Innovation in Retail Banking

October 2018, 10th Anniversary Edition

A Decade in Review

DIGITAL BANKING REPORT

PREVIEW EDITION

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Innovation in banking is not universal, with many organizations needing to create a culture that will embrace the change that is occurring in the marketplace, take qualified risks, and be willing to disrupt current business models to succeed.

— Jim Marous
Owner and Publisher
Digital Banking Report
## Contents

Preface ................................................................................................................. 4
Letter from the Author ....................................................................................... 5
Message from the Sponsor .................................................................................. 6
Key Research Questions and Takeaways ............................................................. 8
Innovation Case Studies - Summary .................................................................... 9
Executive Summary ............................................................................................ 10
Section 1: Innovation Over the Past Decade ...................................................... 14
Section 2: 2018 Innovation Trends ....................................................................... 27
Section 3: Digital Transformation Trends ............................................................ 41
Section 4: Deployment of Advanced Technologies ............................................. 54
  - Advanced Analytics/AI/Machine Learning
  - Open Banking APIs
  - Cloud Technologies
  - Chatbots and Voice Technologies
Section 5: Competitive Trends ............................................................................ 73
Section 6: Interviews with Industry Leaders ....................................................... 78
2018 Global Innovation Award Winners ............................................................... 86
Final Thoughts ..................................................................................................... 96
About the Research ............................................................................................... 101
Online Survey Questions .................................................................................... 104
About Us ............................................................................................................... 106
Efma and Infosys Finacle are proud to present the 10th annual ‘Innovation in Retail Banking’ report. After a decade of charting the development of innovations and business models in retail banking, this year’s study is a milestone that marks just how far the industry has come – and how new technologies are still driving transformation. We also look ahead at what’s in store for banking in 2022.

Customers remain at the center of banks’ innovation efforts as organizations across the industry move to improve digital customer experience across new touch-points and channels. In line with this, we found that delivery channels are the key focus of innovation, with most banks saying that mobile and online will be the primary distribution channels in four years’ time.

In terms of product innovation, we found banks focusing on payments, mobile wallets and lending as the most important areas of banking. These are also the three areas where non-traditional financial institutions pose the biggest competitive threat.

A lot more banks are taking a longer view of returns from their investment in innovation compared to last year’s report. We also found banks prioritizing an ‘innovation culture’ as the primary driver of innovation. More banks now have an innovation strategy in place, although growth is slow in this area. Banks are using a variety of approaches to support their innovation efforts. Notably, we’ve seen a significant increase in the desire to partner outside their organizations compared to previous surveys, as banks realize that internal development may not be enough to deliver the speed and customer-centricity they’re aiming for.

Banks across the world see open banking APIs as the top technology for the future of innovation, ahead of artificial intelligence and machine learning, chatbots and other technologies. But we haven’t yet seen the full impact of open banking, as banks are still considering a range of objectives for how they will use it.

While banks in this year’s survey believe they are well positioned to use open APIs, conversational interfaces, cloud processing and mobility/wearables, we found an ongoing lack of readiness to leverage advanced analytics and machine learning – a factor that could inhibit other technology advancements and innovation efforts.

Looking ahead at 2022, banks continue to see platform-based competitors such as Amazon, TechFin firms and fintech organizations as the innovation leaders. We also found an increasing awareness of challenger banks as competitors compared to last year, while non-fintech or banking firms and incumbent banks were seen as the least threatening.

We would like to thank all the banks that participated in our 10th innovation survey and agreed to be interviewed for the study. Not only do they provide invaluable insights into retail banking innovation today, they also contribute to a bigger picture of the industry’s innovation over the past 10 years. We hope that our readers find this study informative, inspiring and useful.
We also look at the trends in digital transformation, the deployment of advanced technologies, the impact of external competitive forces and a review of case studies from the winners of the 2018 Efma Innovation Awards. Finally, throughout the report, we provide perspectives of industry leaders as they look back at the past and into the future on how innovation has transformed the banking industry.

It is clear from this year’s report, and the reports from the past, that great progress around innovation has been made, but that there is still much to do. The increasing demands of the consumer, fueled by digital experiences from technology leaders, is relegating the banking industry to playing a game of ‘catch up’. This is especially true with smaller organizations, who often lack the resources to deliver the digital functionality of larger peers.

To move forward at the speed of change will require a doubling down on providing a culture of innovation throughout organizations, combined with a willingness to embrace change, take appropriate risks and disrupt what has been the norm in the past. This requires getting out of our comfort zone and finding a way to serve the consumer in the way they are being served by big tech alternatives.

Jim Marous
Publisher, Digital Banking Report
Author, Innovation in Retail Banking 2018
I am delighted to present the tenth-anniversary edition of the annual Innovation in Retail Banking study, in association with Efma and Jim Marous. This edition marks an important milestone in our treasured partnership and endeavor to monitor and chronicle developments in retail banking.

With insights from over 300 leaders and practitioners in the industry, this report invites you to review a decade in banking innovation and also take a look into the future. Research findings articulated and revealed in the following pages recount the unfolding of a phenomenon we seldom realize and recognize as we live through it - the phenomenon of evolution. Innovation efforts and practices in banking have evolved steadily over the last decade. Three crucial observations, a reflection of our experience in the industry show us how.

**Who is the customer talking to?**

A few years into the new millennium, we were still carrying out most of our financial transactions through a teller at the bank branch. The branch housed nearly 50% of the total number of customer interactions. In a striking display of the power of the exponential, less than 15 years later over 90% of customer interactions have moved away from the branch to digital channels such as online banking, mobile banking, digital wallets, and call centers. What’s more, industry estimates suggest that by as early as 2022, nearly 50% of these transactions will move beyond bank-owned channels to channels managed by third parties, thanks to digitization and customer-centric regulations.

**Where are the investment dollars flowing?**

Investment in banking innovation has increased in lockstep with the pace and direction of change. Our research findings over the years suggest a significant investment in digital channels. Leading and progressive banks at the forefront of digital innovation have also invested in the more strategic digital engagement suites and hubs.

These banks are now moving the needle on innovation with new digital models enabled by open banking initiatives across the globe. API-led innovation emerged as the most important area of focus for banks this year reinforcing the sweeping realization that the future of banking is “open”.

**Who is winning the innovation battle?**

What has become profoundly clear in financial services is the firm footprint of technology giants such as GAFA and nimble digital players such as FinTechs. With the democratization of data, these new market entrants are being seen as the frontrunners for innovation in the industry.

According to this year’s findings, digital commerce platforms such as Amazon and Alibaba are likely to emerge as clear innovation leaders by 2022. Consumer technology companies such as Google and Apple come a close second. The growing realization that the biggest threat for banks comes not from within the industry but from new players with advanced digital capabilities in critical areas of competitive differentiation is making banks notch up their innovation efforts.

Progressive banks have already begun preparing for this reality by cultivating ecosystems and investing in platform business models. Our survey this year sought to assess what banking practitioners think about the change in business model in banking. Findings reveal that the traditional front-to-back closed model is visibly disintegrating into specialist roles in the new world of banking which places a growing premium on deep expertise and customer relationships. Banks are aligning themselves more strongly with manufacturing or distribution roles to affirm their position in the platform economy.
Transforming for the digital future

Research findings and customer accounts from our experience with financial institutions in over 100 countries indicate that as banks continue to adopt and transition to new digital business models, the great enabler of change — technology — is becoming an inhibitor, especially for incumbent banks saddled with legacy systems.

In response to the digital disruption brought in by modern technologies, empowered customers, agile competition and changing regulations, all banks have introduced digital initiatives. Amidst constraints of capital, resources, or skills, many banks administered a facelift of select touch points and pockets largely limited to the front office, instead of a holistic transformation that is digital to the core. Their huge legacy estates hinder their ability to respond to market changes swiftly.

Not surprisingly, a whopping 74% of banking leaders and practitioners this year indicated “technology enhancement” as the top area of investment. Invariably all banks are now moving beyond peripheral digitization to truly digital transformation with re-imagined customer journeys for frictionless experiences, larger ecosystem play, insights-driven interactions and ubiquitous automation.

The dizzying pace of digitization in a world where windows of opportunities open and shut faster than ever, demands a sharp vision and agility and creativity to translate that vision into action. And banks do not have the luxury of a trade-off between an unrelenting focus on the digital future and delivering on the demands of the present. It is critical to seamlessly juggle the dual orchestra of transforming for the future and excelling at the regular and the routine.

With this research, we aim to help banks sharpen their vision, bolster their innovation strategies and accelerate their digital transformation journey. The study brings together powerful insights about innovation in the industry and provides a benchmark for investments in various areas of innovation. We hope it helps you prioritize your innovation investments and empowers you in your unique journey in this rapidly evolving world of digital banking.

Sanat Rao
Chief Business Officer and Global Head
Infosys Finacle
KEY RESEARCH QUESTIONS:

• Are financial institutions increasing their commitment to innovation?
• What is the primary focus of innovation initiatives?
• What areas are receiving an increased level of innovation investment since last year?
• Do institutions tend to build, buy or partner to drive innovation?
• What technologies will have the greatest impact on banking in the next year?
• Over what time period is the success of innovation measured?
• Who will be the innovation leaders in the future?

KEY TAKEAWAYS:

• While fewer than half the organizations surveyed have a chief innovation officer, the presence of an innovation strategy increased by 6% since 2017.
• 50% of organizations state that their primary area of innovation in the next four years is in product delivery channels.
• 74% of institutions increased innovation investment in technology, 73% increased investment in channels and 69% increased investment for customer experience.
• The primary ways organizations are driving innovation is by partnering with business partners, large tech firms and start-ups.
• Open Banking APIs (5.68 on a 7-point scale) and advanced analytics (5.66) were the technologies thought to have the greatest impact over the next 12 months.
• In 2018, there was a significant shift to a longer-term perspective of ROI for innovation.
• Bankers surveyed believed big-tech firms, digital commerce platforms and fintech start-ups will be the most innovative competition in 2022.
# Innovation in Retail Banking 2018 Case Studies

The following is a list of financial marketing case studies that are highlighted near the end of this report complements of the *Efma Distribution & Marketing Innovation Portal*. Efma members have free access to thousands of innovation case studies through this portal.

<table>
<thead>
<tr>
<th>Institution</th>
<th>Product</th>
<th>Innovation and Differentiation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Banco Bradesco Brazil Brazil</td>
<td>Multichannel</td>
<td>The main objective of the multichannel initiative was to allow the public to know about and interact with the Lollapalooza festival either in person or virtually. The bank’s sponsorship served to link the music universe to the Bradesco brand.</td>
</tr>
<tr>
<td></td>
<td>Reach at Lollapalooza</td>
<td></td>
</tr>
<tr>
<td>Bancolombia Colombia Colombia</td>
<td>Plink</td>
<td>Award winning analytics and advanced intelligence solution that brings together merchants and consumers, providing value to both.</td>
</tr>
<tr>
<td>Bank Pekao S.A. Poland Poland</td>
<td>PeoPay</td>
<td>Mobile banking application which allows customers to pay abroad in foreign currencies and enables online shopping to be paid directly from a phone. It also enables payments in contactless terminals in Poland and abroad.</td>
</tr>
<tr>
<td>Fidor Bank United Arab Emirates</td>
<td>Moneysmart.ae</td>
<td>The Middle East’s first financial community and smart bank concept. Its objectives are to increase financial knowledge among Millennials, help consumers manage their finances and build their wealth in an interactive bank environment.</td>
</tr>
<tr>
<td>Alior Bank Poland Poland</td>
<td>Konto Jakze Osobiste</td>
<td>Personalized bank checking account that allows account holders to choose the benefits that they want and/or don’t want via online banking platform, mobile application or at any branch.</td>
</tr>
<tr>
<td>Shinhan Bank Japan Japan</td>
<td>Innovative Car Loan Program</td>
<td>Gold winning innovation for social, sustainable and responsible banking involves installing an IOT device in a newly financed car that can identify the location of the car and deactivate the engine if a customer’s repayment falls overdue.</td>
</tr>
<tr>
<td>BAWAG P.S.K. Austria Austria</td>
<td>TRENDE LOUNGE</td>
<td>An event at BAWAG P.S.K. where employees present their innovative ideas for consumer products and services. The event empowers the bank’s workforce and has increased awareness for innovation within the company.</td>
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Executive Summary

Over the years, there has been a growing realization in banking towards innovation as the proven path to differentiation and competitiveness. While the transformation has been slow, over the last decade the industry witnessed an increasing willingness to discard the traditional short-term focus, functional silos and risk-averse culture towards more meaningful advancements and open culture.

While traditional banking organizations have lagged other industries with regard to innovative cultures, the challenges over the past decade seem to be more deeply entrenched at financial institutions in the more developed countries. Evidence of this dearth of exciting innovations by banks in the U.S. and Western Europe can be seen when looking at the big winners at annual financial innovation award presentations.

We have seen over the past several years that start-ups embody the core principles of innovation that drive commercial success. They embrace risk-taking and failure, while rewarding success. They are agile and can pivot immediately to meet market demand and are focused on customer needs. Because they are usually small, they can think big. But because they are small, scalability can be a challenge.

The question is whether banking can replicate the best of fintech start-ups while leveraging their customer base scale advantage to respond to a changing marketplace. Or, will the majority of the industry need to be fast-followers … or laggards, with the inherent risks?

The Challenges of an Innovative Culture

Building a ‘culture of innovation’ is most likely at the top of most banking organizations’ corporate agendas. There is no denying that a firm’s own employees are uniquely positioned to understand both their customers and their own organization. We have seen movement over the past decade toward a greater commitment to innovation, but we have also seen the lack of commitment doom innovation initiatives.

Unfortunately, while many organizations say they are increasing their efforts to build a work environment that inspires innovation and creativity, research indicates that many corporations may have a surplus of ideas that aren’t being nurtured. Worse yet, a risk-averse approach to innovation creates incremental improvements rather than the level of innovation needed to generate meaningful ROI. Finally, the structure of banking makes the entire process too slow, resulting in lost revenues.

While our research over the years has found that an innovative culture is very important to the generation of entrepreneurial ideas, and that the investment in innovation has increased every year, many firms still do not view themselves as strong innovators and there is a lack of disruptive innovations that ever reach the consumer.
What Makes an Innovation Leader?

Over the past decade of evaluating innovation in banking, several key characteristics have been prevalent in innovation leaders:

- **Focus on Customer Experience**: Innovative organizations put the consumer first, knowing that a positive customer experience is good business. They increasingly use data and advanced analytics to understand their customers’ needs and behaviors. They invest in capturing insights from internal and external data sources and build models to enable contextual decision making and communication.

- **Build an Innovation Culture**: The one constant we have seen over the past 10 years is that the most innovative financial institutions have the most evident top-down innovative culture. This goes beyond just support for innovation; to include risk-taking, networking and collaboration (including a meaningful measurement and rewards structure). It is difficult for an organization to achieve the spirit or success of smaller and more agile fintech firms without a commitment from the top.

- **Encourage Internal and External Collaboration**: The most successful innovators take advantage of the best ideas from both inside and outside the organization. In fact, it is becoming more commonplace for innovation to occur through collaboration with fintech firms than to be built from within.

- **Integrate Innovation with Business Objectives**: Investment in innovations must be consistent with overarching business strategies being presented to the public and should be supported by the corporate culture.

- **Take a Long-Term View of Innovation**: Innovation cannot be held captive to the quarterly reporting of earnings. Over the past 5 years, we have seen banking organizations extend their perspective of how fast innovation must generate a return. This is a good trend.

- **Provide a Structured Environment**: If the innovation process at a financial institution does not have a defined leader, it will be more difficult to succeed. Many organizations say they are committed to innovation, but lack the leadership and structure needed. To be effective, an innovation process must run quickly and efficiently, and needs to be separated from the normal banking silo structure that slows the process.

- **Focus on Speed to Market**: Swift execution of innovative ideas is imperative to maximize ROI. Successful organizations aren’t constrained by customary ways of doing things — they remove the words ‘no’ and ‘cannot’ from their vocabularies, and instead focus on finding a way to succeed. They also utilize small, focused project teams.

**Moving Forward**

With the ongoing onslaught of outside firms competing in all business categories, financial organizations must take steps to centralize, internalize and prioritize the innovation process. Some suggestions include:

- Assess the innovation culture and process within the organization to determine if new ideas are encouraged and rewarded.
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- Determine how innovation can be integrated and aligned within the overall business strategy of the organization through innovation road-maps, measurement processes and a rewards structure.

- Publicize the innovation culture within and outside the organization. Make sure this culture begins at the very top of the organization.

- Create opportunities and incentives for innovation and idea development.

The banking industry is faced with the risk of disruption from many known and unknown sources. How organizations respond is critical to continued success, and ultimately, their existence.

Most banking organizations may need to look no further than their own employees for innovative ideas. While potentially being overwhelmed by ideas that may have limited impact or revenue/cost benefits, it is still imperative to harvest ideas with potential.

If the banking industry is going to keep up with the new upstarts and fintech entrepreneurs, organizations need to find ways to cultivate, nurture, implement and reward ideas swiftly. The key is to avoid dampening innovative spirit, while aggressively culling ideas with less chance of success, and selecting innovative ideas that will generate returns.
About Us

Efma

As a global not-for-profit organization, Efma brings together more than 3,300 retail financial services companies from over 130 countries. With a membership base consisting of almost a third of all large retail banks worldwide, Efma has proven to be a valuable resource for the global industry, offering members exclusive access to a multitude of resources, databases, studies, articles, news feeds and publications. Efma also provides numerous networking opportunities through working groups, webinars and international meetings. True to its vocation, Efma has recently developed an Innovation Portal that aims to identify and award the most innovative projects in the retail financial services arena.

For more information: http://www.efma.com

Infosys | Finacle

Finacle is the industry-leading digital banking solution suite from EdgeVerve Systems, a wholly owned product subsidiary of Infosys. Finacle helps traditional and emerging financial institutions drive truly digital transformation to achieve frictionless customer experiences, larger ecosystem play, insights-driven interactions and ubiquitous automation. Today, banks in over 100 countries rely on Finacle to service more than a billion consumers and 1.3 billion accounts.

Finacle solutions address the core banking, omnichannel banking, payments, treasury, origination, liquidity management, Islamic banking, wealth management, analytics, artificial intelligence, and blockchain requirements of financial institutions to drive business excellence. An assessment of the top 1250 banks in the world reveals that institutions powered by the Finacle Core Banking Solution, on average, enjoy 7.2% points lower costs-to-income ratio than others.

To know more, visit http://www.finacle.com
About the Author

Named as one of the most influential people in banking and a ‘Top 5 Fintech Influencer to Follow’, Jim Marous is an internationally recognized financial industry strategist, co-publisher of The Financial Brand and the owner and publisher of the Digital Banking Report. The Digital Banking Report is a subscription-based publication that provides deep insights into the digitization of banking, with over 150 reports in the digital archive available to subscribers.

THE FINANCIAL BRAND

As a sought-after keynote speaker, author and recognized authority on disruption in the financial services industry, Marous has been featured by CNBC and CNN, Cheddar, The Wall Street Journal, New York Times, The Financial Times, The Economist, The American Banker, Accenture and the Irish Tech News and has spoken to audiences worldwide. Jim has also advised the White House on banking policy and is a regular contributor and guest host for the Breaking Banks podcast.

You can follow Jim on Twitter and LinkedIn or visit his professional website.