

Digitization strategies for financial services providers

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1. Digitization as a change driver of business models in banking

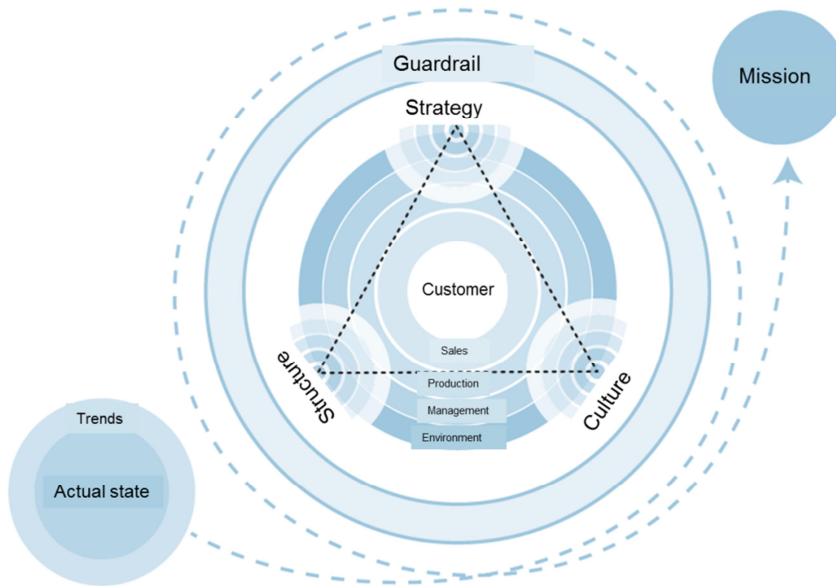
What steps should banks take to make effective use of the digital age? Is the hype about the providers of Fintech services just a hype? How to deal with the discussions about generation Y or Z? Is a radical transformation of one's own business model necessary or will an adaptive adaptation be sufficient? What is the right digitization strategy for banks? This article provides the framework for analyzing these issues for the financial sector. Digitization is an umbrella term for electronic network-based exchange relations.

The authors define the digitization as the mediation and support of economic relations via network technologies. These relationships include the creation, the transformation process and the redefinition of value-creating relationships within and between organizations (business to business) as well as between organizations and individuals (business to consumer).

The average lifetime of companies represented in the S & P 500 Index has declined from 67 to 15 in the past decades. This shows that the competition in the digital age has risen. This era is characterized by the technological possibility of obtaining information at any time independent of location, channel and terminal equipment. This "unlimited" information access is a paradigm shift, which makes the intermediation and thus many business models superfluous and leads to decreasing prognosis horizons. In addition, the new technologies enable a more satisfying satisfaction of existing customer needs and new - also cross-sectoral - combinations in the coverage of customer requirements. The pressure on margins is increasing once again, as such tailor-made offers dispense with the unnecessary elements of earlier solutions. Future-oriented USPs therefore require the ability to focus customer needs consistently.

These developments also lead to growing uncertainty about future management concepts. The Zurich model provides an orientation framework for the digitization of business models.

Fig. 1: The Zurich model as an orientation framework for the digitization of banks



Quelle : Auge-Dickhut, S. & Koye, B. (2015). *Client Value Generation*. Handelsblatt Journal, 2015 (November), 20.

The Zurich model offers a total of four guard rails as an orientation framework for the transformation of banks' business models. Resilient companies are characterized by the ability to be constantly learning and changing along these guard rails.

- A) The development of future USPs in the digital age requires the ability to constantly monitor the development of customer needs and to derive real-world solutions.
- B) Strategic planning is a permanent iteration process.
- C) Structures must be designed to be agile and network-compatible.
- D) The company culture must be able to provide a co-ordinated & partnership-oriented solution orientation and to establish it through appropriate incentive & control logics.

The core of digitization is therefore the consideration of all elements of a business model from the point of view of customer needs. Trends are constantly being evaluated (re) from the point of view of the customer; Methods such as a Customer Journey and Design Thinking are fundamental prerequisites for the development of customer-centric solutions and strategies, which are further developed in a modular fashion. The growing transparency reduces margins. Dramatically. For example, Since 2017 in Switzerland, all-round household insurance 'passgenau for young people at a fraction of the previous package price of all included product components offered. Monetarily speaking, a young person can buy this solution for CHF 10 - and the old package price was CHF 500. This corresponds to a 98% drop in sales. These developments are only beginning and force suppliers to significantly increase efficiency and to implement efficient structures. The basic prerequisite for digitization is thus an effective industrialization of the business processes - ie standardization, automation and consistent readiness to focus on core competences. This in turn requires a clear understanding of the necessary activities in each value-added process step and a precise matching of the responsibilities & roles along the processes within a 'RACI' matrix.

2. Networkability as a core aspect of agile business models

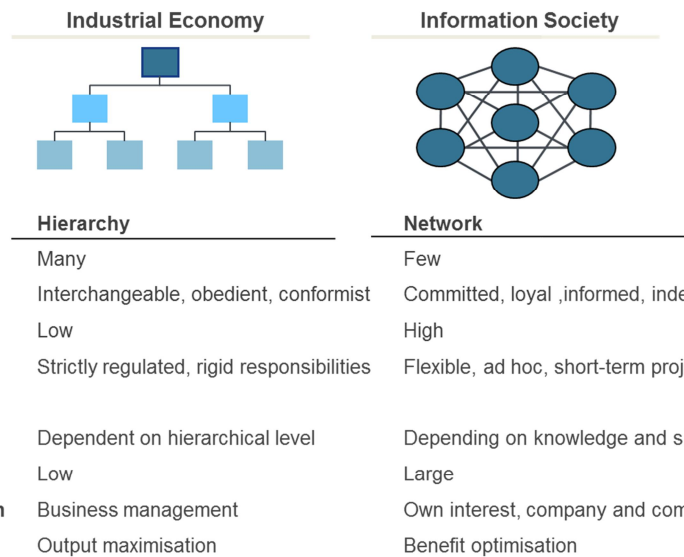
The challenges for companies in the digital age are manifold - the times of continuous success guarantee are definitely past. In this context, resilience reflects the ability to absorb

disruptive changes and real shocks, and to transform its structures and activities against the backdrop of long-term stress, high change pressure and uncertainty towards future business models. In this context, agility is the ability of an organization to act flexibly, actively, adaptively and with initiative in times of change and uncertainty. Network capability is a decisive criterion. (Eye-Dickhut, S., Koye, B. et al., Resiliency in Banking, 2017). On the one hand, digital technologies allow the organization of exchange relationships in networks, both across company boundaries and within organizations, as well as an ever faster and more transparent exchange of information. Due to the network capability, the interaction and cooperation possibilities between the companies and between individuals are increasing. The participants form a network that allows each individual to invest only in those core activities in which they can effectively generate added value. The basic prerequisite for a functioning network landscape is, in turn, a clear understanding of the necessary activities in each value-added process step and a precise coordination of the responsibilities and roles between the network partners along the processes within a 'RACI' matrix.

Networks are critical mass systems. If a critical mass of users is reached - the so-called crossroad of diffusion development - then a product or service is established in the market. Typical examples are e.g. The Google search engine, or the Messenger service WhatsApp. This also explains the observable "the-winner-takes-it-all" effect among intermediaries such as online retailers or comparison portals. As a rule, only very few providers are active. In addition, the interconnectivity of offers is of great importance. A product or service becomes more valuable in the network if it is compatible with those of other providers - this is referred to as network externality. Networks release positive external effects: The total value increases with each additional unit produced. On the whole, these effects lead to an agile specialization of all market participants, because only those who can permanently maintain their value in the network remain successful.

Networks can be understood as a response to the initial situation, which is characterized by uncertainty and great risks. It is therefore important to develop agile & modular business models and to make company boundaries network-compatible. However, digitization has not only an influence on the development of the exchange relationship via networks on the market, but also on the internal organizational development of companies. The softening of existing hierarchies and structures requires a culture of trust and the development of an entrepreneurial, solution-oriented and partnership-based attitude among all employees and executives. Both customers and employees are always better informed and frequently involved. Recognition is increasingly the result of personal contributions and know-how. Only employers who enable networked & self-responsible work remain attractive. Therefore, it is necessary to develop appropriate incentive and control logic and to make use of already existing tools for interlinking employees - e.g. Internal knowledge platforms and agile project collaboration tools. Each area of the existing business models is called upon to make its added value in the digitizing value-added chain more efficient and effective than market solutions make it possible.

Fig. 2: Roadmap for internal network capability



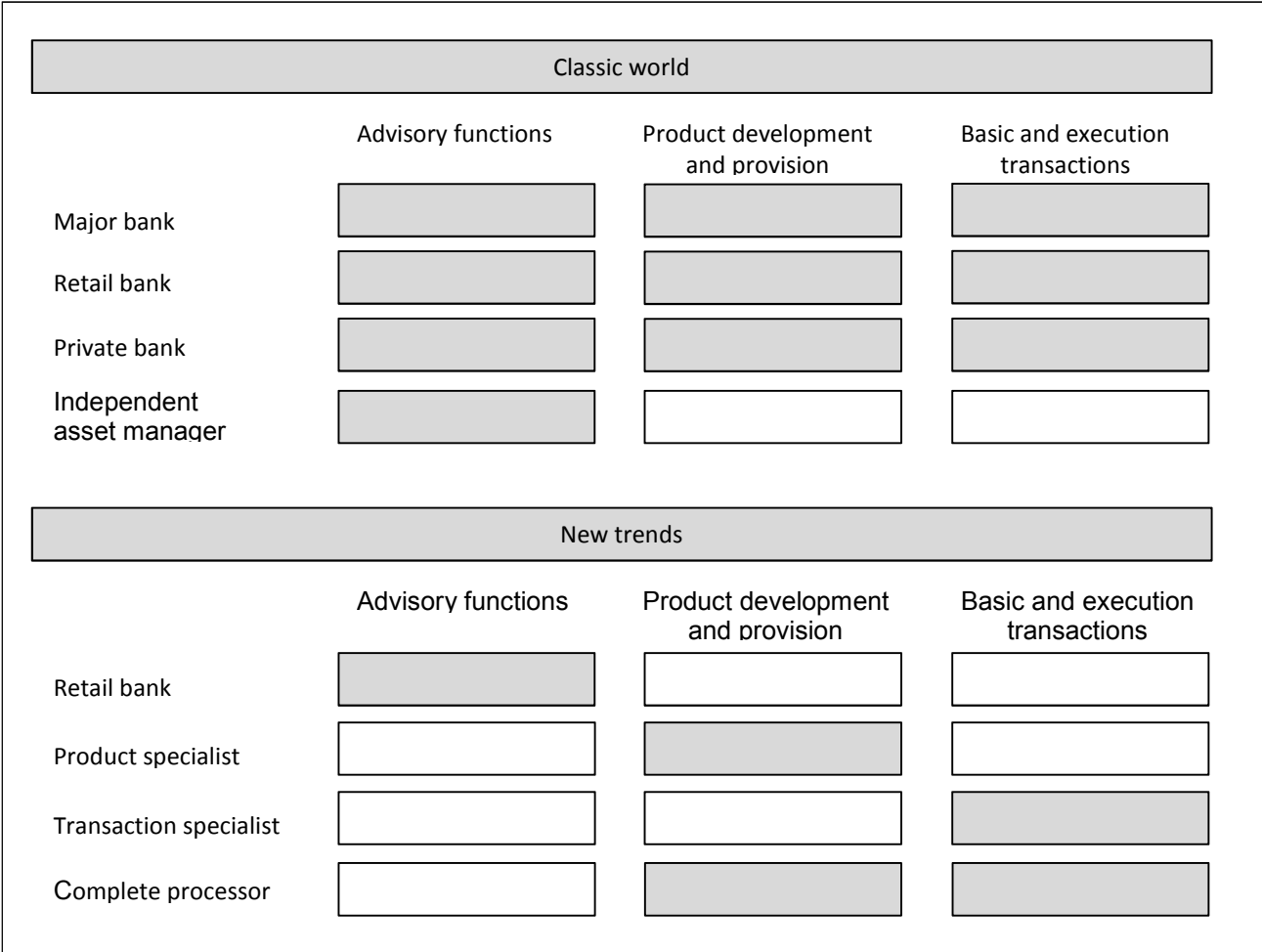
Source: Auge-Dickhut, S., Koye, B., et al.(2015). *Customer Value Generation in Banking - The Zurich Model of Customer-Centricity*. 46.

3. Development stages of the network ecosystems of financial services

The above effects also apply to the banking sector. The banking business is under pressure because many previous USP components are based on intermediation. Bank customers are increasingly less willing to pay for the purely financial information provision by the banks. Declining margins and additional regulatory requirements are forcing the industry to successively focus on efficiency. However, this alone will not suffice for the challenges of digitization. The digitization undermines the success factors so far and also offers numerous competitors, including those from other sectors, the opportunity to occupy at least parts from the value chain. The successive development of the network capability of financial service providers can be divided into three phases.

In the first phase, a classic vendor can consistently analyze its existing value-added chain under the premise of core competencies and focus on customer interface, production or processing, or develop efficiency advances through cooperations with other banks. Through the use of modern technologies, membership in such networks becomes possible. Through a good image, many partners can be attracted, which leads to the realization of scale and interconnection effects. The core competencies are the use of technology and the image protection against the network partners.

Fig.3: Focus on core competences



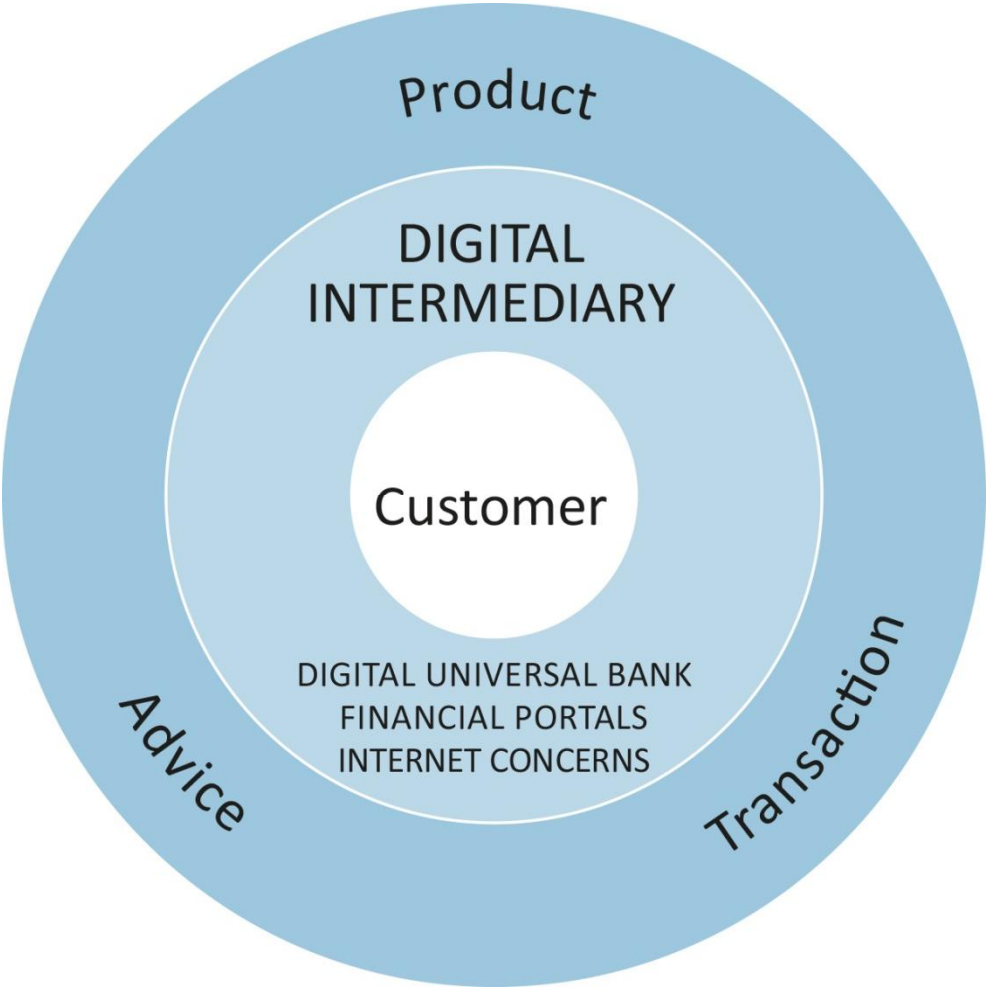
Source: Auge-Dickhut, S., Koye, B., et al.(2015). *Customer Value Generation in Banking - The Zurich Model of Customer-Centricity*. 102.

The networkability of the products is a prerequisite for this strategy. The transaction specialist focuses on cost leadership in the execution of transactions. This business model realizes economies of scale and consolidation by transferring and implementing the corresponding process components from the asset managers oriented towards the customer interfaces, which can be passed on to the customers in pricing. The complete dispatcher positions itself as a product developer and supplier as well as a transaction manager. In the second phase, the sectoral boundaries will be increasingly weakened as a result of specialization, and new technology-driven and customer-oriented ecosystems are emerging. In the future, the customer interface will not necessarily be among the banks, as the cooperation between the FIDOR bank and Telefónica shows. The account opening and the contract relationship is made here via the telecom provider and the individual product components are combined. For example, higher data volumes are possible as "interest rates". This is an example of a cross-sectoral & combined fulfillment of customer needs, which has been addressed theoretically above. However, to a large extent, Fintech functionalities are still being integrated by the banks - e.g. The integration of the Personal Finance Manager (PFM) from Contovista with now 6 banks in Switzerland or the offer of the Swiss Fintec Award 2017, Qumram. By acquiring a minority stake in Moneymets,

Postfinance wants to enable Peergroup comparisons and thus promote the 'community banking' comparison with other customers in investment, financial investments or insurance. The Glarner Kantonalbank, which already offers its Hypomat to Whitelabelling for two other partners (Fribourger KB and MoneyPark), is a good example of the development of new core competencies. Finally, FIDOR is a digital bank that allows it via API interface to its core banking platform, enabling other financial services providers to market their products through FIDOR.

The customer interface will be occupied by a wide range of partners in the future. Potentially, these are not only sales banks or digital full banks, which operate, for example, without classic branches, but also financial portals or Internet groups such as Facebook. In 2017, he announced that he would receive a banking license from Ireland - initially in the area of payment transactions. As the discussion about the further development of the business model of Amazon as logistics providers shows, this is only the beginning of the redefinition of customer interfaces.

Fig. 4: Customer Interfaces & Intermediaries



Source: Auge-Dickhut, S., Koye, B., et al.(2015). *Customer Value Generation in Banking - The Zurich Model of Customer-Centricity*. 103.

The end customer sales are carried out by the focal network partner at the customer interface. The company has modern consulting know-how and a high brand reputation. The product specialist focuses on product development and production and is characterized by independence and the pursuit of the best-in-class positioning of his product. The Network

Capability of the Products is an Expectation of the Probable Third Phase of Developments in Digital Financial Systems. Customers could discuss and resolve their financial needs, for example with modern systems such as IBM's WATSON, using voice recognition. These AI (Artificial Intelligence) systems are presumably in the future able to independently identify and select the modular elements for realizing the solutions.

4. Policy options for the digital transformation of banks

With regard to the timing and organization of the digitization of banks, three approaches can be distinguished in practice: An integrated top-down digitization can be envisaged if the management has a high degree of unity on the topic and the internal resistances can therefore be rationalized. Selected cross-border reference initiatives are triggered in parallel and various areas are integrated digitally. Postfinance can be cited here as an example of an integrated digitalization strategy, which is deliberately triggered by management, for all areas of value creation. In addition to the consistent development of the electronic channels for the classic business, the whitelabelling of products for other suppliers while at the same time using other products for their own customers, new models such as crowdfunding are offered as credit financing on electronic platforms. But also the approach of the Zürcher Kantonalbank can be seen from this optics. Customer responsibility at ZKB was consistently solved by the management of the company. The responsibility for all channels is concentrated in the multichannel team - as is the use of modern innovation methods.

Digitization can, however, also only be started in individual areas, in which case the silos are then cross-linked in a second step. Examples are e.g. The digitization of the customer interface with subsequent or parallel digitization of selected processes - such as 'digital onboarding' or 'mobile payment' at many banks. In the UBS, too, digitization is being pushed ahead. On the one hand, the two front areas 'Switzerland' and 'International' work with separate teams on the digitization. On the other hand, there are self-responsible innovation cells that combine the modern methods of innovation (design thinking & customer journey) with the front-line managers for concrete innovation developments and have to prove themselves in the internal market. Glarner Kantonbank, the most digital bank in Switzerland in 2016, has also chosen this route by launching online sales parallel to classic sales, without first clarifying the organizational responsibilities ahead of schedule. A frequently observed measure - also to raise the awareness of employees in the organization for digital issues - is the launch of complementary "fast boats". An example of this is TWINT, which has been developed in the Postfinance as a reference project across departments. A further approach, especially for financially strong banks, is to outsource entire projects into innovation labs or incubators. These projects can be developed independently of existing structures and cultures. An example of a complete new development of a bank "greenfield" is the successful online banking platform George of Erste Bank and the savings banks in Austria.

How can you balance the focus between the existing and the future success factors? Customer centricity and the precise development of strategy and organization within the company are combined with digitalization to become the decisive dimensions in the realignment. It is for each supplier to develop their own path along the guidelines formulated here. At the customer interface, the ability to tailor the solution will be critical; in the other areas of the value chain, scale effects, critical size and compounding effects will have a significant impact on future industry structures. This is the differentiation opportunity for organizations and stakeholders.

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