

The birth of brand banking

A passing trend, or the shape of things to come?



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Executive Summary

The liberalisation of financial markets throughout Europe is changing the way banking products are offered and how banks operate. With a younger generation no longer tied to bank brands, more non-financial services players are seeing an opportunity to use their brand recognition to offer banking products.

Technology has made it easier for new market entrants to move into this space by levelling the playing field, enabling, for example, delivery of online only banking services. New solutions that offer component re-use and web services mean that organisations can also pick and choose the applications they need, providing the flexibility to add new applications as the business demands, while keeping a check on total cost of ownership (TCO).

This is placing even greater pressure on traditional players, many of whom are constrained by legacy mainframe systems that lack the flexibility to efficiently meet changing demands. Customer acquisition and retention is a challenge for the traditional banks and represents a market opportunity for the new entrant brands.

This white paper assesses the emerging trend of 'retailer as banker' and the pressures that smaller/medium size banks and new market entrants are under to deliver innovative services in order to gain and maintain market share. It also examines the technology challenges that they face and outlines factors to consider when choosing a core banking system today.

The changing financial services landscape

Retail banking in Europe has historically been based on branch networks offering a limited range of products all of which were manufactured in-house. There was limited competition between retail financial services providers with customers typically staying with their bank for life.

Market liberalisation has changed that. Retail banking is now one of the most dynamic financial services sectors, with the high street banking brands looking to steal a march on each other through new product offerings and well publicised branch renewal schemes. However, this advantage is often short lived as new products that gain market share are quickly copied by other banks.

Competitive pressures from non-banks is also intensifying. Established financial services brands, such as insurers and credit organisations are looking at retail banking as a potential avenue to expand their brands and increase their share of customer wallet. Dutch financial services group ING, for example, has witnessed great success entering the UK savings market through its 'Direct' service built on a strong marketing campaign and the offer of above-average interest rates.

However, the biggest shift has been the number of non-financial services brands taking an interest in financial services. For a long time, many have provided credit and loans to purchase their goods. Now they are examining how to use their high street presence and brand recognition to deliver current accounts, credit cards and even mortgages.

As a result, customer acquisition and retention for banks is an increasing challenge. Financial institutions are seeking technological advances that can deliver competitive advantage. This can take many forms – reduced operational costs, improved customer service, or the ability to bring new products to market more quickly.

Technology lowers entry barriers

The established banks are struggling to continually patch old legacy mainframes and to manage the complex array of application connections. Their IT complexity has made running an efficient operation difficult. Many are investing considerable percentages of IT budget simply to fire fight problems to ensure core systems don't fail.

As new distribution channels have emerged they have been forced to introduce additional layers of complexity to their architectures, or risk losing business. The evolutionary developments of distribution channels have also created silos of data, requiring further integration layers. This is making IT infrastructure management ever more time consuming. As a consequence, there is additional pressure on banks to provide a consistent customer experience across these channels.

But technology has moved on and the options available to banks are far more extensive. The internet in particular has been a great leveller of the competitive landscape, lowering entry barriers. Paper free, real-time processing via a browser has made the traditional bank assets more of a liability. And while white labelling solutions from banks was once the norm, many new entrants are now able to go it alone thanks to powerful commodity hardware and the use of web services.

This has made it far easier for competitors to take market share by implementing new technologies far quicker than an existing bank. In a market where time-to-market is critical, they can introduce innovative products and manage multiple channels effectively.

"Channel proliferation is a major concern for banks and new market entrants. The internet is a great tool for providing services but it has already become a commodity service that customers expect," says David Vander, Worldwide Industry Manager for Banking at Microsoft. "However customer expectations are now far higher than they used to be. They expect to choose the channel that suits them, so banks must be prepared for that. Customers compare their banking experience to other retailers and the banks are not fairing well in many people's eyes. They want to be the most important aspect the experience, not their product."

The online financial services brands have a flexibility that enables them to concentrate on creating innovative, personalised services to differentiate from traditional banks. Generally, they are not interested in duplicating the traditional branch-led banking model.

Beginning with a blank sheet, new market entrants can use the latest technology to provide efficient online services. For them, siloed data simply isn't an issue. They also do not have to worry about branch overheads or legacy applications and the costs they entail, creating a much lower cost-to-income ratio per customer.

The birth of brand banking

Technology's ability to lower the barriers to entry has heralded the arrival of non-financial brands entering the retail financial services space. It has also led to the emergence of a new phenomenon – the brand as a bank.

While for years the traditional high street branch represented a notion of a safe and secure institution, younger generations do not have the same associations or attachments. The emergence of the brand among the key 18 to 35 demographic has affected how banking services are offered. Organisations and retail brands are all eager to boost their bottom line by expanding their reach into the banking market with new products and services.

Existing players have also recognised brand power, launching products under new banners to appeal to a new audience. HBOS for example has launched new insurance products through sub-brands 'Sheilas' Wheels' (car insurance for women) and 'Esure' (home, car, travel and pet insurance). Also being recognised are the skills and experience that can be found in the highly competitive retailing sector where the customer is at the heart of the organisation. This has led to a cultural shift at management level in many banks, with several appointing senior executives from the retail sector to use their knowledge to shape the next generation of banking products.

Strong, established retail brands have four advantages:

- **Brand strength:** trusted retail brands have a large number of loyal customers open to being offered financial services products. In many cases these brands are viewed more favourably than existing bank brands.
- **Lower costs and competitive products:** with existing and established outlets, the operational costs for offering financial services products are lower for retailers than financial services firms. This enables retailers to pass savings on in the form of competitively priced products, particularly in the insurance sector.
- **Ease of access to customer base:** potential customers already visit stores to purchase goods and know the brand, so do not need to be enticed by large marketing campaigns. There is plenty of opportunity to engage with these customers at various times during their retail experience, both in store and online.
- **Business intelligence:** retailers have more in-depth customer data than many financial services providers and have a track record of running successful loyalty schemes. They are also used to extracting and analysing this data to manage their businesses. There is an opportunity to extend this knowledge to their financial services operations.

Technology considerations

Investing wisely in IT continues to be an issue for most banks. While new entrants do not struggle with the legacy mainframes or the data silo issues of traditional providers, it is important to learn from previous mistakes.

Organisations looking at establishing banking businesses need to carefully examine their requirements and the technology they need. It is essential that new market entrants consider every aspect of their technology investment to ensure their architectures meet both today's and tomorrow's business needs.

"The cost pressures in retail banking are relentless. Integration projects are expensive and often fail to achieve their aim, which is why new banks must think very carefully about their architectures," says Stewart Foster, Director of the Activebank division at Financial Objects. "They need to learn from the multi-channel efforts to date where channel migration has been achieved but up-sell and cross-sell of services has remained elusive."

Success is therefore dependent on using the right technology and the right channels to efficiently deliver banking services. There are four key factors that must be taken into account:

- **Customer experience** – how can the bank attract and retain customers? Providing market leading customer services through multiple channels is the only way to increase your share of customer wallet.
- **Process excellence** – online services offer far greater automation. By reducing manually intensive processes as much as possible, the business is simplified, and the cost-to-income ratio is greatly reduced.
- **Reduce cost and risk** – reducing infrastructure complexity makes it far easier to manage risk. There are significant technology risks associated with old platforms and applications that are still in production. Cost and maintenance overheads will also be reduced compared to competitors using legacy mainframe systems.
- **Sustainable leadership** – the technology must support the brand. Brands with the greatest equity are the most profitable because their customers are generally more loyal and willing to pay higher prices for the product, and have a closer relationship with the brand. That means greater cross-selling opportunities, increased share of wallet and bigger profits.

ICA Banken

ICA Banken was launched by the Swedish retail giant ICA in 2002 to offer retail financial services to its substantial customer base. Since its inception ICA Banken has been using innovative business models and cutting-edge technology to challenge the four established banks that dominate the retail banking market in Sweden.

ICA Banken implemented Financial Objects' *activebank* core banking system and components for: lending, retail, cards, payments, general ledger and collections. This uses Microsoft SQL Server running on 64-bit Intel Itanium hardware, offering massive scalability and performance. The system regularly handles upwards of 75,000 payments, 50,000 card transactions and 100,000 internet banking requests per day.

ICA Banken was named "Bank of the Year 2003" by *Privata Affärer* and was the winner of the Best Internet Bank award 2003 by *PC för alla*.

The cost of deploying and supporting many enterprise applications often dwarfs the initial development or acquisition costs. Much of this cost can be associated with the tools, technologies, processes and best practices for managing applications.

Advances in standards, tools and application methods offer new approaches to deliver value and establish a solid foundation for future growth. The increased use of industry-proven standards such as XML, Simple Object Access Protocol (SOAP), J2EE and Microsoft .NET has greatly increased channel integration options. The traditional programming language for mainframes, COBOL (COmmon Business Oriented Language) has existed for more than forty years. However developers are harder to find as many no longer want to write applications in older procedural based programming languages. Because developers capable of building a banking system in these languages are now such a limited resource they are inevitably more expensive.

Regardless of the approach, there two key issues that must be taken into account:

- How are online services, with no physical customer contact, using technology to differentiate themselves from the competition?
- How are new market entrants ensuring they have the right systems in place to provide the right services?

Microsoft .NET is a strategy for developing connected business applications. The .NET Framework provides:

Common services to aid faster development
Virtualised environment
Code libraries
Interoperability with other languages and systems
Common runtime platform

“Connected systems pull together a constellation of services and devices, to more effectively meet modern day business challenges. Building connected systems requires not only a comprehensive enterprise software platform, but also a new service-oriented architectural approach to address the integration imperative. Many banks already use Microsoft in the front office and are progressively using more Microsoft server and integration products to create new efficiencies in middle and back office. 98 of the top 100 financial services firms have implemented solutions on the Windows platform with .NET and web services.” **DAVID VANDER, WORLDWIDE INDUSTRY MANAGER FOR BANKING, MICROSOFT**

Flexibility delivered through SOA

New development approaches can enable the creation of application architectures that are much more flexible than their predecessors. Service oriented architectures (SOA) have gained in popularity as a way for organisations to develop and deploy new applications efficiently. A 'service' is defined as a set of logical functions that have been abstracted together for reasons of efficiency and/or effectiveness; it describes the capabilities of the service and its scope.

The service oriented approach provides a framework for thinking about the business as a set of services rather than a set of organisational structures and departmental processes. SOA is based around common platforms, protocols and reusable code to support enterprise-wide applications and business processes.

"Before organisations can reap the benefits of reusing and enhancing their existing technologies, instead of simply upgrading existing systems or building new ones from scratch, they need to adopt modern development architectures centred on the notion of service orientation," says Foster. "Service orientation is a crucial prerequisite to creating connected systems. With the development of messaging standards based on XML, service orientation is quickly becoming the mainstream approach for building connected systems."

For financial institutions, an SOA approach creates a new level of flexibility in how they can interface and integrate applications. For example, when a bank needs a new application, a component architected solution enables implementation without impacting existing applications or workflows.

When considering what technology to choose, the focus should be on maintenance cost and operations cost. Other important factors include:

- Is the technology future proofed?
- Is the solution based on open standards to facilitate straight-through processing and real-time information capability?
- How easily can the solution be implemented and maintained?
- Can commodity hardware and software be used to lower the total cost of ownership?
- Is the technology stable and user friendly?
- Can the solution be modified without compromising the architecture or re-writing millions of lines of code to evolve with business needs?
- How easy will it be to add new applications to support new lines of business such as loans, mortgages and credit cards?
- Is the solution scalable to handle a ramp up in business volumes?
- Does the vendor have a proven track record with implementations in similar sized institutions?

CAF

The Charities Aid Foundation (CAF) needed to handle donations effectively for its customers and secure more business. CAF selected *activebank* as the platform to support all of its back-office operations. As an end-to-end core banking solution built on standard Microsoft architecture, *activebank* provided the flexibility that CAF required. With a component-based architecture CAF has gained a custom-built solution for the areas of its business that do not conform to standard banking activities.

activebank currently manages 700,000 accounts, based on 20 different account types and handles up to 750,000 transactions a day within the application. CAF expects the number of accounts to grow by more than 20% in 2006 and the volume of transactions to increase to above one million per day.

"We recently secured a contract to manage Give As You Earn for an organisation that has 180,000 regular donors. Having the *activebank* platform in place has given us the ability to bid for contracts of a size that we would have previously not been able to accommodate."

STEPHEN AINGER, CEO, CHARITIES AID FOUNDATION

Implementation options

When examining implementation approaches, it is important to recognise that the decision should be driven by business imperatives and the ability to commit resources. Whether the bank is a start up, or part of another organisation, there are three implementation options:

- A 'big bang' where all branches (if applicable) and lines of business go live simultaneously;
- Phased pilots where a few pre-selected branch locations use the solution before a full roll out begins;
- A line-of-business approach where the bank rolls out one or more lines of business, such as accounts, and then introduces new lines (mortgages, cards, insurance) over a period of months or years.

The first approach provides faster implementation cycles and greater visibility. However, it also demands much higher resourcing levels and represents a higher risk for new entrants. There is no second chance to bring the products to market.

For start-up banks, the phased and line-of-business approaches are ideal. These afford the new banking operation time to understand how the solution is working and how it affects their service offering. It also enables the bank to incorporate lessons it has learnt from its operations and ensure a perfect business fit.

The line-of-business approach provides additional flexibility to the bank. It can introduce particular channels or products and add new channels as the organisation matures. In a traditional bank, this might create siloed structures with disparate customer information, different workflows and inhibit the bank from deriving the complete benefit of the new technology. But by implementing a component-based solution, these issues do not arise.

The benefits of a component-based architecture

Component-based architectures offer rapid application development tools and techniques. These can be used to create functionally-independent and interoperable solutions, built to common industry standards. A bank's core system should protect current investments by offering sets of components without data duplication and redundancy. It should also allow third party applications to be integrated without the need for system re-engineering or re-writing code.

Component-based architectures fit all types of banking operations. New entrants can implement application suites as a core solution, or build a system using components as a line-of-business application.

Aegon

Leading life insurer Aegon decided to launch its own banking service, Aegon Bank, in The Netherlands. Unencumbered by legacy core banking applications, Aegon Bank wanted an advanced solution to build a component-based banking system.

It also required a solution that would support an aggressive strategy to bring new products to market quickly to stay ahead of established providers. Aegon was one of the first *activebank* customers having selected the solution in 1998. In 2003 it bought the source code to *activebank* to support its outsourcing model with LogicaCMG.

The flexibility of the *activebank* platform means that bespoke developments can be undertaken at a fraction of the cost of implementing a bespoke solution around a legacy application. This approach enables the bank to retain its competitive edge and take immediate advantage of initiatives such as new banking products introduced by the Dutch government.

This approach also works for existing banks looking to gain new flexibility to meet the challenge of new market entrants. Their main concern about replacing legacy applications is the complexity of unravelling old interfaces and patches. With component-based solutions, there is no need for 'rip and replace' projects – individual applications can be replaced without ever touching the mainframe or affecting how it works.

“Approaching banking applications using a component strategy provides a method for addressing the problem of bringing the right building blocks together to create highly distributed business process management,” says Vander. “The component approach is based on SOA, which provides a modular architectural framework or a composite infrastructure that enables software components to interact seamlessly.”

Rather than developing new applications for every product or channel, banks should aim for an open IT architecture where all systems are integrated. This enables new services and products to be added quickly and cheaply within an SOA architecture model. The bank's technology infrastructure is divided up into components, based around a set of pre-defined services, separate, but integrated with one another.

The advantage of this approach is that the different components can be upgraded or repaired without re-writing millions of lines of code or impacting on the core processing systems. By implementing an open architecture model, web-based banking simply becomes part of another 'layer' of the bank.

The benefits of the component-based approach can be summarised as:

- **High return on investment** – the low cost of ownership running applications on commodity hardware and software and a low cost of deployment delivers a fast and high return on investment;
- **Improved productivity** – the ease of use allows organisations to greatly increase efficiency and productivity;
- **Customer-centric operations** – the complete flexibility enables any delivery channel to be used. This lets the bank meet and exceed the customer service level expectations;
- **Increased revenues** – a complete view of all customer activity allows new products to be brought to market quickly. This delivers competitive advantage and additional revenue through cross selling of additional products and services;
- **Reduced costs** – the costs associated with servicing each account are reducing through greater levels of automation and the use of the most appropriate delivery channel;
- **Lower levels of IT investment** – the open architecture model, with its inherent XML connectivity makes it easier to interface components with any other system;
- **Component re-use** – source code is inherently flexible and re-usable components increase the speed of development resulting in quicker, simpler deployments and reduced time to market.

activebank

activebank Banking is the only proven, end-to-end Microsoft .NET banking system available in the market today. Built on an advanced technology platform, with a component-based architecture, *activebank* provides banks and financial services organisations with a clear alternative to legacy core banking systems.

Quick to implement, flexible and cost-effective to maintain, *activebank* is a new generation core banking system that provides comprehensive functionality and seamless interoperability with other legacy and bespoke applications via service oriented architecture (SOA). Thanks to its component-based architecture, the *activebank* Banking Application Suite can be implemented in its entirety as a core system replacement, or on a component basis as a line-of-business application. It also offers customised development at a fraction of the cost of bespoke work undertaken on legacy systems.

Don't get left behind

The proliferation of new technology and outsourcing has made the cost of entry into financial services relatively low. This is making it easier for non-financial institutions to sell products they have not produced and has led to the rise of niche players taking valuable market share from existing providers.

Whether a new bank, subsidiary of an existing financial services provider, or retailer, it is critical to make the right technology investments. Technology has moved on and banks need to ensure they don't get left behind.

Advanced, component-based systems enable the customer-centric services demanded by an increasingly selective client base. They offer new market entrants the opportunity to efficiently implement a new architecture. Providers can choose the applications they need for their lines of business, or implement the solution in its entirety as a core system.

Banking is all about knowing your customers' needs, and providing them with the right products at the right time through the right channels 24 hours a day, 7 days a week. Without the right technology, building a strong and loyal customer base will be impossible. Customers will choose a competitor that can offer the services they want, through the channels they choose. Banks cannot afford to take that risk.

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