THE BUSINESS TRANSFORMATION IMPERATIVE:  
change now or become obsolete

The financial services landscape is changing faster than at any time in history. The FinTech revolution is creating an entirely new breed of competitor that is forcing “the establishment” to look closely at themselves and determine how they can transform to continue to be leaders in tomorrow’s marketplace. Goldman Sachs estimates that $4.7 trillion worth of revenue is at stake and could be claimed by new entrants to the financial services space if today’s market leaders do not adapt and change. While this is a concern for most CEOs, it is also a great opportunity. In this article, Josh Sutton discusses the following four topics that are central to helping financial services firms transform their businesses in the era of the digital enterprise:

› Why today’s incumbent firms have an unfair advantage
› The four pillars of business transformation
› Understanding and leveraging the firm’s culture
› Choosing the right approaches to drive business transformation

AN UNFAIR ADVANTAGE

Every start-up in the world wants to have the customer base, balance sheet or product offerings that nearly every leading incumbent firm possesses today. Thinking like a start-up does not mean figuring out how to do things from scratch — it means determining how to provide a better service that people will pay for that leverages available assets. For most Silicon Valley firms, those assets are not very substantial; however, they are usually fairly massive for today’s leading financial firms.

› Customers. There is a certain amount of “stickiness” with financial services customers. This holds true across the spectrum, as retail banking customers, institutional investors and corporate clients alike have a natural predisposition to avoid switching institutions unless there is a compelling reason to undertake that effort. Conversely, customers want to consolidate their relationships to as few providers as possible if it makes their lives easier. There is a large opportunity for financial firms to increase the amount their customers spend with them by providing improved experiences and easy-to-purchase incremental services. An example is the success of Amazon Prime. By creating an improved service platform, Amazon has been able to entice a large set of customers to join Amazon Prime. Based on data from Consumer Intelligence Research Partners, the revenue generated from an Amazon Prime customer in 2014 was $1,500 per year versus $625 for a non-Prime member.
Capital. There is an oft-repeated quote that it takes money to make money. Nowhere is this truer than in financial services. Business lines in today’s firms, ranging from retail lending to treasury services, rely on a significant balance sheet to operate successfully. The net result is a large number of business lines shielded from FinTech start-ups to date. Some new ideas, such as peer-to-peer lending, have launched as a result of Silicon Valley firms seeking to identify models that do not require large amounts of capital. This will not last forever, as funding for FinTech firms is increasing rapidly — $8 billion worth of funding was granted during the first two quarters of 2015. For the near term, however, this environment creates an opportunity for the larger, established firms to innovate and create meaningful improvements within their core business lines.

Products. Every person and firm has slightly different financial needs. In a perfect world, these needs would be met by unique and bespoke products. Yet the complexity involved in creating such products, along with the regulatory hurdles they would impose, make this a rather impractical solution. Today’s established firms have the benefit of possessing a large catalog of products that can be assembled as part of a custom portfolio that achieves the same net effect. The hurdles to this are largely internal at most firms, as there is little incentive to cross-sell and deliver custom solutions. Therefore, the potential is significant, and this is an opportunity that is not possible for new entrants to the business.

THE FOUR PILLARS OF BUSINESS TRANSFORMATION

There are four primary lenses that must be considered when undertaking a business transformation effort. While each lens can be viewed independently, the sum of all four should be considered when prioritizing investments and business model changes.

Customer Experience and Engagement

The customer is always right. In today’s world, this saying applies to nearly every industry, including financial services. The first step in transforming the business is to look at it through the eyes of the customer (either consumers or corporate customers). What are they really trying to accomplish? What would make their lives easier? What services would a firm provide to them in their ideal world? These are all questions that need to be answered without being influenced by the constraints of how a business operates today. Firms often confuse a great user interface with a great user experience. The former is a technology solution while the latter is about business design and ensuring that it is built around customer needs.

Employee Empowerment

What can firms do to better enable their employees to add value? These are the people who best understand the business and its customers. Oftentimes, however, the way an organization is structured can impede employees’ ability to leverage insights to improve the business. Any transformation effort must include a robust analysis of how to increase the value that a firm gets from its employees. This can be as simple as ensuring that employees are working on the same platforms and systems as their customers so they can better interact with them. It can also be about how to increase employees’ leverage by using technology to make them more effective. Technology and employees work hand in hand to create better results. In the wealth management space, for example, many financial advisors fear being replaced by technology. Instead, they should be focused on leveraging technology to serve a significantly larger client base.

Process Optimization

The streets in London or Boston are a direct result of quite literally the paving of cow paths. Too many businesses have processes that suffer from the same mindset. A process that once had to be manually performed was automated; unfortunately, the process that was automated was never examined to determine if there was an opportunity to improve it. Many of the costs associated with middle- and back-office processing can be traced to this behavior. Firms should take a close look at what can be done with today’s technology and business landscape that might not have been possible even five years ago. Can business lines that were once separate due to cost pressures now be integrated? Can services that were once too costly to provide now be offered to a wider range of customers?
New Business Lines

The creation of new business lines receives a significant amount of media attention, but this approach should only be considered if it provides value that customers want but are currently not receiving. New business lines can be segmented into two areas: those that are accretive and those that are disruptive. Accretive business lines are things that firms can provide as a new revenue stream that does not destroy any current business lines. One example would be giving retail banking customers the ability to allocate a portion of their savings to be invested in sector-specific ETFs. This provides a new set of investors for ETF products without damaging any existing business lines. A disruptive example along the same lines would be using digital platforms and robo-advisors to provide wealth management services and advice to every retail banking customer. While potentially accretive to the firm as a whole, there would definitely be an impact on the wealth management business and how it operates. Truly disruptive areas, such as using blockchain to redefine how settlement works or artificial intelligence to identify investment opportunities, would also fit into this category. As a general guideline, accretive business lines are best considered part of a transformation of an existing business, while disruptive business lines are best considered outside of the lens of today’s business model.

BUSINESS TRANSFORMATION VERSUS DIGITAL TRANSFORMATION

Nearly every major firm has had discussions about digital transformation and what it means to their firm. There is a fear of being “uberized” or becoming the next Borders bookstore. The term “digital transformation,” while important, is ultimately misleading, as it conveys an implicit thesis that firms need to move from legacy channels to digital channels in order to conduct business. This is not always the case. To fully assess how to transform a business, a firm must first review the underlying areas that have changed as a result of technology.

› Access to information. Technology has created an environment in which people expect to have access to information on demand. The days of sending out monthly NAV reports are quickly disappearing.

› Mobility. People no longer work in physical offices or during fixed times. Instead, they are working at their offices, homes, restaurants and a plethora of other places throughout the day and night. They need to be able to access any information from any location on any device.

› Analytics. While the industry is in the early days of big data and machine learning, these technologies are quickly redefining how people expect business to be conducted. Financial services will benefit the most from changes in this area, and the firms that lead the way will be leaders of tomorrow. Just as sub-prime retail credit cards are a well-understood and profitable business today, it is safe to assume that there will be a number of new business opportunities originated by the intelligent use of complex data analytics and even artificial intelligence.

Only after firms have reviewed their business in the context of these three changes, can they begin to complete a true business transformation — which will likely involve an increased use of digital channels. However, if firms do not start with a thorough business review, they will be simply putting a veneer over a potentially obsolete business model.

CULTURE

Understanding and leveraging a firm’s culture is one of the most critical yet overlooked components to any business transformation program. The first step in this process is to undertake a frank assessment of what the culture is today. Is it aligned with taking risks or is it risk adverse? Do people gravitate toward working in silos or do they prefer collaboration? Are decisions made by executive mandate or group consensus? Each of these items, along with other intangible components of the firm’s culture, is critical to understand before attempting to change the firm.
Once a firm understands its current culture, it is important to assess which components of that culture are complementary to transformation and which are counterproductive. In doing so, organizations can determine how to best leverage the characteristics of the firm to create a bias toward transformation. Certain characteristics can influence how to drive action. For example, a firm with a competitive culture can incorporate that into how it drives transformation ideas. Firms can make the funding of transformative ideas a competitive event and let the natural aggressive culture of the firm create an environment where people are competing to create the best and most transformative ideas.

Understanding the current culture will also help firms identify any parts of the culture that will be detrimental to the firm’s ability to transform. One example is a firm that has a cultural bias toward silo-driven behavior. This can often be a showstopper for many transformation opportunities presented in today’s digital enterprise. Creating a plan to change any behaviors such as this is critical to any well thought-out transformation plan.

The final step in understanding the impact of a firm’s culture on its transformation efforts is to determine how best to create an environment that makes people want to be part of the program. This must be done within the constructs of the culture as it was assessed, but often will have some common components. People must understand that transformation is important to the firm and therefore to them. This cannot be conveyed through words alone; it must also be backed by actions. Some common actions that people generally notice are career advancement opportunities as well as financial rewards and penalties. Ensuring that the people who are actively exhibiting the right cultural behaviors are being visibly promoted is a good first step. Another action is making a clear link between increased budget funding for parts of the firm that are making efforts to participate in the transformation efforts, while decreasing budgets for those business lines that are not.

It is important to note that people will expect transformation to be internal as well as external. For example, when a firm creates a great communication platform for its clients, but its employees still use Lotus Notes, it implicitly tells people that the firm does not value its employees to the extent that is should in today’s world. Actions speak louder than words, and firms must ensure that the actions they are taking are aligned with any transformation program.

**Approaches to Drive Business Transformation**

The real challenge with business transformation is how to make it actionable and beneficial. The obstacles are substantial. There are often decades or even centuries of history at every firm. This history creates a cultural perception about how things have been done, which is difficult to overcome. Equally challenging is the natural resistance to change. People will have a vague idea at best about what the future might look like, but can understand in explicit detail what changing today’s model might mean to their personal role at a firm. With this in mind, three models have yielded successful results at firms within financial services as well as other industries:

1. **Journey-driven Transformation.** This is the approach that is best-suited for situations where there is a clear executive mandate to explore and enact transformation to improve the business. It starts with a high-level articulation of the functions that are core to a firm’s business strategy. Examples could include things like mortgage origination or third-party distribution of funds. Once this list is assembled, it should be reviewed and prioritized. For each business function, a cross-functional team should create a future-state “journey” that clearly articulates what that business process would ideally look like for both customers and employees. This cross-functional team should comprise key employees as well as external team members who can challenge legacy models and prevent “group think” from taking over. These future-state journeys can then be mapped to actionable plans that can be executed. Often, a critical part of the plan is the internal communication required to ensure alignment and garner the necessary support from existing employees and customers. A common best practice is to designate a leader for the transformation program who is accountable to the CEO and does not have any specific ties to the legacy business models currently in place. This can be somebody from within the firm (divisional CEO, chief innovation officer, etc.) or someone external.
2. **FinTech Investment Models.** Leveraging the start-up mentality to bring new and innovative ideas into a firm is a model that is growing in popularity. At the highest level, the goal of this model is to leverage a group of people who are not part of any existing business line or burdened by any preconceived notions to develop transformative business opportunities that can generate incremental revenue or even disrupt entire business lines. There are a variety of different approaches firms are taking to implement this model. Two of the more common ones are as follows:

- **Venture Capital (VC) Model.** The firm effectively acts as a venture capital firm for potential disruptive start-ups in the industry. It provides them with capital in exchange for equity and access to the firm’s technology platforms, usually taking some type of leadership position, such as a board seat. This model enables the firm to have a wide range of visibility into potential disrupters so they can leverage those insights to inform their business decisions. Goldman Sachs’s investments into such firms as Motif and Kensho are good examples of this model in action.

- **Private Equity (PE) Model.** Some firms are choosing to operate as PE firms rather than VC firms. They are buying controlling stakes in firms they believe could be either accretive or disruptive to their businesses. These acquisitions are then used as core components in the transformation of their business processes, occasionally creating entirely new business lines that did not previously exist. Some examples of this model are Capital One’s acquisition of Level Money as well as BBVA’s acquisition of the start-up Simple, a Portland-based bank that operates entirely online.

3. **Innovation Incubators.** Innovation incubators, sometimes called accelerators or innovation labs, are a good model for creating an environment that allows new ideas to flourish in an organization that is not necessarily fully committed to transforming its core processes just yet. The high-level construct of this is a firm-funded lab focused on progressing disruptive concepts from ideation to a minimally viable product, at which time it is transitioned into the core business. There are successful models in which the innovation incubator team is given a high degree of freedom to ideate in any areas they believe could improve the business and models in which different business lines fund more targeted innovation efforts (i.e., how to disrupt and improve the mortgage origination process). Both of these models have proven successful because they combine a core group of people who know and understand the firm with a group of people from outside the firm to push the boundaries and ensure that historical precedents will not rule out potentially innovative ideas. Similarly, this model is most successful when the team is placed outside of its normal work environment — either at an entirely different physical location or, at a minimum, within a unique space inside the firm.

All of these models can be deployed independently or in parallel. The right combination will depend on a firm’s business strategy and perceived market differentiators.
CONCLUSION

The world is changing faster than it ever has before. The ability for firms to both adapt to the changes that the concept of a digital enterprise has created and capitalize on the opportunities it presents will determine future success. Disruption has been slower to attack financial services than other industries as a result of the capital and regulatory hurdles that are in place. Those hurdles are no longer viewed as insurmountable as they once were; however, with investment in FinTech, disrupters are accelerating rapidly. The larger, established firms still have an advantage over these new entrants, but those advantages will only last for so long. In an industry that values risk management, perhaps the greatest risk that CEOs and boards need to be concerned with today is that of having one’s business model become obsolete.

THE AUTHOR

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