Plotting a course through disruption and distraction

2021

Commercial Banking Top Trends

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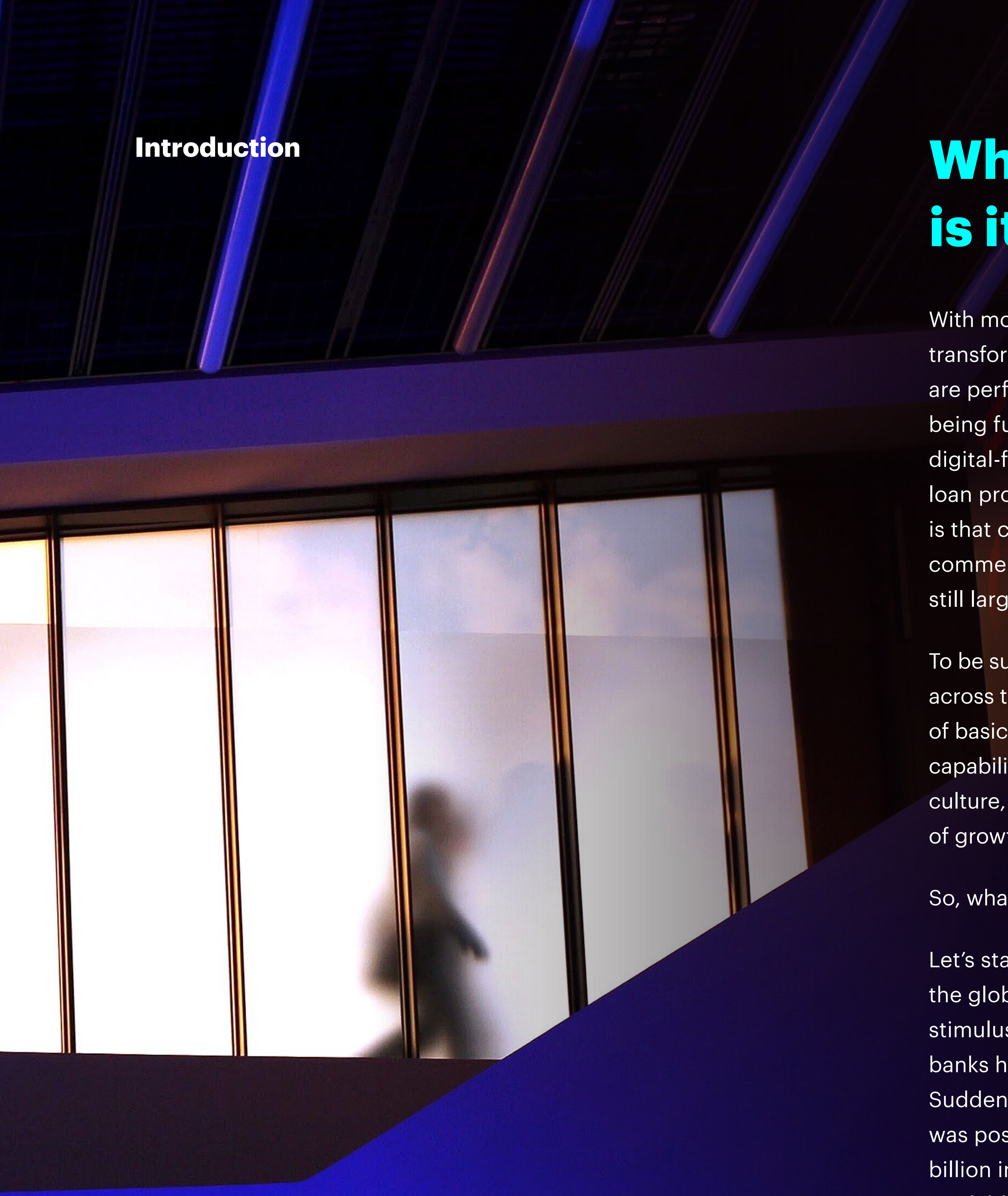

When digital is everywhere, is it really anywhere?

With most commercial banks being several years into their transformation journey, it is time to gauge how these major investments are performing and the extent to which the potential of digital is being fulfilled. While there are many compelling reasons to adopt a digital-first mindset (including increased client engagement, faster loan processing, and significant long-term cost reductions), the truth is that commercial banking is still in its digital infancy. Because of commercial banks' massive technical debt, the promise of digital is still largely unrealized.

To be sure, commercial banks have begun deploying digital strategies across the value chain. But the focus on modernization and digitization of basic functions first has resulted in a smattering of digital capabilities. These aren't yet part of a truly client-centric, digital-first culture, which is needed to propel organizations into a new era of growth.

So, what will be different in 2021? And what's holding the industry back?

Let's start with what's different. In March 2020, governments around the globe began paying out more than $12 trillion in economic stimulus. To get those grants and loans into the hands of businesses, banks had to rapidly stand up digital end-to-end capabilities. Suddenly, commercial banks realized that, with a little push, digital was possible. In the US over just six weeks, banks made $300 billion in small business Paycheck Protection Program (PPP) loans available. Most of those were applied for and distributed digitally. This achievement has led to small business owners and bank CEOs saying, "If banks can deliver digital PPP in six weeks, why can't they deliver broader digital change just as quickly?"

What is holding the industry back? Honestly, not much. Over the past several years, commercial banks have painstakingly modernized and digitized their technology infrastructures. While not glamorous, this has been a vital step on the path to digital. Commercial banks are not done yet, and will need to continue to make substantial investments. But 2021 will be the year banking clients really start noticing digital capabilities. Banks will need to set their digital priorities to ensure that their technology investments not only deliver the more obvious business capabilities but also enable traits such as empathy, responsiveness, focus and efficiency. It is these, in combination with the capabilities, that will produce the required business outcomes. In that vein, it is critical that banks migrate to a culture in which digital fluency and technology quotient (TQ) flourish. In this new culture, the days of the chief digital officer (CDO) could be numbered as digital priorities become central to the business as a whole. But by reaping the benefits of the past several years of investment and making digital central to banking culture, 2021 will be the year when the power of digital is felt everywhere.

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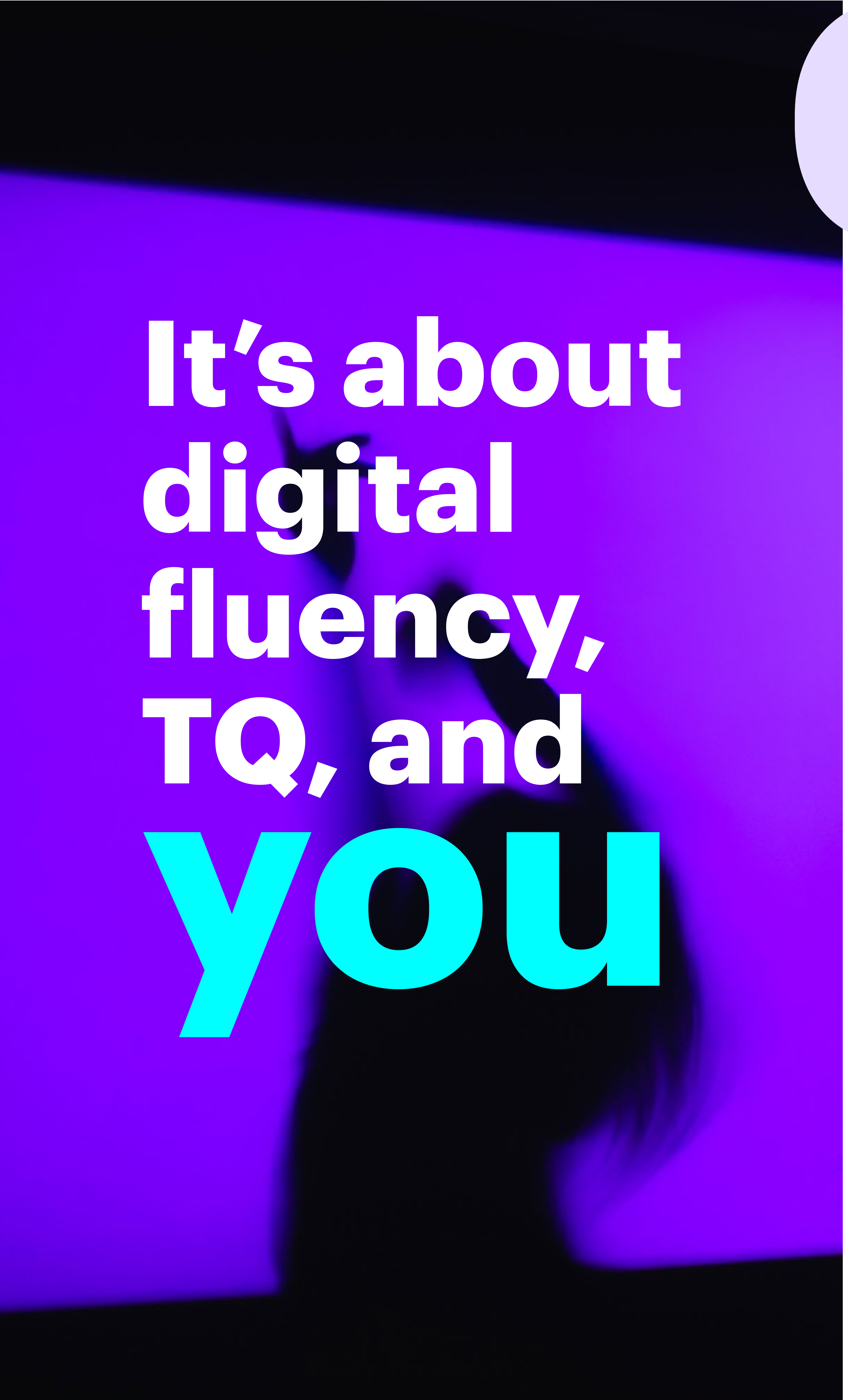


It's about digital fluency, TQ, and you

01

The chief digital officer could become obsolete as digitization becomes everyone's responsibility.

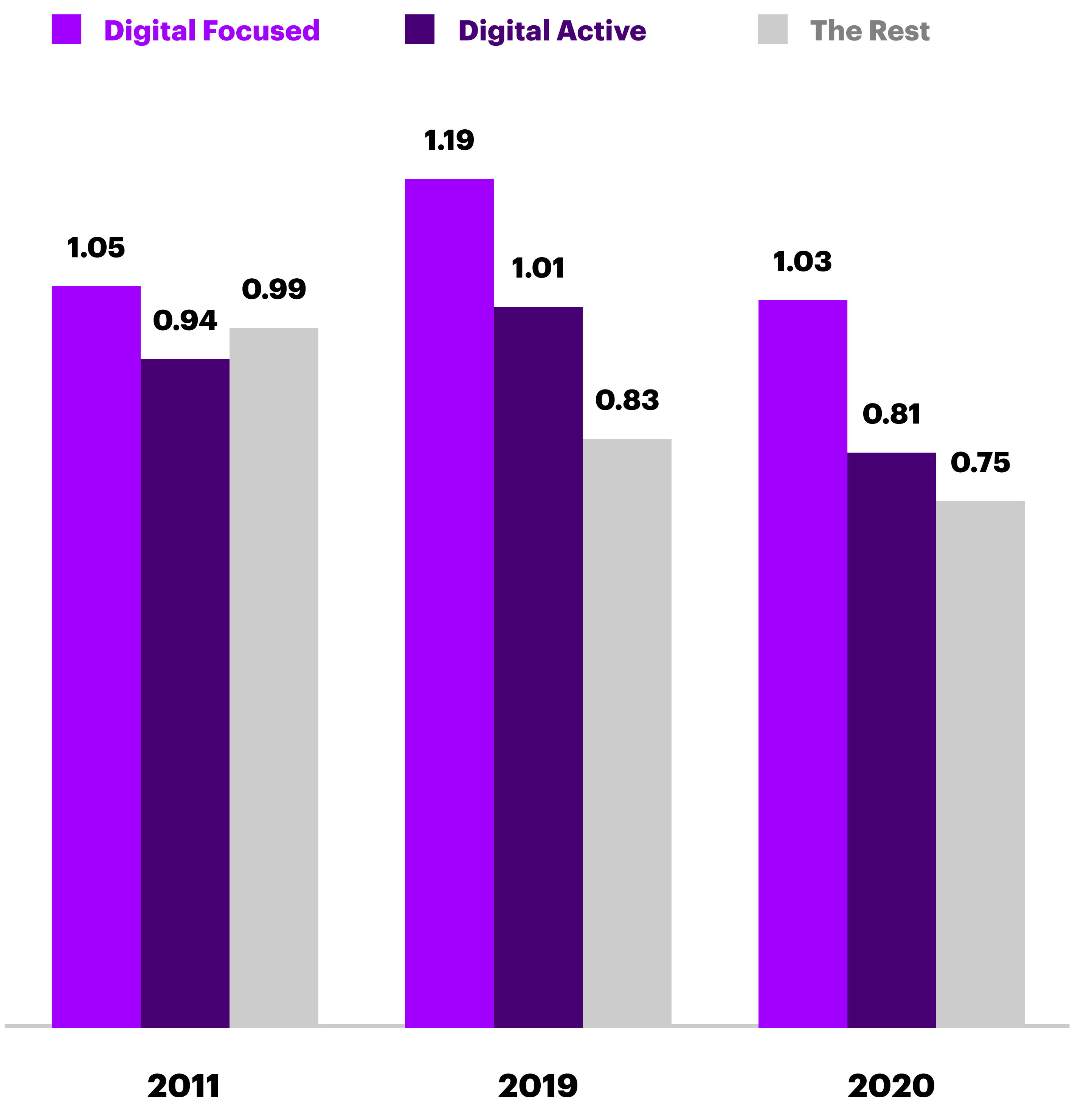
As commercial banks universally move towards digital, we believe they are likely to phase out the role of the chief digital officer. This reflects less on CDOs and more on the simple fact that technology is no longer the domain of technology professionals alone. Gone are the days of the business defining the "what"—the capabilities needed—and technology dictating the "how." On the back of agile pandemic-driven business transformation, banks realize it's everyone's responsibility to define and execute the digital strategy.

Although many skilled bankers may push back, this mindset shift will be required to build a winning digital culture. In 2021, the successful commercial bankers are likely to be those who master business leadership and become digitally savvy: digital fluency and TQ. This mix of traditional and new skills is essential if commercial banks are to realize the full value of digital.

We've seen that banks with a digital focus are twice as likely to grow as those without it.[1] Accenture's 2020 Global Digital Fluency Study shows that just 14 percent of companies are digitally mature.[2] The more digitally fluent they are, the more likely they are to see strong returns in innovation, people experience and customer value—because their workforce has learned to put technology at the core of how they deliver.

Figure 1. Digitally mature banks receive consistently higher valuations

Price to book value ratio



Note: Values calculated as simple mean of 97 banks with P/BV data available in all periods

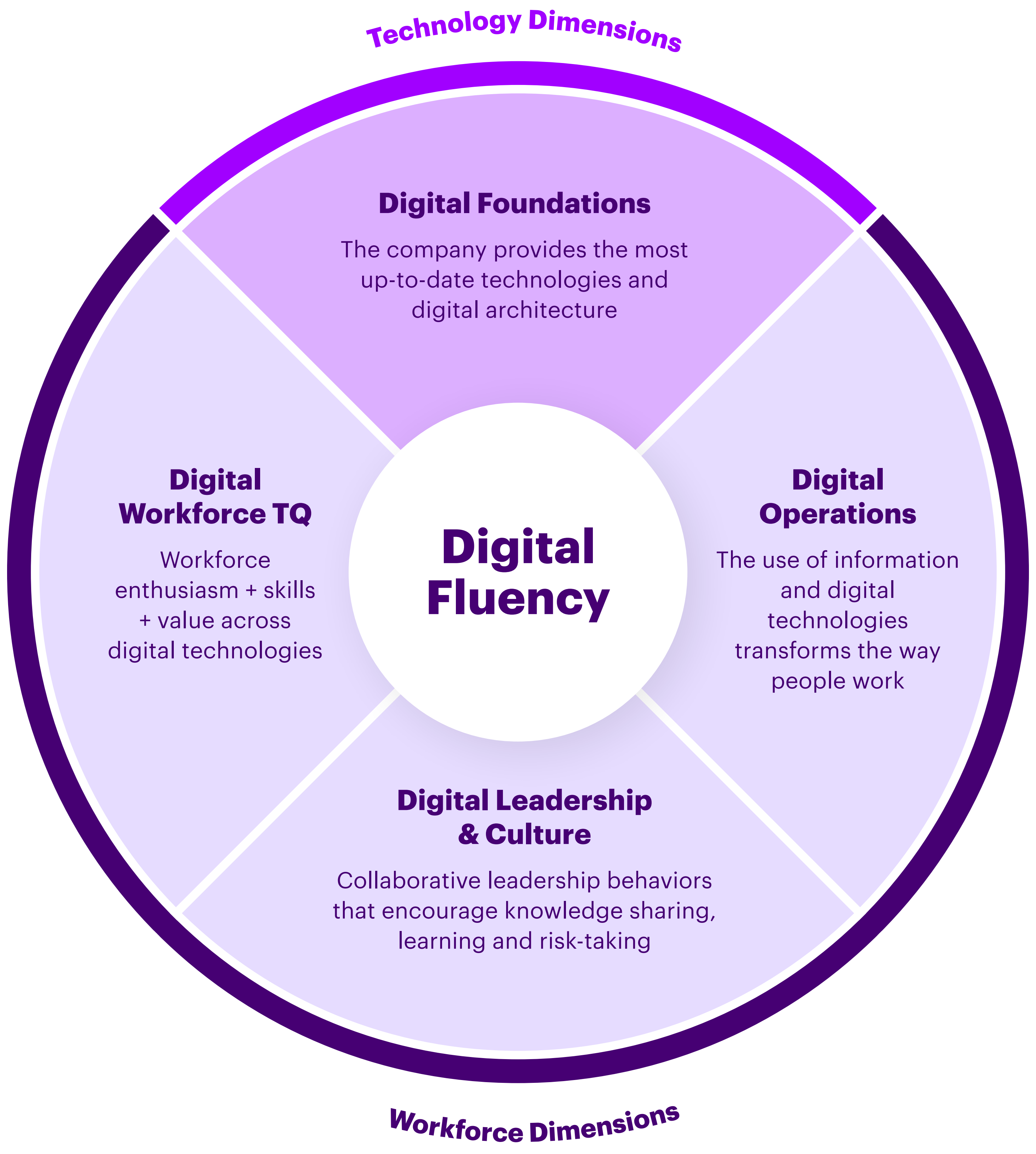
Source: Accenture Research on S&P Capital IQ data

It's about digital fluency, TQ, and you

Despite the successes of 2020's rush to digital, digital fluency is still the missing ingredient in many transformation efforts. In language, literacy means understanding basic linguistic tools like reading and speaking, while fluency implies the ability to create with those tools—like crafting a poem or engaging in robust debate. Fluency unlocks new knowledge, creativity, and innovation.

It's probably no surprise that our research revealed that digital fluency is the lynchpin to unlocking workforce agility. We found that our digital fluency framework (see Figure 2) predicts and explains 54 percent of a worker's ability to be agile.[3] However, workers too often remain far removed from technology transformation. In many cases, it's not the technology itself that is holding individuals back but the lack of digital infrastructure, culture, leadership, and skills.

Figure 2. Becoming digitally fluent: A framework



Source: 2020 Accenture Global Digital Fluency Study

Digital foundations aren’t built in a day

02

Banks will continue to invest in their digital foundations. It will take a while to see the returns, but faith and patience will be rewarded.

The observation that “Rome ne fu pas faite toute en un jour” (Rome wasn’t built in a day) was first made by Phillippe of Alsace way back around 1190. Eight hundred years later it is still remarkably apropos. Whether you are updating, converting, migrating, or replacing your core commercial applications, the transformation to a truly digital infrastructure takes institutional focus, significant available resources and, ultimately, patience. Most banks have already embarked on their digital journey and many can no longer see the port they sailed from. Unfortunately, most can also not see their destination. But landfall may be closer than they think.

The top priority for banks needs to be the transformation of commercial loan origination and accounting. We made this point in our 2020 trends and it’s worth highlighting again. These systems are integral parts of the bank’s commercial infrastructure and essential to any digital foundation.

Cloud will be imperative to that transformation. Banking leaders understand this and have already invested in elastic data and technology capacity as part of their cloud strategies. In fact, banking is leading other industries in adopting a cloud-first posture. A 2020 Accenture survey confirmed that 47 percent of banks have a high share of their workloads in the cloud, compared to all industries at 33 percent. COVID-19 has accelerated this trend.[4]

The business case for cloud is compelling. Organizations that migrate to the cloud generally achieve significant improvements in time to market (30-50 percent), provisioning speed (40-50 percent), and operational costs (10-20 percent).[5] While adoption of the public cloud has been moderate, we expect it to accelerate. Cloud service providers are upping investments and showing strong solution performance across an expanding suite of business use cases. That, coupled with a demanding and digitally savvy commercial banking customer base and increasing competitive pressures, will help public cloud adoption grow.

Cloud is just one aspect of fintech, which has stimulated banking innovation and efficiency and driven improvements in customer experiences more than most trends we’ve seen in the past. Most financial services companies feel confident that fintech will continue to help grow their company’s revenue. Commercial banks are moving from a strategy that has a fintech partnership as a single pillar to one that seamlessly weaves together capabilities and services from multiple organizations. As digital commercial banking matures and connectedness increases, the resulting ecosystems will lead to heightened disruption and the emergence of new innovative business models. It may seem we are talking about cloud a lot, and that is because we are—the significance of cloud enablement is just beginning to come into focus within banking.

As cloud adoption scales and digitization accelerates, 2021 will see the rise of multi-layered, interconnected commercial banking ecosystems with SMEs and corporations at their heart. Banks may not yet be able to see the shore, but fear not, it lies just over the horizon.

Digital ROI is the name of the game

03

It may be a while before your digital foundation is complete, but you can start to harvest the benefits now.

Why are we focusing on digital capabilities? Even though more than 80 percent of the average bank's digital spending is on foundational technology, over 50 percent of business enablement and differentiation will come from the new digital capabilities it introduces.

When it comes to updating foundational technology (see Trend 2), most banks are well past the halfway point in their multi-year journey. And while a strong foundation is critical to the long-term viability of the business, leaders driving bank transformation tend to get little credit for it and are under pressure to show results from the more interesting and innovative targets of their investments.

A vineyard can exclusively grow grapes only for so long—at some point it needs to produce wine. So how does a commercial bank produce wine? By unleashing the new digital capabilities enabled by its digital foundation. Empower relationship managers with actionable analytics. Provide customers with digital tools to drive self-sufficiency. Or use machine learning to make powerful predictions amid uncertainty.[6] Even though their foundation remains a work in progress, banks must find a way to redirect limited resources—financial, technological, and personnel—to leverage the foundation and unlock business value.

04

Digital experiences: Your clients are taking notice

Clients see the power of digital in their daily personal lives. Commercial banks need to get more serious about the business of experience.

As commercial banks took the lead in designing digital interactions for customers requiring PPP loans, they not only reduced their costs but also expanded their ability to support large numbers of customers. What's more, they generated customer appreciation and loyalty. Along the way we've seen a strong increase in customers' willingness to engage digitally with their banks—even, in many cases, a new love of digital capabilities.

In truth, this hasn't arisen solely from their banking experiences. Excellent digital experiences have become part of everyone's personal lives—even more so during the past year. What has changed is that customers are now demanding similar experiences in their business lives.

Commercial banks have shown they can provide a digital experience. But as their retail counterparts have discovered, this poses the risk that they will disappear in a "sea of sameness." Therefore, the challenge is shifting from simply digitizing to providing differentiated, meaningful digital experiences. Banks will need to progress from prioritizing their customer experience (CX) to committing themselves to what we call the Business of Experience (BX). BX requires a new organizational mindset that makes it everyone's responsibility (not just the chief experience or digital officers) to create, sustain, and enhance the CX. Banks that embrace BX will be well positioned to make innovation an everyday habit. They will sync their technology, data, and human agendas to build and deliver excellent experiences across all channels. These experiences will clearly distinguish them from their competitors, providing a solid foundation for driving higher rates of growth than their more inwardly focused peers.

05

From data experiments to actionable insights

By placing actionable data in the hands of relationship managers, loan officers, and customers, banks will get tangible results from data analytics solutions.

With muted credit signals and a near-virtual work environment, commercial banks in 2021 need innovative data and analytics solutions to function efficiently and craft tailored service interventions that help address clients' particular needs. This won't be easy. Progress could stall in the face of too many options and not enough funding. Then there are the challenges of managing an evolving data and analytics ecosystem, sustaining momentum, and enabling future scalability.

But the efforts will pay off. Financial services C-suite executives are already reporting ROIs of over 60 percent[7] along with significant improvements in customer experiences, workforce productivity, and new product offerings. Fast rollouts are also turning "fit for purpose" products and services from goals into realities. One-size-fits-all commercial banking solutions are giving way to more customized, easily accessible information that lets RMs reduce administrative burdens and spend more quality time with clients, albeit virtually.

In the second half of the year, leaders will capitalize on enhanced 360° views, micro-segmentation and data-driven cross- and up-selling opportunities to help RMs work more efficiently and drive up revenue. They will continue digital RM enablement, boosting the satisfaction of both RMs and their clients. Long-term work on customer relationship management and early warning credit insights will continue to dominate the applied intelligence transformation journey in 2021. But banks are likely to also take advantage of more modular, quick-win rollouts of data analytics solutions and partnerships with fintechs or technology vendors to drive meaningful customer growth and improve predictive risk strategies and insights.

06

Every business is a fintech business

More and more firms are embedding financial services into their offerings and experiences. Banking as a service is becoming a game-changer.

A famous fintech observer once claimed: “Those who enroll, also control,” meaning companies that are the customer’s first landing point have an advantage when it comes to addressing all of that customer’s needs. Last year we saw digital brands like Amazon, Shopify and Apple embed financial services into their own products and experiences. Over the next 12 months, this trend should grow as businesses recognize a new, potentially lucrative revenue stream and offer financial services right at the point of sale.

Shopify, a Canadian e-commerce business, enables convenient access to financial services for small and mid-sized enterprises (SMEs). Merchants can finance purchases through buy-now-pay-later loans, obtain debit cards and accept payments from customers—all on the Shopify platform. How? Shopify has partnered with a commercial bank which uses open APIs to provide the underlying banking products and services. According to research by the consultancy 11:FS, Shopify is the tenth-largest platform providing financial services for SMEs in the US (Bank of America is sixth).[8] On the surface Shopify is an e-commerce business, but on the balance sheet it’s a fintech.

While the commoditization of banking services is not new, it is set to accelerate thanks to the rise of trusted APIs and greater collaboration across commercial banking strategy. Banking as a service (BaaS) ensures the execution of a financial service over the web through an end-to-end process.

Commercial banks that use BaaS as a distribution channel achieve two to three times the industry average return on assets. Westpac, an Australian bank, recently introduced the first partner on its new BaaS platform. Its collaboration with Afterpay, the leader in Australian buy-now-pay-later services, will allow Afterpay to diversify the financial services it provides to its three million customers—with no banking license.[9]

In another example, Stripe has partnered with Evolve Bank and Goldman Sachs to launch Stripe Treasury, an API-enabled service that helps millions of its business customers embed financial products into their marketplaces or platforms.[10]

07

Responsibility gets real

Client demand for sustainability and social responsibility is driving banks to take actions that are good for them—and the world.

Over the past decade, social responsibility has become increasingly important at many leading global corporations—including banks. The past year was an inflection point. Commercial banks' stakeholders are starting to demand that banks' core purpose be aligned with something greater than profit—and will expect action. In 2021, we expect this trend to accelerate with increased urgency. While an individual bank's focus on corporate responsibility may vary slightly by region, banks are now actively involved in topics such as sustainable investing and renewable energy, and also social justice, racial inequity and other societal issues.

With respect to the environment, customers, regulators, and industry leaders already expect their banks to be sustainable. Many banks have responded by publicly sharing a host of aggressive targets for their internal operations. Standard Chartered Bank, for example, has rolled out a Green and Sustainable Product Framework[11] which is used to evaluate whether potential lenders' "green" projects qualify for special loans. Under the new Biden administration, the US has rejoined the Paris Climate Accord and early actions indicate a more aggressive stance on renewable energy than we have previously witnessed. While this will impact society and the environment much more than any changes to banking operations, banks still need to focus on social responsibility. Customers will value banks whose sustainable lending policies are quantifiable—and punish those lending to demonstrably "unsustainable" organizations. In a similar vein, regulators will demand stricter disclosure of how ESG-friendly banks' assets are.

We expect commercial banking to be the driving force within the bank, because of its ability to have a higher impact—thanks to relatively fewer loans and a greater number of external ratings. Many banks, including ING, BBVA, BNP Paribas, Standard Chartered, and Société Générale, have already pledged to use lending to help drive a shift from a high- to a low-carbon economy. Various US banks have publicly refused to finance oil and gas exploration in the Arctic National Wildlife Refuge in Alaska.

However, commercial banking's responsibility extends beyond the environment. As stakeholders have focused on companies that embody social responsibility principles, we have witnessed CEOs of leading global banks issue formal public statements condemning racial inequities and advocating social justice. Banks have the opportunity to leverage their financial position with clients to drive meaningful change in society. We expect the role of commercial banks as the proverbial corporate good citizen to grow as they look to establish themselves as societal change agents.

08

From disruption to distraction

Banks need to establish the right structures, portfolios, priorities, and leadership to sustain momentum and flourish through a year that will move from disruption to distraction.

In 2020, we saw a wave of disruption in commercial banking as COVID-19 forced banks to laser-focus on getting themselves, their clients, and their employees through this historic and abrupt economic crisis. While the disruption of 2020 is behind us, the year ahead will bring many distractions, making it difficult for banks to focus on their digital agenda. The pandemic continues to spread and will dominate the news for the next two quarters at least. As the global economy responds to the K-shaped recovery, we have yet to experience the true impact of non-performing loans. Corporate real estate books, so long the anchor of commercial portfolios, will be exposed and present new, significant challenges. Aside from the pandemic, Brexit's aftermath and a new US administration will alter both local and international policies and dynamics.

Additionally, we expect further consolidation of regional banks and possible divestiture of far-off operations, such as BBVA selling its US operations to PNC. Commercial banking leaders are likely to use parallel strategies to balance these very real distractions with the need to recover momentum in their longer-term strategic investments.

Amid the calamity, COVID-19 shone a light on the need for game-changing transformation. In response, commercial banks rose to the challenge and exceeded their own expectations. To build on that ability, astute banks will seize the moment to use strategic investments to get ahead of the pack. For those in the early stages of significant digital transformation, the answer is to resist turbulence-driven paralysis and push harder and faster. The near-term competitive threat from big tech (the Amazon partnership with ING in SME lending, for example)[12] looms, and those companies do not face the same distractions that confront traditional commercial banks. To stay competitive, banks will need to establish the right structures, investment portfolios and priorities, and leadership to maintain momentum and flourish through the year of distraction.

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