
An Unorthodox View of the Future of Banking

A speculative agenda for
challenging the banking
industry to imagine a
future beyond the
traditional models

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Abstract:

The aim of this paper is to introduce a new point of view on the future of banking, based on the author's collective informed opinion and experience in innovation from within the banking industry as well as related industries.

The opportunities for banking are enormous if the industry can transform and adapt to the 21st century. Unfortunately little evidence exists that such a transformation will be led from within the banking industry. Therefore banking may be subject to similar threats that have disrupted mature markets in the past. The pace of change in society and the growing power of consumers enabled by global technology changes will present serious challenges to the status quo in financial services.

The very conception of currency, as it has existed for centuries as paper tender, may be dramatically influenced by the secure mobile devices that people already carry. Technical advances have been constrained by a variety of industry forces with vested interests in the status quo that combine to stall innovation. A critical mass of new technical capabilities are gaining momentum, and the profit pools in banking are so large that it is inevitable that new companies will form to attack the banking industry. These companies will seize the opportunity to provide superior value that is aligned with the new reality of customer expectations and new technical capabilities.

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Banking is on the verge of changing forever. This change is being led by consumers exercising their creativity and embracing new technologies which are fueling dramatic societal changes driven over the last twenty years by widespread adoption of Information and Communication Technologies (ICT). Consumers expect to use new channels and have access to new solutions that leverage these powerful information and communication technologies

This consumer-led transformation joins three key trends that define the future evolution of the banking industry.

- Demographic: Increasing US diversity, aging baby boomers, rise of “Digital Natives”
- Technology Evolution: Multi-channel integration, emerging digital distribution/mobile, non-traditional banking competitors, cloud computing evolution
- Macro-economic Changes: Increased wealth concentration, regulatory pressure, economic uncertainty, the rise of the rest (previously economically disadvantaged), globalization

These trends bring challenges and significant opportunities. The companies that harness these shifts will capture portions of the two largest profit pools in the world: Banking with its financial services and Payments of all forms.

Traditional models of banking and payments have demonstrated that they are not as stable as once believed. The loss of confidence in traditional institutions revealed by the recent financial system collapse highlights complex, systemic problems within the financial system that has not adjusted to the needs of its customers and lacks the leadership needed to make the necessary improvements to secure their future.

The short term focus on operational controls, that is prevalent in banking, has undermined its very survival for the longer-term. Little evidence is apparent within the Banking Industry of the profound innovations that are needed or of longer-term investments in rebuilding the foundations of Banking. However, there is some evidence that appropriate innovations and investments are being made by non-traditional companies adjacent to banking-related activities. These non-traditional players are destined to truly threaten traditional banks as they collide in the pursuit of satisfying the expectations of customers.

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The Challenge

Customer expectations are rapidly changing as they use enabling technology in ways unanticipated by the inventors and designers. The demands on banks to catch-up are growing, yet the ability of banking systems to adjust and the willingness to service the customers in ways that match their rapid adoption is lacking.

The “anytime, everywhere”, informational needs of the average person are staggering and growing. To manage the information overload, consumers need trusted brokers to help them navigate options and personalize their experiences so that they get “just-in-time,” trusted information that is relevant and enriched with knowledge about the person’s preferences and goals.

The network is king: networks of people, things, places, events, and the information about them. These networks are intersecting and creating new social fabrics that enlarge the opportunities for commerce. Banking, as we know it, and the foundations of entire industries are changing rapidly. Information drives the value inherent in banking systems, and this is changing the way that consumers think of their assets. Consumers understand that their assets are not just financial, but include all the information about their lives that is accumulated on-line and stored in various locations in various forms. These assets, which are behavioral indicators, have demonstrated value, as markers of the person’s preferences and aspirations.

This change in the importance of networks and information flows means that the understanding of risk is different than in the past, but so too is the opportunity. Scale and globalization take on new meaning when connectivity is pervasive and ubiquitous for consumers.

A summary of the many challenges facing banks are as follows:

- **Fragile Infrastructure** – the legacy systems within Banking have reached a point of un-maintainability. Many systems are too large and not integrated, creating discontinuous information flows. The infrastructure may need to be replaced, but no straightforward solutions exist for doing this without disruption and risk, especially given the scale of the conglomerated banking system with its high levels of interdependence and lack of diagnostics to assess the impact of changes.
- **Regulatory Climate** – new regulations continue to be debated and even more are likely to be introduced in the near future as a result of industry failures and abuses. Perceived disregard for consumers and dubious risk management practices are generally thought to have put the general welfare of the global economy at risk. Lack of leadership has forced governments worldwide to impose regulations that may burden commerce with additional cost, but may be necessary to safeguard the public and the industry against practices that jeopardized banking status as a trusted industry.
- **Information Overload** – as the banking industry consolidates and simultaneously expands its reach into the lives of its customers and merchant businesses, the

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amount of data that is generated is beyond the capacity of most traditional banking systems to manage and extract value. The lack of reliable analytics with valid indicators of the financial health of the company, its customers, and the markets they transact in, is a clear evidence of the inability to deal with the volume of data collected. Inter-related data is often used to assess very narrow risks, but most banks have failed to create critical connections between related data points that could predict widespread risks. Thus, the traditional methods have lacked the performance that provides great confidence in existing risk management analytical methods..

- **Trust Brokers** – Banks historically held the position of trusted brokers, enabling commerce and trade to be conducted. That role is now commoditized. Moreover, the growth of banking conglomerates and their lack of leadership and innovation has eroded much of the remaining trust in the systems. This is not just a brand issue but a systematic failure to provide safeguards against check and credit card fraud, money laundering, identity theft, and many modern banking system vulnerabilities. Using financial risk models to bet against systemic losses is inadequate for customers who are affected by a fraud or identity theft. Once customer's accounts are affected, they experience the lack of trust directly and are naturally intolerant of the excuses that their banks would provide for not guaranteeing their financial safety. The banking industry has yet to set the appropriate bar for customer risk issues, - zero tolerance for fraud and absolute safeguards for the wealth entrusted to banks. Today risk models have broken down, fraud continues to be a problem for consumers, and many customers perceive that they receive excessive and incomprehensible punitive fees, which drive bank profits. Each of these elements combines to erode trust.
- **Archaic Business Models** – the branch model of banking is a remnant of traditional banking that could be impacted directly by competitive threats. Lack of change in the basic branch format speaks to the inability to create innovation from within the industry. A typical branch provides a range of paper-based services (check cashing, cash handling, etc.) and a face-to-face venue for more complex customer service tasks, many of which could be handled by newer technologies. The continuing existence of paper forms, signatures, and other traditional operations demonstrate how far banking is from more leading-edge paperless industries that affect customer's daily lives. These paper-based tasks take critical time away from one of the highest-value added activities that occurs in bank branches – customized sales and service activity. Instead of spending time getting to know the customer needs, the largest banks have turned banking from personalized, community-based institutions, with all its former dignity and connectedness, into the equivalent of the franchise fast food of financial services in a sanitized branch box.

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Consequences

As a result of the multiple challenges within banking, many new players are aligning to take advantage of the inherent weaknesses in the traditional banking industry. These new competitors are looking beyond their current profit pools, increasingly attracted by adjacent strategies that could redefine their businesses or create new ones, all by attacking the current banking incumbents who are vulnerable to fast-moving, innovative companies who understand the new power that customer have to make informed choices.

Additionally, incumbent banks are under pressure for near-term company performance, stock value and to stem existing market erosion, as well as the pressures of government involvement following the TARP investments. These banks have minimal resources at their command to maintain current operating environment, let alone create new platforms that could differentiate themselves or fend off attacks from this new breed of competitor. Some savvy banks may use partnerships to off-set threats and maintain the status quo, but this will not solve the endemic problems of the banking industry which require investments in innovation and research. Consequently, the non-banks that attack the edges of banking could have devastating effects on the banking industry and its existing profit pools.

Net Neutrality continues to fuel opportunity growth, and economic systems will be open and managed the same way. Cloud banking will drive common infrastructure and commoditize the “utility” functions of banking, enabling horizontal segmentation of the banking market and technology. This new foundation will give way to next generation peer-to-peer enablement. Banking becomes owned and operated by the users’ network.

Incumbents

- First generation systems become last generation legacy,
- Leaders become trailing companies due to bloated legacy systems.
- Incumbents show no evolutionary path forward, leaving the market open for discontinuous innovation.
- Infrastructure replacement is needed to respond to the market, but difficult to achieve.
- Incumbents have no simple way of future-proofing banks.

New competitors

- Secure devices such as mobiles phones or PCs with appropriate software enable information transfer and transaction to occur. Any large entity with sufficient

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resources can provide the services to make information deposits and withdrawals as commonly done by billions of users now connected to the global network.

- Secure and trusted accounting already is done by many companies. Bill payment, credit processing, loan origination and servicing, prepaid debit, money transfers and other bank-like activities are already done in various forms by third party processors, retailers and technology companies. Large retailers like Wal-Mart certainly have the scale and customer base to seize large opportunities in financial services. The cell phone carriers are in a similar position. At the same time, the continued survival of credit unions highlights the willingness of people to form smaller collectives to serve their interests.
- While many existing regulatory constructs prevent non-banks from performing some very specific banking functions, these regulations do not prevent non-banks from participating in the transactions or creating relationships with bank customers. Thus, these regulations may also enable innovations from outside the banking system that dis-intermediate banks from all but the most commoditized customer transactions. For example, the growth of pre-paid gift cards has moved large amounts of cash into plastic, mostly outside the banking system.

One of the most significant consequences of ICT adoption is the emergence of the “Brand of Me”, an age of unprecedented user control over their own experiences and identity management and proliferation of content. Each person is able to manage aspects of their identity much as traditional Brands are managed. MySpace and Facebook can be viewed as personal brand building systems that leverage the power of social networks to transmit attitudes, sentiments, knowledge, and culture. The impacts of these changes are not yet fully understood by social scientists or marketing companies, both currently studying their potential implications.

No one argues that these developments have changed the relationship between Brands and their consumers. However, traditional Industries like Banking are disadvantaged in this fast paced environment, because, they are constrained by internal cultures of risk aversion and conformity to allow greater control over employees and customers, and thus, most are at a loss as to how to react to the new power for information flows afforded by these self-organizing networks.

Fragmentation of broadcast advertising media further erodes old models of brand building. A new strategy is needed that is suited to the reality of the consumer control that will instill trust in financial institutions by having them become an integral part of the emerging networks instead of “bolting on” old business models to the new media.

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Solution

By combining the current information leaders' platforms and with non-traditional companies - one can envision a radically different environment that solves much of the issues of financial transparency and redefines what banking may be on a global scale. It is conceivable this new state will create significant new revenue opportunities.

With an opportunity to provide service and solutions to customers in novel ways, it is possible to give them control and co-create and co-configure compelling solutions that are of great value to customers accustomed to the user-controlled, Web 2.0/3.0 reality. In addition, Web 3.0 will have an intelligent layer to augment people's lives in ways that assist them to improve their lot by using the power of computation.

- Customer configures their own customized and relevant solutions
- Banking evolves to help customers secure their entire digital life
- Zero tolerance for error and risk related to customers' information
- Transactional, product specific "Life Logging" turns into Life Advising
- Risk is managed and turned into opportunity

This emerging reality will require companies that want to capture this opportunity to plan:

- how to handle a billion accounts with infinitely configured product bundles
- how to address large unbanked market coming on-line.
- how to stop thinking of accounts and instead clusters of money pools controlled by the household and the community
- how to make banking simpler and more streamlined, with personalized solutions bundling that are relevant and valuable to each stage in a customer's life
- how to structure an industry that deals with large and small banks so that the industry grows as a network instead of a monolith.

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Results

What do these new realities of 'banking' mean for the future? A list of future possibilities, many of which are already technically possible, can illustrate how banking might be radically different than it is today:

- Information itself will emerge as a new form of currency, and the industry will need to support this new paradigm, with the ability to store much more data than simple financial transactions and assets.
- Cloud banking will enable "micro credit unions" and other small, context-specific financial services with Google- style data center container, banking anywhere
- Non-banks also have opportunities to play utility service provider roles in areas where banks no longer need to compete.
- Banks could become the repository of large datasets and the processing models to extract insights. Transparent banking and early warning systems.
- Opportunities exist to create privacy preserving techniques where security is no longer an issue since it is embedded into the process and data at the lowest level.
- International retail banking will become more important. Even as telecommunications reduce the need for physical travel, it increases opportunity for cross-national collaboration and commerce. The industry therefore must allow business to be conducted seamlessly and electronically across international frontiers.
- Opportunities exist to become the trusted center point for opt-in marketing, promotion, and advertising.
- Dramatic reduction in the use of cash and the emergence of new virtual currencies is likely to occur. Systems support thousands of currencies, this including forms of loyalty points but other variations might be created.
- Nano-banking, micro-payments and macro-banking router requirements create still other opportunities that allow for complete integration with total autonomy. All messages become part of the repository for analysis.
- Total life long financial management for individuals, the household, and the community, cost consequence tracking, beyond budgeting, behavioral decision making is another area of opportunity.

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- Healthcare-related banking and DNA storage may become opportunities. This would extend beyond secure medical records to managing processes to help advise individuals on daily health management.

There is no debating change in society and the power that consumers are gaining with the global adoption of technologies will present a challenge to the status quo. These possibilities highlight a potential way forward for the future of the banking industry. The opportunities are enormous if the industry and its technology and information partners are able to transform into 21st century institutions. Players with awareness of these possibilities and the willingness to invest in seamless, customer-centric solutions will be well-positioned to take advantage of this new environment.