Looking Ahead, Staying Ahead.

In a moment where looking ahead is both challenging and exciting, companies seek to move fast to defend and extend their position while exploring new growth opportunities.

Executive Briefing: BFSI Edition

Introduction

The longest boom in the US's economic history was officially recognized last month. Global leaders, however, know that the celebration cannot divert their attention. All good things, after all, must come to an end, and the US economy's 10-year upswing may eventually run out of steam.

The US economy continues to send mixed signals. But one thing is becoming clear: companies should prepare for an extended period of global headwinds, exacerbated by three compounding pressures most executives have likely never experienced — persistent high inflation, scarce and expensive talent, and global supply challenges — signaling an imminent recession.

The truth of the matter is nobody escapes a recession unhurt. However, historical precedent shows that the greatest financial institutions, especially banks, perform significantly better than the weakest, positioning themselves for greater success when the cycle flips again. But simply saying that we live in the digital age is increasingly becoming passé amid the looming threat of recession — more and more companies across industries, including the banking sector, are going digital, diminishing the value of having digital capabilities as a differentiator. Further, the ubiquity of technology and the rapid pace of innovation are fueling new customer, employee, and societal expectations that require a new set of rules to succeed. So, where can competitive advantage come from?

The new era of banking innovation will demand industry leaders to reassess their business paths to get the most value from current investments and figure out what's next. This means doubling down on digital transformation, not just adopting digital tools and concepts but embracing the industry ecosystem with a newfound operational sophistication and having the strategic foresight to make investments for the future.

In this short paper, you are going to find some of the key trends, lessons, and insights shared by organizations from across the globe that are strategically investing in capabilities, people, processes, structures, and technology to set themselves apart, strengthen their core business, and navigate the risks and opportunities arising from an evolving and fraught geopolitical and economic landscape.

The Rise of the Super App

First coined in 2010 by BlackBerry founder Mike Lazaridis, a super app is a one-stop tech app that allows users to access several services and functions from a single platform, offering a seamless, integrated, efficient, and contextualized experience. From a user standpoint, opening a single super app is more convenient than managing dozens of individual apps. Businesswise, the rise of open banking and application program interfaces (APIs) enables super apps to leverage customers' financial data from multiple sources to offer hyper-personalized experiences and customer-focused products while consolidating financial interactions under one platform. With access to a host of partners, super apps can provide more products at a faster speed to market, not only gaining customer preference but also forcing the market to adjust.

Let's take Apple, for example. Their super app is actually hardware: watches and phones that already contain all the features and apps once you buy them. The whole customer journey is set up within the phone, and the data migration from an old device is seamless — even when it's not originally Apple-to-Apple. At the same time, taking Apple Pay as an example, consumer preference has forced merchants to include Apple Pay in their checkout process to maintain their share of wallet. Merchants who take advantage of this frictionless checkout process can leverage the prevalence of iOS-dominated economies.

For banks that would rather promote their own app and product suite, this would mean a reduced share of transactions as people switch to super apps that can accommodate their needs, financial and otherwise. On the other hand, those that would offer unbranded Banking-as-a-Service (BaaS) to existing super apps and become part of the ecosystem can extend their reach. While this is an excellent revenue-generating opportunity, the number of super apps in the market is limited, so banks must act quickly to secure a partner to maintain or grow their market share. The third option would be for banks to develop their own super app that covers financial and non-financial services or to create a banking and financing super app. Forward-thinking banks are prime candidates for this new business model and equally new territory.

Neobanks, for instance, are quickly understanding this trend and surfing it. In Latin America, at least 12 out of the 20 most prominent neobanks have already launched their own marketplaces where cardholders and non-clients can shop. Actual clients get extra loyalty points and better prices/payment conditions than the rest. They can also use their points to shop — something most retailers don't offer. For example, Brazilian neobank Banco Inter launched its marketplace at the beginning of 2020, and by January 2022, it had already reported over BRL 1.1 billion in gross merchandise value (Forbes). The marketplace can become the source of profit to sustain the financial operation when the financial services have extremely low fees.

Innovating Operations and Offerings

The past two years have accelerated digital behaviors and redefined how customers engage with banks. While boosting revenue remains a top priority, financial institutions are also focusing on improving their operations and offerings, keeping in mind that digital, on its own, can no longer sustain growth and differentiation. To remain relevant, banks must innovate faster than ever.

At the industry level, **collaboration on platforms** seems to be inevitable. With technology moving too quickly for banks to build their capabilities themselves, partnerships with technology upstarts such as fintech companies can give banks access and exposure to newer technologies that would enable them to extend their services to a broader consumer base, deploy innovations quickly, streamline existing processes, avoid costly infrastructure or in-house development expenses, and improve compliance and risk management frameworks.

At the line-of-business level, banks can **capitalize on segments that have been thought of as too costly to serve**. Micro, small, and medium-sized enterprises (MSMEs), for example, are a **$5.2 trillion** opportunity that is left on the table — roughly 1.5 times the current lending market. However, banks often struggle to create the right lending solutions for their MSME customers and to cut the cost of serving them. By adopting advanced analytics and integrating it into the existing banking environment, banks can optimize their target segments and develop a clear vision of product and service offerings, rendered with a streamlined, robust experience.

At the foundation level, emerging technologies such as AI, cloud computing, robotics and automation, open banking APIs, embedded solutions, and cybersecurity are making strong headway for financial institutions, as evidenced by the growing number of banks looking at **technology as a product and a potential revenue stream**. Embedded finance solutions, for instance, have already started to streamline financial processes by reducing barriers to entry for various products and services. An example of this is the integration of payment technology within the infrastructure of an app or E-commerce site for instant settlement of transactions.

Fabella, one of the largest retailers in Latin America, has an integration process between its store and the bank, allowing customers to buy online and choose to pay with their cards. Customers don't have to do anything else because everything is integrated! And when placing a return, the store only asks for the document number, and the refund is automatically credited back to the card within minutes. Revenue diversification comes from many streams, with a digital factory that works on an agile model and a great example of a traditional bank that uses a startup process to handle payments.

Purpose-Driven Banking

There is a consensus that financial institutions are commoditized, transactional, and lacking a client-driven approach, with financial metrics prevailing over customer relationship building. It's no wonder that many firms face declining customer loyalty and brand reputation. Confronted with ever-changing business needs and rising customer expectations, can financial institutions balance their traditional, profit-driven approach with a humanitarian perspective? The answer is a resounding "Yes."

Putting the customers first is central to purpose-driven banking. And those that take this to heart will always stand out. Purpose-driven banking revolves around expanding service offerings to cover financial advice, even if it doesn't generate short-term revenue, prioritizing customers' economic well-being over internal sales targets, adopting the latest technologies to deliver superior and personalized service, including cost efficiencies, and ensuring the well-being of employees to keep them motivated in executing purpose-driven banking initiatives.

Making Banking Human Againg

With digitalization sweeping across industries, banks have increasingly embraced the convenience and efficiencies of technology to refresh and transform their offerings vis-à-vis the modern consumer's instantaneous mindset. Given the number of touchpoints throughout the customer journey, customer experience is quickly becoming the point of difference. So, while digital transformation is crucial to making a profound impact on customers' lives, there is great value in striking a balance between genuine innovation and authentic human touch.
Although machines will not completely replace human-to-human interactions, they can help increase the value of personal interaction by augmenting human capabilities, whether by automating repetitive, low-value tasks, increasing productivity, or identifying customers amidst a sea of data, among others. The human touch, on the other hand, can help banks create meaningful conversations by restoring humanity and empathy to an otherwise emotionally devoid business. Money matters, after all, are complex and personal. Thus, leveling with customers by understanding their financial and emotional circumstances and responding to their needs with a heart would go a long way to building and strengthening trust, loyalty, and advocacy.

The World of Open Payment Networks

In the banking space, technological advancements have translated into developmental leaps in payment mechanisms. The one currently making the most noise is open payments or the opening of banks' payment services to other companies. This was set into motion when the Payment Services Directive Two (PSD2) came into force in Europe four years ago. As a result, a number of successful European neobanks and fintechs made open banking APIs key to their proposition.

Essentially, open payments, powered by open banking, enhance the payment experience for both customers and providers — no more traditional bank transfers with manual data entry and reconciliation difficulties and no more card payments with a slow settlement, high failure rates, and higher fees. Customers have a more fluid and integrated experience, while providers leverage the technology to reduce the cost to serve.

We are now at a turning point in open payments, with technology, regulation, and economic conditions coming together to drive momentum for open payments in lieu of card payments. Banks will now have to align their investments with innovation and comply with payments-related policy and regulatory changes. The objective must be to satisfy demanding customers who want to pay any way they want. In the world of open payment networks, banks must figure out how to compete and cooperate with rivals to create new opportunities for sustainable growth.

Organize to Innovate

In an era of transient competitive advantage, the rule of thumb is to adapt or perish. That's why it is crucial for industry leaders to reorganize their structures to keep pace with ever-changing marketplace conditions, reshape their culture to boost customer and employee affinity, and redefine their work practices with an agile and collaborative approach augmented by technology and continuous process improvement.

Simply investing in digital and becoming their best digital version isn't going to cut it. Instead, financial institutions must carefully examine their current structure to understand how innovation evolves and develops within the company and identify the inertia, the sticky routines, and the silos that stifle the flow of ideas and information across the organization, which progressively undermine growth. By addressing these bottlenecks and empowering the workforce, organizations can become truly innovative and, more importantly, agile enough to capitalize on new ideas that drive growth, now and in the future.

According to Workday, more than half (52%) of executives across various industries say there is a growing divide between where their business is and where it needs to be to compete. To bridge the gap and do so in a timely manner, legacy financial institutions are looking more into investing or acquiring fintechs as a quick means to leverage technology. According to Cornerstone Advisors, 65% of banks and credit unions entered into at least one fintech partnership over the past three years, with 35% investing in a fintech startup. Fintech partnerships by banks have also accelerated over the past three years. In 2019, banks that partnered with fintech firms averaged 1.3 partnerships per institution. That number grew to 2.5 partnerships in 2021. In other words, the economic downturn could create significant potential for legacy banks and credit unions to improve the speed and scale of digital innovation through fintech partnerships.

Conclusion

When conditions spur financial entities into action, those that can recalibrate their time-tested strategies for the new reality and design them around individual client needs will be best positioned to win. Hence, companies will need to evaluate and implement these measures with their clients individually but at scale. While it is not an easy task, companies within industry verticals may take roughly similar steps toward their operating accounts. Still, financial institutions and banks need to recognize the wide variations among companies in their depth of resources, relative strengths coming out of the pandemic, working capital positions, and philosophies toward financial management.

In the grand scheme of things, digital acceleration, the emergence of new technologies, and the blurring of industry ecosystems are increasing the focus on innovation as the catalyst for growth and sustainability in the banking sector. However, innovation efforts are overwhelmingly directed at internal targets and sales figures at the expense of customer experience. While those priorities are essential, the customers can't be ignored, especially as fintech and big tech providers continue to enhance their customer-centric solutions.

In a complicated and dynamic environment, customer experience matters. Although there are no one-size-fits-all solutions for management teams, innovation, done right, helps financial institutions to thrive where their competitors cannot and can be highly advantageous during slowing economic cycles. If industry leaders remain resolute in doing things the way they have always been done, even the most determined organizations will fail to establish a culture of innovation that anticipates change, continuously adapts, challenges convention, and embraces collaboration.

Let's keep this conversation going.

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