

# Combating digital transformation fatigue

## Lessons for banks from their digital-only challengers

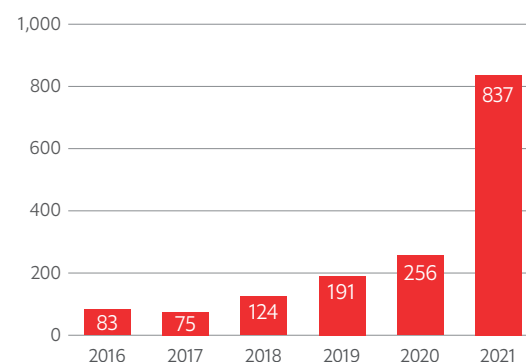
Before the covid-19 pandemic hit, the world of banking services was already undergoing significant changes, with digital transformation being one of the most consequential. A 2020 survey sponsored by Mambu and carried out by Economist Impact revealed that 98% of the banking and credit union executives in Latin America said that their firms had a digital transformation strategy and 85% believed their digital strategy was “making good progress” or “advanced”.<sup>1</sup>

At the time executives suspected covid-19 was going to have a long-lasting impact on their digital transformation strategy, 40.2% believed there would be a sustained acceleration of both front-end and back-end digitization. And they were right. According to a recent McKinsey study, the covid-19 crisis accelerated the digitisation of customer interaction by an average of three years and the share of digital offerings by seven years.<sup>2</sup>

However banks were not the only ones that benefited from this leap towards digitisation.

Digital challengers were also strengthened by the pandemic, as investors poured money into fintechs in 2021. During this period, the number of so-called fintech unicorns – private start-ups valued at US\$1bn or more - doubled from 75 to 217, bringing the total valuation of the largest fintech firms from 256 billion dollars to 837. (See Figure 1)

**Figure 1**  
**Annual total valuation of fintech unicorns**  
Total valuation of fintech unicorns by year  
(\$Bn)



Source: CBInsights 2021

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<sup>1</sup> The Economist Intelligence Unit (2020) “Making up for Lost Time: The Race to Digitise Financial Services in Latin America” <https://impact.economist.com/perspectives/financial-services/making-lost-time-race-digitise-banks-latin-america>  
<sup>2</sup> <https://www.mckinsey.com/business-functions/strategy-and-corporate-finance/our-insights/how-covid-19-has-pushed-companies-over-the-technology-tipping-point-and-transformed-business-forever>

The growth of fintechs does not necessarily represent bad news for traditional banks, as many of these companies are not their direct competitors. In fact, some of the highest valued fintechs are those that offer B2B services to banks and other merchants. In our 2020 survey, most banking executives perceived fintechs as potential partners rather than competitors (See Figure 2). However the fast growth of digital-only banks' users and investors' preference for mature start-ups offering a broader suite of financial products could be a cause of concern for traditional banks.

While digital native banks are able to innovate and roll out products without spending time and money solving the problems of the past, traditional banks are reaching a point of digital transformation fatigue.<sup>3</sup> Incumbents find themselves in a permanent state of digital transformation, anchored by their outdated legacy IT systems, and unable to keep up with consumer demands. What can banks learn from their digital counterparts in their race to digitisation? What can they do to compete with the rising digital challengers?

This article explores three strategies that some of the world's biggest banks are deploying to become more agile and consumer centric including:

1. Balancing front-end innovation with digitisation of the back end,
2. Developing subsidiary digital-only alternatives to serve niche markets, and
3. Exploring new avenues for growth through the creation of banking ecosystems.

### Balancing front-end innovation with digitisation of the back end

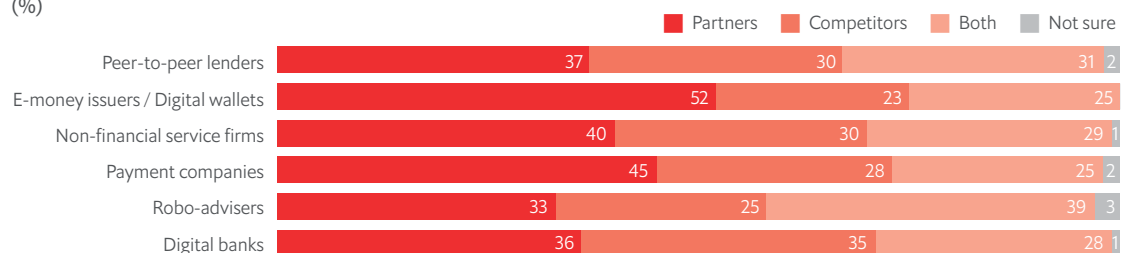
One of the greatest advantages that digital-only banks have over their traditional counterparts is their ability to gain a 360 degree view of the customer through data-driven insights. For example, the analysis of customers' transaction data can help identify patterns in their spending and prevent fraud by flagging unusual transactions. A 360 degree view can also allow more thorough assessments of a customer's financial capability, analysing existing expenses like mortgage and insurance when they are considering a big purchase. In contrast, traditional banks are often unable to extract insights from the large amounts of data they store in outdated back-end legacy systems. As Montserrat Roca, a leadership strategist that advises financial services companies explains, "front-end solutions allow companies to capture data on customer behaviours and

**Figure 2.**

#### Non-traditional new entrants as competitors, partners or both

Would you characterize the following non-traditional entrants into the retail banking industry as more of a competitor, potential partner or both?

(%)



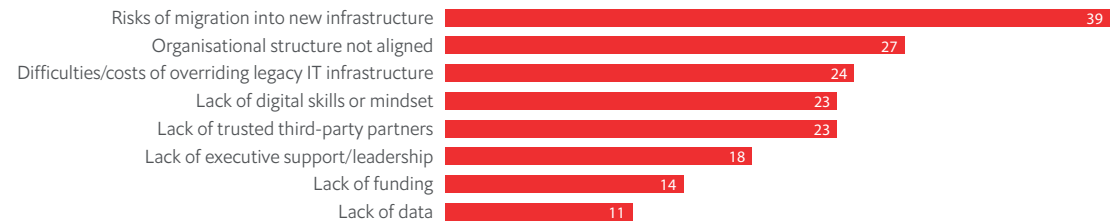
Source: Economist Impact 2020

<sup>3</sup> <https://bankingblog.accenture.com/how-banks-can-break-cycle-it-transformation-fatigue>

**Figure 3**

**Perceived barriers to digitisation in banking organizations**

Which of the following are the main barriers to digitisation in your organization?  
(%)



Source: Economist Impact 2020

other aspects of the business while back-end technologies are needed to make decisions based on this data.”<sup>4</sup> Another advantage of connecting front-end and back-end systems is the ability to automate day-to-day operations. Banks can integrate data from their website to the Customer Relationship Management (CRM) systems, to invoicing, production and shipping processes, without duplication or human error.<sup>5</sup> For this reason, it is important that the digitisation of back-end infrastructures is able to keep up with the expansion of front-end digital channels. However, instead of investing in modernising these back-end systems, most banks prefer to accelerate their front-end digital transformation. According to a recent BCG survey, 90% of companies have customer-facing initiatives among their top business goals of transformation which likely contributes to the development of front-only strategies.<sup>6</sup> Only 16% of companies see end-to-end business transformation as the top goal of their digital strategy.<sup>7</sup>

Front-end only strategies deliver companies speed and focus at the start of their digital transformation.<sup>8</sup> They also often have the biggest impact on consumers and how they perceive a brand. Furthermore, front-end only strategies skirt some of the perceived risks to digitisation. According to the Economist Impact survey, the risks of migration into new infrastructure and the difficulties and high costs of overriding legacy IT infrastructure are the main barriers for digitisation in the banking industry (See Figure 3).

However front-only strategies are a temporary fix and can add unnecessary complexity on the back-end. According to Montserrat Roca, “businesses should think twice before devoting budget to front-end solutions unless they deliver increased product or services capabilities that will impact returns on investment.”<sup>9</sup>

As Niek de Visscher the CEO of Digital Innovation Benelux notes “without integration between the front ends and back ends, companies will not realize the cost and efficiency savings that ultimately make a digital-first strategy so attractive.”<sup>10</sup>

<sup>4</sup> Interview with Montserrat Roca

<sup>5</sup> <https://www.datanami.com/2019/09/05/4-reasons-why-its-critical-to-integrate-front-and-back-office-data/>

<sup>6</sup> <https://www.bcg.com/publications/2020/the-evolving-state-of-digital-transformation>

<sup>7</sup> <https://www.bcg.com/publications/2020/the-evolving-state-of-digital-transformation>

<sup>8</sup> <https://www.linkedin.com/pulse/whats-right-path-digital-transformation-front-end-only-de-visscher/>

<sup>9</sup> Interview with Montserrat Roca

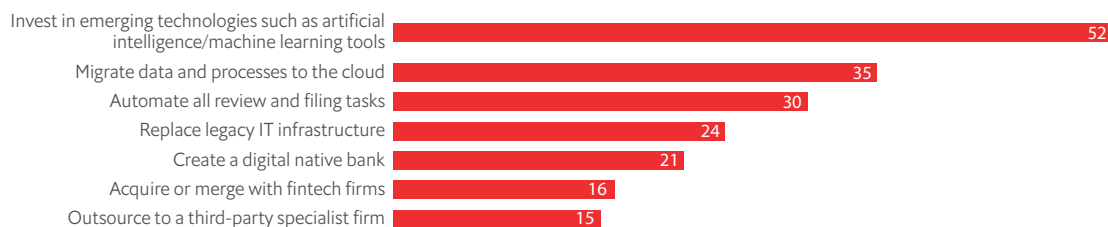
<sup>10</sup> <https://www.linkedin.com/pulse/whats-right-path-digital-transformation-front-end-only-de-visscher/>

**Figure 4**

**Top priorities of banking executives to enhance their organisations digital capabilities**

Looking ahead three years, which of the following should be the top priorities for your organization to enhance its digital capabilities?

(%)



Source: Economist Impact 2020

### Developing speedboats -subsidiary digital-only alternatives- to serve niche markets

A second advantage that digital-only challengers or speedboats, as they are known in the industry, have over traditional banks is their agility, which allows them to respond quickly to consumer demands and test and iterate new products. For example, during the pandemic digital banks were able to quickly adapt to conducting remote operations, as they do not depend on a large network of branches to deliver their services. In order to keep up and go to market faster with a new set of product offerings, several of the largest incumbent banks have set up their own digital-only banks. These digital-only subsidiaries allow banks to leverage their customer data, risk management and governance capabilities while adding new functionalities focused on hyper-personalisation.<sup>11</sup> These digital-only banks are also able to capitalise on their incumbent banks' existing customer base, putting them ahead of newly created enterprises.

According to the Economist Impact survey conducted in 2020, 21% of banking executives believed that creating a digital native bank should be one of the top priorities for their organisation

(See Figure 4). These digital-only banks do not aim to replace or create a digital copy of their parent companies. The goal is to create a complementary entity with long-term profit potential.<sup>12</sup>

BNP Paribas was a pioneer in the creation of a digital-only mobile bank in Europe with Hello Bank! Launched in 2013, this digital brand took advantage of the digital banking wave in Belgium and Germany targeting millennials. Today, Hello Bank! customers represent most of BNP Paribas's users in the 18 to 28-year old segment.<sup>13</sup> The digital-only bank has also successfully expanded its operations to France, Italy and Czech Republic. Hello Bank! is one of the few names that compete with Revolut as the most popular digital bank in Europe.<sup>14</sup>

Other large banks have followed BNP Paribas example, and created their own digital-only subsidiaries with very specific business purposes. HSBC recently announced the launch of HSBC Kinetic, a mobile-first banking service for small and medium enterprises (SMEs). The service was designed using insights from 3,000 small business owners, the digital bank allows SMEs to apply for an account online and offers multiple services including credit, savings and an app specifically designed to manage their finances.<sup>15</sup> Similarly,

<sup>11</sup> <https://fintechworldreport.com/wp-content/uploads/sites/9/2021/05/World-FinTech-Report-2021.pdf>

<sup>12</sup> <https://fintechworldreport.com/wp-content/uploads/sites/9/2021/05/World-FinTech-Report-2021.pdf>

<sup>13</sup> <https://www.euromoney.com/article/b19xm3g9v8rjxq/hello-bank-bnp-paribas-creates-a-pan-european-digital-brand>

<sup>14</sup> <https://thefinancialbrand.com/124264/the-most-popular-digital-only-banks-in-the-world-neobank-fintech-square-revolut-monzo/>

<sup>15</sup> <https://www.about.hsbc.co.uk/news-and-media/hsbc-uk-launches-hsbc-kinetic>

ABN AMRO, a Dutch bank, was able to develop New10 a self-directed SME lender in less than 10 months.<sup>16</sup> New10 targets entrepreneurs and allows them to apply for loans through a fully automated assessment which facilitates a fast on boarding and credit decisions, making funds available in two business days.

Like these, there are a growing number of examples of large banks that have created digital-only subsidiaries to remain competitive in a changing market. However, this strategy does not replace the need to modernise the core banking infrastructures of parent companies. 65% of bank leaders say they would prefer to leverage their parent's bank core to support their digital-only subsidiary.<sup>17</sup> Furthermore, the creation of subsidiary digital enterprises does not necessarily advance a company's digital transformation strategy. As Niek de Visscher explains, "by setting up a new company, you might be able to change the look and the feel but you do not change the DNA of the company, which is essential to achieve their digital transformation goals."<sup>18</sup>

### Exploring new avenues for growth through the creation of banking ecosystems

Many digital banks emerged as part of a broader digital ecosystem that allowed them to bundle financial and non-financial services, serve a large pool of new costumers and gain deep insights about their behaviours to personalise services. An ecosystem approach involves offering services beyond banking focusing on different aspects of individuals' lives such as housing, retail, mobility, and wellbeing.<sup>19</sup> Mercado Pago in Latin America emerged as a complement to the services offered by Mercado Libre, the largest e-commerce

platform in the region. AliPay and WeChat Pay have enabled the growth of China's two largest digital platforms, Alibaba and Tencent. And in the UK, Starling, a digital bank, has created a digital ecosystem that allows several other fintechs such as Quickbook (Accounting), SoSure (Insurance) and Habito (Mortgage brokerage) to lend services that complement its digital app and debit card.

Several banks have taken note of this trend and are looking for ways to transform costumer interactions into hyper-personalised digital experiences. According to a recent Accenture survey, 88% of banking executives believe that ecosystems will change the bank-customer relationship and 89% agree that ecosystem-related initiatives will be the main driver of value-creation in the banking industry.<sup>20</sup>

Banks like BBVA and DBS have come up with house hunting services and affordability assessments to inform their customers' real estate and housing buying efforts. BBVA Valora and DBS Property Marketplace allow users to identify properties, calculate their value and assess their ability to purchase each property. Similarly, DBS Car Marketplace, Capital One Auto Navigator and Chase Car Buying Service offer platforms that allow users to buy and sell cars and offer users financing services to make the purchase.

Bundling financial services with other non-financial services allows banks to expand their offer to customers engaging in more complete digital experiences and also gain a better understanding of their customers' behaviours and preferences. Using their services to enable digital ecosystems allows banks to multiply their interactions with customers and develop new products that adapt to their users changing preferences.

<sup>16</sup> <https://www.bundl.com/articles/examples-abn-new10-digital-approach-to-business-lending>

<sup>17</sup> <https://fintechworldreport.com/wp-content/uploads/sites/9/2021/05/World-FinTech-Report-2021.pdf>

<sup>18</sup> Interview with Niek de Visscher

<sup>19</sup> [https://www.ey.com/en\\_gl/financial-services-emeia/why-digital-ecosystem-enabled-banking-transformation-is-the-way-forward](https://www.ey.com/en_gl/financial-services-emeia/why-digital-ecosystem-enabled-banking-transformation-is-the-way-forward)

<sup>20</sup> [https://www.accenture.com/\\_acnmedia/pdf-102/accenture-banking-ecosystem.pdf](https://www.accenture.com/_acnmedia/pdf-102/accenture-banking-ecosystem.pdf)

## Conclusion

For Niek de Visscher, digital fatigue does not only stem from banks' setbacks and disappointments as they pursue their transformation strategies. This sense of fatigue is common among companies that have a very urgent need to change but have not been built for change.<sup>21</sup> Banks sit in a machine that was built to support transactional operations and are now suddenly confronted with a new set of customers that demand more from them. Since the pandemic, fintechs customer base has expanded at a faster pace, increasing banks' need to speed up their digital transformations. According to a recent survey 42% of Americans use at least one fintech and more than 6% reported becoming a user since the pandemic. 21% have opened a new account

in a digital banking platform since the pandemic began. As users become more comfortable with emerging services, banks risk losing customers and will have a harder time gaining new ones. Digital transformation strategies should aim to disrupt the way banks work, not just digitise their existing processes. Building partnerships with more agile tech start-ups or plugging themselves into ecosystems that provide users with more holistic digital experiences are some of the ways in which banks can keep up with their digital challengers. The companies that are not able to rethink this paradigm and freeze in their intentions to change will be left behind and likely disappear.

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<sup>21</sup> Interview with Niek de Visscher

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