Banking reinvented

Beyond value chains to value networks

By Mauro Macchi, David J. Levi and Steven Westland
Reinventing markets

Like many consumer-facing industries, banking has entered a new era. Changing customer attitudes and continued volatility are compounded by increased mobility and the relentless rise of FinTech ventures. Technologies are now disruptive—no longer being applied to fix specific business demands, but must be integral to business strategy and exploited for maximum impact. The combination of these factors is creating a fundamental shift in the structure of the banking industry as we know it. Banks need new value chains without boundaries—to drive innovation, scalability and speed they are seeking out value networks.

What is a value network?

A set of interdependent connections (relationships) between multiple nodes (members) interacting with each other for mutual benefits (tangible and intangible). Products, services, technology as well as information and knowledge can be exchanged among members. Value networks can grow across adjacent or complimentary businesses and provide composite customer experiences that meet unfulfilled needs.

Many FinTech players already own the characteristics that banks desire. Moving fast up the traditional S-shaped growth curve, FinTechs’ development costs are contained and they can compete at speed. Timing is everything. Technology, together with its specific business impact, is changing from being an enabler to becoming a key driver of distinctive strategic positioning. Technology advances, such as the cloud, APIs, robo-advisory, big data and blockchain, can radically change the way banks are running their businesses—introducing increased agility, a highly-connected operating model and a streamlined cost structure.
Banks are not protected from obsolescence and the risk of disintermediation is real. According to recent Accenture retail banking research, banks are at risk from losing more than 30 percent of revenues. Accustomed to the superior experiences offered by digital natives, customers expect more from their everyday interactions with their banks—and their loyalties only extend as far as these expectations are being met.

Industry value is under pressure; more than 60 percent of banks in Europe have a price-to-book value of less than one, significantly lower than the overall market average of around 1.7 in the period before the financial crisis (2007). The recent collapse of the stock market, together with a slow-down of emerging markets, a fluctuating socio-political landscape in Europe, as well as new regulation, has further exacerbated this phenomenon. Industry risk profiles are being redefined. The focus has shifted once again to efficiency and cost containment but, given the new competitive landscape, efficiency must be instrumental to fuel new, disruptive growth.

Banks need to adopt a flexible, customer-centric strategy. They must become more agile, so that they can be more responsive to cultural change, manage a digitally savvy workforce, keep pace with regulatory and security demands and explore the technologies that underpin the new wave of value networks.

Global investment in financial technology ventures continues to expand every year. FinTech financing reached US$22.3 billion globally in 2015—a significant increase from US$12.7 billion in 2014 and US$4.8 billion in 2013. The highest growth rate was found in Asia Pacific which more than quadrupled in size to US$4.3 billion. Asia Pacific is now the second biggest region for FinTech investment after North America and represents 19 percent of global financing activity. The rate of growth in Europe, although still buoyant at 122 percent in 2015, is slowing down, in part due to one of its major capitals, London, reaching a new maturity level.
Embracing change

Banks are embracing digital change at different speeds. They are focusing on open innovation, which is at the heart of the digital transformation, engaging with external technology solutions, knowledge capital and resources early on in the innovation process. One example is in the area of blockchain, the protocol that underpins the distributed architecture of the Bitcoin cryptocurrency. Forty-two banks are joining the Blockchain Consortium R3 and most global banks are evaluating blockchain technology. Santander, for example, has identified 25 “use cases” for the technology. Deutsche Bank expects commercial blockchain technology to be introduced within the “next 12 to 24 months,” and an online survey of FinTech entrepreneurs and investors found that 24 percent of participants see the biggest opportunity for FinTech disruption currently in the area of infrastructure (blockchain or APIs).

Collaboration—or “co-innovation”—is not a new concept in the financial services industry, but is becoming more important, inside and outside the industry, to identify new ways to generate value. Banks are undertaking partnerships and acquisitions, creating incubators, and strategic investments to help them rebuild themselves as consumer platforms that are inherently digital. And it is not only FinTechs that are changing how customers manage their banking needs. Third-party “aggregators” are enabling customers to serve their banking needs by visiting one platform, eliminating the need for any direct contact with the bank.

According to Accenture Research financial institutions prefer to collaborate with start-ups or entrepreneurs through corporate venture investment (36 percent), accelerators or incubators (34 percent) or joint innovations (26 percent). More than half (55 percent) of financial institutions are already collaborating with start-ups or entrepreneurs specifically on innovation. Forty percent of respondents stated that they are planning such collaborations in the next three years.
There is a shift from competition to co-opetition. On one hand, banks are looking to the FinTech community for innovation at speed, partnering with FinTech to develop faster and better products, target new customer segments (millennials, digitally savvy customers, unprofitable segments) and grow new ecosystems. On the other hand, FinTech companies recognize the need for banks' infrastructure, their key capabilities (for example in large-scale distribution, risk and compliance, scoring), their client base and capital to run a sustainable and scalable business. For instance, Betterment is teaming with Fidelity Investments to provide advisors with automated investing services and client experience to grow their business. JPMorgan is working with On Deck to speed small-business loans to offer virtually real-time approvals and same- or next-day funding.

Removing limitations

Incumbent banks have three main limiting factors in tackling their changing landscape:

- **A gap in technology acumen and expertise in the "decision rooms":** Accenture found only 6 percent of board members and 3 percent of CEOs have professional technology experience. Since technology is no longer an enabler of strategy, but serves as a critical competitive advantage, improved technology capabilities could help banking leaders make informed decisions, faster and more effectively.

- **A gap in the speed of change and time to act:** Incumbents have strength in being large, well-structured organizations, but are weak in terms of agility and speed to change. Timing is crucial. Banks should evaluate their degree of “readiness” (in terms of technology, business, compliance and overall agility to change) and take action accordingly. Banks need to accelerate the pace of innovation and revitalize their businesses if they are to remain competitive.

- **A cultural attitude and aversion to change and risk:** Start-ups may have the advantage of having less to lose, but being too conservative is risky in a fast-changing, digitally disruptive environment—culture must not be a barrier to the concept.

These limiting factors can be overcome when banks focus on digital financial solutions to redefine their businesses.
Competing effectively

In a new environment, where FinTechs are well established, technology is disrupting the industry, pressure from regulators is increasing, and banks are being exposed to new risks. Incumbents face some hard choices. Banks can either try to compete or embrace the FinTech culture. They must rethink their business and operating models, reevaluate the customer experience and adopt technology as a driver of a distinctive strategic positioning. In short, incumbent banks must upgrade their value chains to value networks that fundamentally redefine their businesses.

Banks need to consider three fundamental “truths” when defining their new strategy:

- **Platforms rule.** Transformation is necessary at the core of banking business. Using platforms (see sidebar), banks can build an ecosystem of partners that operate outside current industry boundaries to establish disruptive revenue streams.

- **Data is the new currency.** In the past, traditional players have gathered detailed data on customer interactions—whether via the website, in the branch or by selecting preferred services and products. Such data contains vital information around developing a better and more tailored online/mobile presence (for example, generating improved cross-selling opportunities), which gives banks a considerable advantage over FinTechs.

- **Agility is key.** A “faster,” more agile organization, where every aspect of the business excels, is better equipped to compete at speed. Banks need to avoid a linear or incremental perspective and be prepared to manage the resultant risk.

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The platform economy

Just as the “Internet of Things” is transforming the manufacturing industry, shifting products to services and establishing platform business models, digital is forcing banks to create new business and operating models. Platform ecosystems are nothing less than the foundation for new value creation in the digital economy, bringing products and services together to offer a richer, more personalized experience.

Adopting a platform strategy opens up new paths to strategic growth—essential for organizations to defend their position in the market and take advantage of digital disruption. Industries such as healthcare, virtually at breaking point in many parts of the world, are being entirely reshaped and reignited using a platform model—offering benefits to the public and governments along the way. Using platform ecosystems, organizations can tap into resources and capacity that they do not have to own.
Value networks for superior performance

By developing value networks, banks can reconfigure each “business line”—and its value chain—to compete with the best disruptors by being focused, faster, better, and cheaper. Incumbents can take advantage of their unique scalability skills, capital availability and customer reach to unleash excellence and compete at the next level. Managing a portfolio of digital platforms that provide digital financial solutions is becoming a new strategic imperative.

Banks seeking inspiration around value networks would do well to look to the East. Chinese banks and eCommerce players are already capturing customer data to drive increased sales and revenues through extended value networks. For example PingAn, a leading personal financial services provider in China, has developed a value network to connect its various eCommerce and financial services businesses. The company now has 3,600 specific data elements related to a customer that it can use to better segment and cross-sell products and services. PingAn is also using innovative technology platforms to connect its value network—such as P2P lending, enterprise-wide customer loyalty and connected payments across services through their wallet.

Digital ecosystems are here to stay; the potential value largely depends on the timing and quantity or quality of relationships in the network. Those banks who choose to ignore fundamental changes in their business and operating models and fail to act fast risk their survival in the next wave of growth. In an ecosystem-based digital economy, banks cannot avoid the prospect of building their own value networks—or be slow to reinvent themselves in the new era.
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