effective and timely way.

Investment banks should also note the changing nature of the industry’s technology providers. Varying in size, many of these providers no longer see themselves as developing enabling technologies, but rather as helping to define and satisfy end-client expectations related to service delivery and overall customer experience. Firms like Can Capital, Motif, and Funding Circle (among others) are demonstrating that technology and experience-led innovation are not limited to the retail space. These types of providers are creating competitive offers that challenge aspects of investment banking and push other players in the ecosystem to innovate.

“Investment banks could jumpstart ecosystem development by acquiring businesses (particularly high-potential tech startups), investing in greenfield ventures that emphasize new client categories or banking capabilities, and forming joint ventures.”

They have access to deep talent pools and attract many of the most promising new entrants to the technology field. New techniques and technologies let them innovate and scale quickly at minimal cost.

To take advantage of these developments, investment banks must embrace participation in digital ecosystems and begin to forge ecosystems of their own. This shift in thinking represents a fundamental leap “back to the future”—to a time when innovation was institutionalized, the battle for talent was being fought (and won), business and technology architectures were open, and collaboration and utilities reigned.
Specific steps for investment banks

- **Redefine clients, value propositions and roles in the ecosystem.** Investment banks need a clear, up-to-date picture of the clients they want to serve and the services they want to deliver to those clients. They must understand how value is derived in order to identify areas for investing, partnering and leveraging third-party innovations. Taking advantage of the ecosystem—particularly in the areas of design and experience—to bring valued information, products and ideas to clients is essential to a winning strategy. Banks must clearly define their role in the new ecosystem, collaborating with partners to achieve scale and pace and try to relegate non-core functions to other ecosystem participants when appropriate.

- **Embrace modern architectural principles and concepts.** The design of all future products, services and platforms must be experience-driven, service-oriented, collaborative and cloud-based. Micro-services architecture, development operations (DevOps) and XaaS, should no longer be considered technical jargon, but fundamental to the business and technology vocabulary of the investment banking industry.

- **Establish a renewed focus on talent.** Today's entrepreneurial and digital talents are motivated by opportunities to work in innovative environments and solve complex challenges with the latest approaches, tools and techniques. Investment banks should aim to recruit candidates who are focused on design and accustomed to working at pace, and seek to create an environment where such individuals will thrive and grow (see Challenge 1: Workforce of the Future: Dealing with Business Change and the Millennial Challenge).

- **Encourage and institutionalize innovation.** An external perspective can help investment banks initiate cultural change. That may involve adding individuals with a track record of digital success to the board of directors, establishing an internal growth council, setting up a "seed fund" and an incubator to cultivate promising digital opportunities, and forming closer ties with the venture capital community.

Establishing momentum is an important element of any successful change journey, but it is particularly critical when tackling digital innovation and ecosystem development. It is an opportunity to demonstrate early results and gain recognition for a willingness to innovate and experiment. Investment banks could jumpstart ecosystem development by acquiring businesses (particularly high-potential tech startups), investing in greenfield ventures that emphasize new client categories or banking capabilities, and forming joint ventures. In addition to identifying and exploring areas of "white space" with high potential for returns, banks should look to establish pace, momentum and a reputation for forward-looking investment.

**Conclusion**

The move to an integrated digital ecosystem is not an option for investment banks—it is an imperative. The nature of each ecosystem will depend on the customers, capabilities and value proposition of each firm. Successful firms will be willing to unbundle their current offerings and combine financial expertise with digital sophistication to create new ways to deliver value to customers and differentiate themselves from less adept competitors.
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