Viewpoint

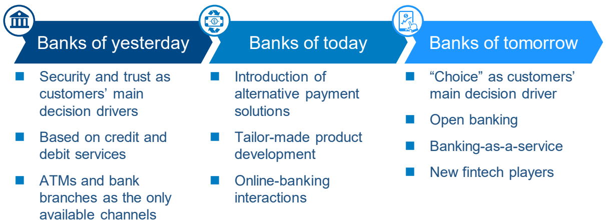
# Open banking: The beginning of a new era

*Article 1 of 3*

**Due to digital disruption, an important dichotomy erupts: banks have more interaction with customers than ever, but customers have many more choices to fulfill their financial needs. As customers prefer choices and experience over being locked into single suppliers, banks need to transform into open banks, striving to give customers "choice". This will turn financial services into a supply-side market.**

## The now and the forthcoming of banking

The evolution of banks




Source: Arthur D. Little

Overall, the financial services industry has presented several changes since the last century, in which banks' transactional model has experienced the maturity and decline of their previous achievements. (ATMs and bank branches are representing less significant client interaction channels year by year). The introduction of mobile banking through client interaction by SMS set a tipping point in the banking industry in 1999.

Managing strategic decisions in a fast-paced technological environment has forced banking to evolve into a new era – the era of digital banking, in which competitors will not be traditional financial institutions and where clients' loyalty will be ephemeral and expensive. It will be an environment whose pillars stand in "choice" and technology. It will reshape the structure of the financial services industry for years to come with trends that are here to stay:

1. **Customers demand digital native solutions:** Upcoming generations (e.g., millennials) believe they won't need banks in the future, with the availability of alternatives such as digital start-up providers.
2. **Financial services incumbents continue to push process digitalization:** According to recent Arthur D. Little studies, 25 percent of banks have entirely digital offerings. In parallel to regulatory compliance, digitalization is the key element of focus by banks attracting strong investments and attention.
3. **Fintechs continue to innovate in all areas of banking:** There are more than 100 million new fintech initiatives per year in different business lines (e.g., payments, crowdfunding, "sharing economy"), some of them in collaboration with third parties. It is important to highlight that these fintechs' initiatives threaten all banking business lines, which will not be limited to customer relationships, but also affect operations, products and services, customer experience, etc.
4. **Regulatory pressure to open banking to third parties continues:** New digital regulations will boost open-banking initiatives (e.g., Europe's PSD2 and GDPR) for the following reasons: (i) standardize access to data and banking infrastructures; (ii) improve security in information flow; (iii) promote the use of APIs and reusability in order to reduce integration cost and time to market. Entry barriers will drop, allowing fintech solutions to be part of banking offerings and threatening banks' control over their customers.
5. **New technologies continue to emerge:** There are several ways of introducing digitalization initiatives into banking: OAuth APIs, blockchain, telematics, robotics, AI, big data analytics and cloud computing, just to mention the big trends.

However, banks are not alone in this journey any more. Due to the fast evolution of technology, customers have new alternatives and solutions to replace the current banking model. One of the business lines most affected by technology is payment solutions, in which players such as Confinity (nowadays PayPal) have found their way up, establishing themselves as leaders in the payment industry with market caps in line with American Express. Nevertheless, all business lines are affected by new financial technology solutions, even internal operations (credit scoring, compliance services, loan allocations, etc.). Digital technologies are transforming the competitive environment of banks, wherein value is created based on customer choices and experience rather than being locked into a single supplier.

Additionally, there are important competitors pursuing bundling of different financial services. In China, both Tencent and Alibaba have raised the concept of social financing to a new level by integrating their social networks with a vast array of financial services. Meanwhile, the western world is starting to see GAFAM (Google, Apple, Facebook, Amazon, Microsoft) building ecosystems around financial services. Furthermore, banks in Europe face financial marketplaces dominated by digital banks (i.e., Number 26, Tandem, Starling and Fidorbank) and the eruption of telecom financial services pioneered by Orange Bank. In particular, new digital banks are winning the customer perception race against traditional banks, as shown by the recent J.D. Power 2017 US Direct Banking Satisfaction Study[1]. Digital banks scored higher than traditional retail banks – 865 out of 1,000 points, 49 points higher than conventional banks, although they currently represent just 6 percent of total bank deposits in the United States.

Due to these emerging technologies, there has been an unbundling of financial services, i.e., many suppliers for multiple needs. At Arthur D. Little, we observe that banks are fighting to maintain their status as one-stop shops with an increased bundling trend. For example, half of Americans have more than one banking account[2], and over 50 percent of mortgages originate with non-bank lending[3]. The race has started, and banks need to run, as the competition is much tougher than before.

## Evolve to thrive

Holding onto traditional banking models will be the biggest challenge for banks in the long run. They have to move their legacy processes, organizations, IT and cultures to the new digital space, which implies agile and lean capabilities. Many banks, realizing the difficulty of the transformation, have launched digital banks to assure that they do not lose out on the opportunity while they transform their organizations.

Others have joined forces to launch networks for payments – JPMorgan, Bank of America Corp (BAC.N), Wells Fargo & Co (WFC.N), U.S. Bancorp (USB.N) and Capital One Financial Corp (COF.N) will be the first to plug into Zelle. The network is the product of an industry consortium called Early Warning Services LLC, whose seven owners have more than 86 million US mobile banking customers.

An overview of various digital banks initiatives is shown in the following table.

1 http://www.jdpower.com/press-releases/jd-power-2017-us-direct-banking-satisfaction-study
2 https://www.gobankingrates.com/banking/banks/how-many-bank-accounts-americans-have/
3 https://www.americanbanker.com/opinion/is-one-stop-banking-viable-anymore

Recent digital banks launched by traditional banks

| Traditional parent bank | Where? | Digital-only bank | Launch |
|---|---|---|---|
| BBVA | United States | Simple | Acquired Feb 2014 |
| Customers Bancorp | United States | BankMobile | Jan 2015, sold in 2017 to Clearwater |
| JP Morgan | United States | Finn | November 2017 |
| Goldman Sachs | United States | Marcus – focusing on loans & CC debt | October 2016 |
| HSBC | United Kingdom | "Project Iceberg" | Pending |
| BBVA | United Kingdom | Atom | Acquisition in November 2015 |
| CaixaBank | Spain | imaginBank | Launch January 2016 |
| Banco Santander | Spain | Openbank | Relaunched in June 2017 |
| Bancolombia | Colombia | Nequi | Launched in July 2016 |
| Mediobanca | Italy | CheBanca! | Launched in June 2017, relies on omnichannel |
| Banque Travelex | France | Ditto | Launched in May 2017 |

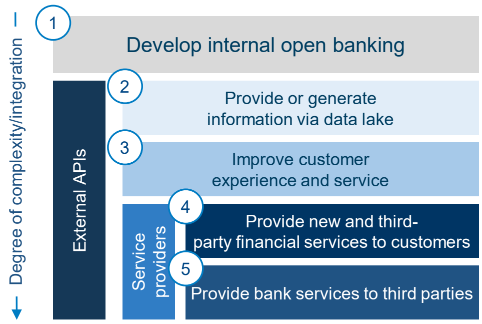
Notes: HSBC already operates an online bank in the UK – First Direct, formed in 1989 – and recently launched Fusion in the US for personal banking and SME customer
Source: Arthur D. Little

However, similar to insurers' handling of the direct insurance challenge, banks cannot rely on a purely digital model. They need to seek a hybrid model, which will allow them to bring their customer relationships and digitalization together. Through open banking, banks will bridge these challenges and gain the advantage of becoming customer-centric, multi-sided financial platforms.

## The opportunity relies upon both the strategic area selected and the degree of complexity

Now that we have already gathered several reasons to adopt an open-banking approach, it is necessary to understand strategic development areas where the concept of open banking applies. (The most suitable approach should be based on the current country, legal barriers, and the bank's competitive position and interest). The development areas to aim for, ordered by their degrees of integration complexity, are:

Areas for development in open banking




Source: Arthur D. Little

1. **Develop internal open banking:** Internally, banks have the opportunity to facilitate communications with standardized and homogeneous services (promoting omnichannel management). An appropriate application programming interface (API) strategy with the corresponding implementation allows streamlining the innovation efforts of banks, with clear advantages such as stability, flexible and manageable business processes, and shorter times. There are also self-service features with integration of new devices.

2. **Provide/generate information via a data lake:** As it is commonly known, providing information to customers about their industry trends, clients' behaviors, geolocation preferences, and new business-line opportunities will be of great interest to most players, irrespective of the industries they belong to. An alternative that banks should consider is to implement data lakes that deliver additional external and internal services and information. A sustainable business model could be created using an open platform with the ability to capture and combine information from multiple sources. This would involve players throughout the market, and establish a market analytic center based on customers' characteristics.

   Data lakes will transform banks into information suppliers, and they will be able to offer their customers precise and concise business intelligence as key tools of management (from development of marketing campaigns to creation of new products). BBVA PayStats is a best-in-class example showing development of data services, which has created a new payment information service to benefit small and medium enterprises (SMEs).

   In the context of a broader consortium set-up, banks might also reflect on complementing the data lake with decentralized ledger technologies such as blockchain, with the goal of making effective use of shared data (e.g., for know-your-customer or similar regulations).

3. **Improve customer experience and service:** Personal finance platforms provide valuable information when making commercial offers. Customers consider banks reliable sources of recommendations. Spanish start-up Fintonic is a clear example of taking customer services and experience to the next level. Fintonic's current business lines are online loans from mobile phones (loans in three minutes). It also offers commission for proactive notices of the best insurance prices and selling of clients' information for account usability and client segmentation. In addition, the platform can consolidate all of a customer's bank and card information into one place, creating a joint-vision understanding based on customer preferences and interest.

4. **Provide new and third party services to customers:**

   Examples of new digital opportunities for banks

| | B2B | B2C |
|---|---|---|
| Platforms | ■ Integrated trading platforms<br>■ Third-party risk assessment<br>■ SME commercial platforms<br>■ Banking-as-a-service (BaaS) | ■ Loyalty systems<br>■ Fintech Multi-sided platforms<br>■ Personal finance management<br>■ Financial health tools |
| IoT | ■ Fleet management for leasing | ■ Telematics<br>■ Smart cities<br>■ Urban mobility ecosystems (e.g., taxis) |
| Digital channels | ■ Loan syndication platform<br>■ SME channels<br>■ P2P lending platforms | ■ P2P lending & payments<br>■ Wealth management robo-advisors<br>■ Geolocalized offers<br>■ Integrated PFM<br>■ Simplified banking for the underserved |

   Source: Arthur D. Little

   With the increasing trend of new technologies such as the Internet of Things (IoT) and digital and mobilization platforms, new business opportunities will appear (both B2B and B2C).

   BBVA offers several best-in-class services to its customers. Its recently incorporated personal finance management (PFM) tool helps customers follow, classify, remain informed on and manage their personal finances by aggregating all of the customers bank-account, credit and card information into one place. Other examples include the BBVA Valora service, which estimates the value of housing, and the BBVA Bconomy tool, which allows customers to monitor their financial health and provides made-to-measure plans to improve it. BBVA Bconomy also offers customers personalized recommendations and tools according to their situations.

   Banks should bet on fintech developments instead of competing against them. Most of the largest US banks have already begun to integrate or acquire their portfolios of products (for example, Citigroup, Goldman Sachs, Morgan Stanley and J.P. Morgan are now using Square as a Fintech payment solution).

5. **Provide bank services to third parties:** Another feasible alternative relies on offering banking services (banking-as-a-service) to third parties. Not long ago, LISIM (a cloud software solution) started to operate as a credit-scoring tool for non-bank players. It offered its clients real-time scoring (scoring-process consulting through various traditional and non-traditional sources), with the option of customer parametrization risk policies according to target customer and risk tolerance. There is a clear opportunity to expand the portfolio and customers' profiles from a banking perspective. Areas such as procurement, compliance, risk, IT and research could offer significant value to companies outside the banking industry.

At Arthur D. Little, we recognize several threats (technical, external and internal) that need to be overcome in order for banks to achieve successful implementation of open-banking strategies.

Threat implementation of an open-banking strategy

| | |
|---|---|
| Internal affairs | Fear and risk aversion in the management |
| | Cultural shock |
| | Corporate processes slow on third party providers offering integration |
| External affairs | Lack of third party providers offering suitable to our needs |
| | Fear to lose control over customer relationship and transactional margins |
| | Lack of clear regulation that controls and drives the adoption |
| Technical | Technical incapacity to accelerate transformation |
| | Problems with security and trust |
| | Untrained staff for new work model |

Source: Arthur D. Little

However, considering these challenges, we suggest:

- Developing a strong analysis of the value chain, as well as a suitable strategy to strengthen contribution of new ideas.
- Uncovering successful industry-specific operating models.
- Adopting a top-down promotion approach (e.g., starting with the CEO).
- Defining a new collaborative business model with pre-set rules (versus stakeholders) to mitigate internal business barriers.

Activities such as encouraging clients' trust in the bank's products, taking on a mix of external staffing, training, and creating a team to support implementation of internal services are among hundreds of different alternatives to overcome technical, inexperience, distrust, and inability challenges.

In addition to the solutions mentioned before, banks should bet on the development of interest groups or consortia that endorse (from an opportunity perspective) making new regulations and developments. If the bank is part of this movement, its odds of a strong position in the future will increase.

## Conclusion

As we have emphasized throughout this viewpoint, banks have the potential to leverage many opportunities in this new environment. Despite all the challenges and threats new players might represent, there are several ways to achieve an open-banking strategy that is suitable to a bank's competitive advantage and interest. Customers' preferences, new regulation resolutions, technological trends and players will establish the ground for a new era of banking.

However, market attractiveness and banks' current positions will start eroding if banks refrain from digging into open-banking solutions. The traditional banking model will present banks with losses of 20 to 30 percent of their current revenues, and that is a strong enough reason to start now – before this opportunity matures into a deadly threat.

Banks should start to bet on this open banking model as soon as possible. It represents the perfect opportunity due to timing and current market competitiveness, but it will not last forever. Customers prefer choices and experience to being locked into single suppliers, and newly established fintechs and digital banks have just arrived.

Beyond this viewpoint, we will explore API-powered business models that are emerging in banking due to open-banking opportunities. We will also analyze the technology implications of this new model and the potential technical approaches.

## Contacts

**Austria**
hessenberger.gerald@adlittle.com

**Belgium**
pankert.gregory@adlittle.com

**China**
russell.pell@adlittle.com

**Czech Republic**
brabec.dean@adlittle.com

**France**
bettati.aurelia@adlittle.com

**Germany**
pfirsching.volker@adlittle.com

**India**
srinivasan.srini@adlittle.com

**Italy**
matera.fabio@adlittle.com

**Japan**
akayama.shinichi@adlittle.com

**Korea**
hwang.hoonjin@adlittle.com

**Latin America**
gonzalez.alejandro@adlittle.com

**Middle East**
dadhich.lokesh@adlittle.com

**The Netherlands**
eikelenboom.martijn@adlittle.com

**Norway**
thurmann-moe.lars@adlittle.com

**Russia**
ovanesov.alexander@adlittle.com

**Singapore**
ito.yuma@adlittle.com

**Spain**
gonzalez.juan@adlittle.com

**Sweden**
kileffors.petter@adlittle.com

**Switzerland**
opitz.michael@adlittle.com

**Turkey**
baban.coskun@adlittle.com

**UK**
eagar.richard@adlittle.com

**USA**
mcdevitt.sean@adlittle.com

## Authors

Alejandro González, Bela Virag, Juan González, Gerald Hessenberger, Rocío Castedo, Mateo Jiménez

## Arthur D. Little

Arthur D. Little has been at the forefront of innovation since 1886. We are an acknowledged thought leader in linking strategy, innovation and transformation in technology-intensive and converging industries. We navigate our clients through changing business ecosystems to uncover new growth opportunities. We enable our clients to build innovation capabilities and transform their organizations.

Our consultants have strong practical industry experience combined with excellent knowledge of key trends and dynamics. ADL is present in the most important business centers around the world. We are proud to serve most of the Fortune 1000 companies, in addition to other leading firms and public sector organizations.

For further information please visit **www.adlittle.com** or **www.adl.com**.



www.adl.com/OpenBank