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WHITEPAPER

**Building a future proof**

# **Digital Bank**

**The future of banking**

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# Executive summary

Banks are facing unprecedented challenges in terms of margin pressure and increasing threat of competition from fintechs, payment banks and neobanks, among others. Incumbents will have to work towards a robust digital ecosystem strategy pivoted on sustainability to build a “future proof” bank. Key pillars of this strategy include:

- 1 Implementing banking-as-a-service model**
  - » Go branchless; develop a subscription-based platform
  - » Build core solutions, including payments integration, wallets, personalised and predictive investment recommendations
  - » Develop data-driven and predictive solutions for retail customers, small and medium-sized enterprises (SMEs) and private banking clients

- 2 Building ecosystem partnerships**
  - » Develop partnerships that add value to the core solutions of the subscription-based platform, such as e-grocery, e-commerce, online food delivery, mobility aggregators, social media players, fintechs and e-wallets
  - » Regularly evaluate the utility of partners to the digital customer base

- 3 Evolve as an SME incubator**
  - » Support financial inclusion of SMEs, who constitute 80-90% of all enterprises, through ecosystem partners
  - » Platform can quickly provide scale while tapping into the vast SME segment
  - » Solve key SME issues through platforms and partnerships – access to capital, taxation, invoicing and trade finance

- 4 Investment in sustainability**
  - » Use bank’s balance sheet to finance sustainable projects
  - » Exit sectors with irreversible, large carbon footprint, i.e., coal mining and thermal energy
  - » Offer a suite of ESG-compliant products, focused on financing (climate bonds and sustainability-linked loans [SLLs]), blended finance, transition advisory and investments (sustainable deposits)

# Banking – on the cusp of a massive transformation



# A “tectonic” shift in traditional banking

Banks are facing a wide range of legacy issues. Technology offers a unique opportunity for the industry to radically transform itself.



## Legacy issues faced by incumbents

### INEFFICIENT BUSINESS MODEL

- » Branch and agency model is expensive
- » Leads to high friction in customer experience
- » Low financial inclusion due to an inefficient model; c.26% of the population in the APAC is still unbanked

### HIGH COST-INCOME RATIO (CIR)

- » Opex of incumbent banks is on the rise. Overall high costs have wiped out USD850bn of global banking profits since 2009
- » In 2020, the EU recorded a CIR of c.64%; German banks had the highest CIR, at 77%. In the US, the ratio came in at c.60%
- » In the face of cost pressures, global banks have had to rationalise their operations. In 2020, Citi announced plans to exit its consumer business in India. Even before this, Deutsche Bank had announced it would exit operations in 10 countries

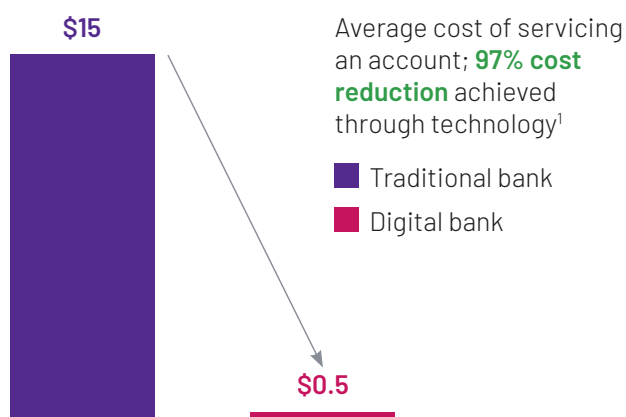
## Key cornerstones of transformation

Direct-to-consumer (D2C) – lower OPEX using technology

Financial inclusion – frictionless; superior customer experience

Universal banking – tie-ups with ecosystem partners

## The cost arbitrage via tech



Source: S&P Global Market Intelligence, Chris Skinner on Digital Bank Strategies, Statista

<sup>1</sup> Indicative analysis; WeBank's average digital cost of servicing; all figures are in USD

# Major trends shaping the transformation

This decade is anticipated to witness a convergence of key themes guiding the future strategy of a bank – integration of technology, personalisation, financial inclusion and sustainability.

## Integration of technology



## Personalisation and financial inclusion



## Sustainability



### OPPORTUNITY

Two billion people to have access to digital banking accounts by 2030

Each financial service will be unbundled and will emerge as an individual battleground

The transformation of the global economy by 2050 would require \$9.2 trillion in annual average spending

### IMPACT

- » AI-powered virtual banking; inter-connected ecosystem
- » Faster and safer access to customer data on the cloud through blockchain technology
- » 60% of the organisations will make wearables a common mode of payment by 2030
- » Rise of cryptocurrency, with an expected 200 million blockchain wallet users by 2030

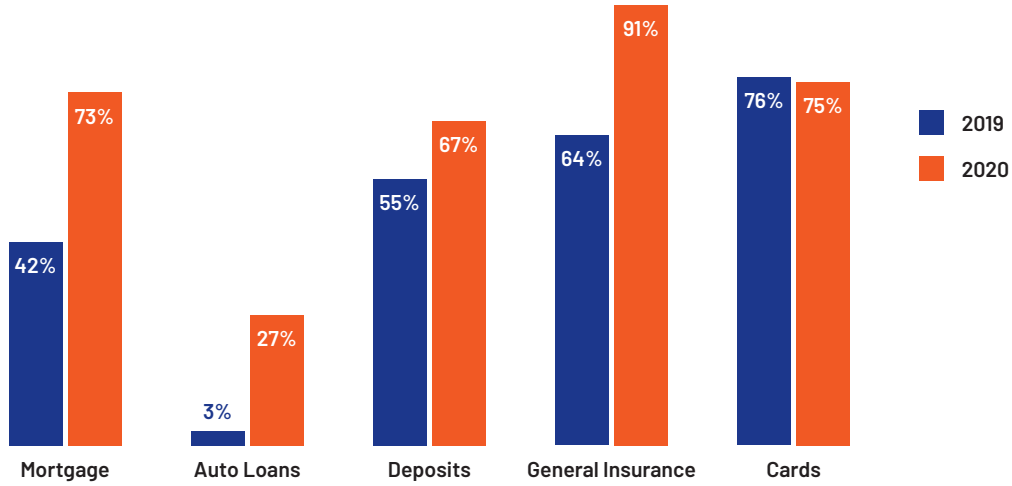
- » Creation of unique customer profiles leveraging data across platforms
- » Bespoke solutions for customers using data-driven predictive insights
- » Financial inclusion of unbanked communities
- » High penetration of smartphones and 5G technology will make c.90% financial inclusion easily achievable by 2025

- » Sustainable investment in physical assets to achieve net-zero emissions by 2050
- » Investor focus and regulatory pressure to finance decarbonisation pathways for high emitters
- » ESG investments in technology focused solutions that reduce carbon footprint

Source: Investor presentations, McKinsey & Co.

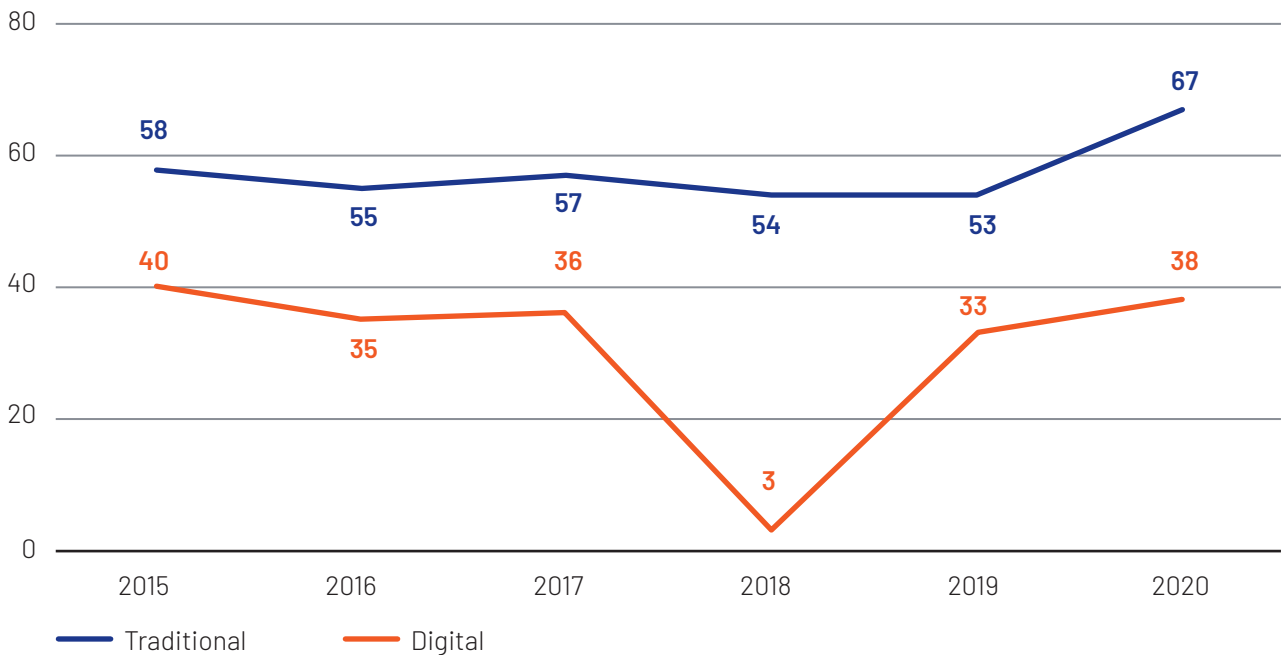
Digitalisation is already creating impact for traditional banks. Integration of digital technology by traditional banks will further accelerate, as it has proven to generate better financial performance for incumbents and improve customer experience.

**Digital acquisition of customers – products sold digitally in APAC**



**Cost-to-income ratio (%) – consumer and SME segments in APAC**

- » Digital banking has delivered better results than traditional banking
- » The delta increased in 2020 and is set to widen further as the cost of technology comes down



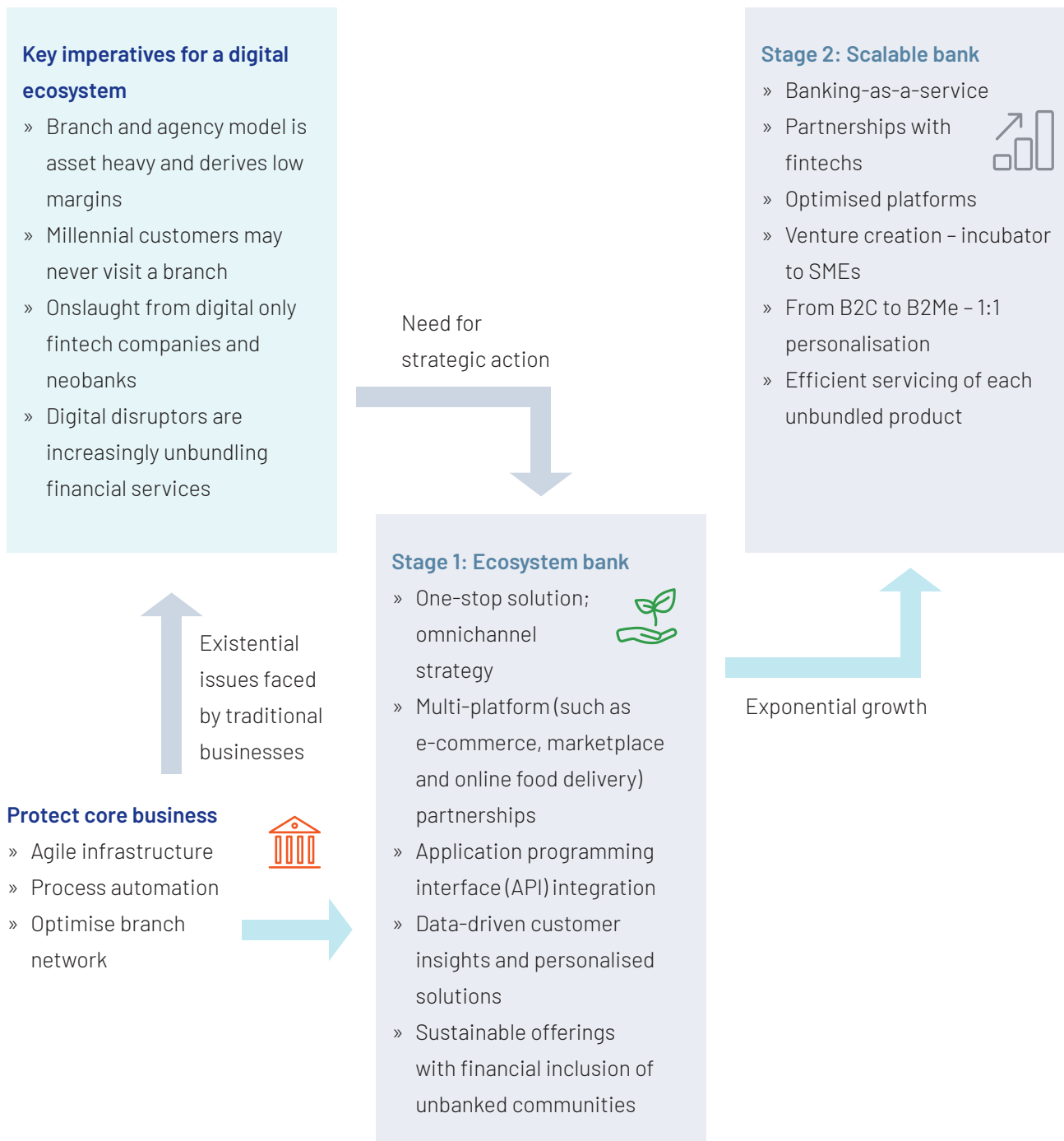
Source: Company Filings, UOB, DBS Results 2020

# **Ecosystem will guide future strategy**



# Ecosystem bank provides a platform for exponential scale

By 2030, 80% of legacy banks will cease to exist. Technology, partnerships and data-driven predictive insights will become vital to facing competition from fintech companies and neobanks.





# Digital ecosystem – a game changer for incumbents

Transitioning into an ecosystem bank will be an “Uber moment” for incumbents. Banks would have to integrate their suite of offerings with technology and build strong partnerships.

- » Robo advisory; voice-based virtual assistants
- » Predictive recommendations with insights generated using big data
- » Platform for trading in stocks and cryptocurrency

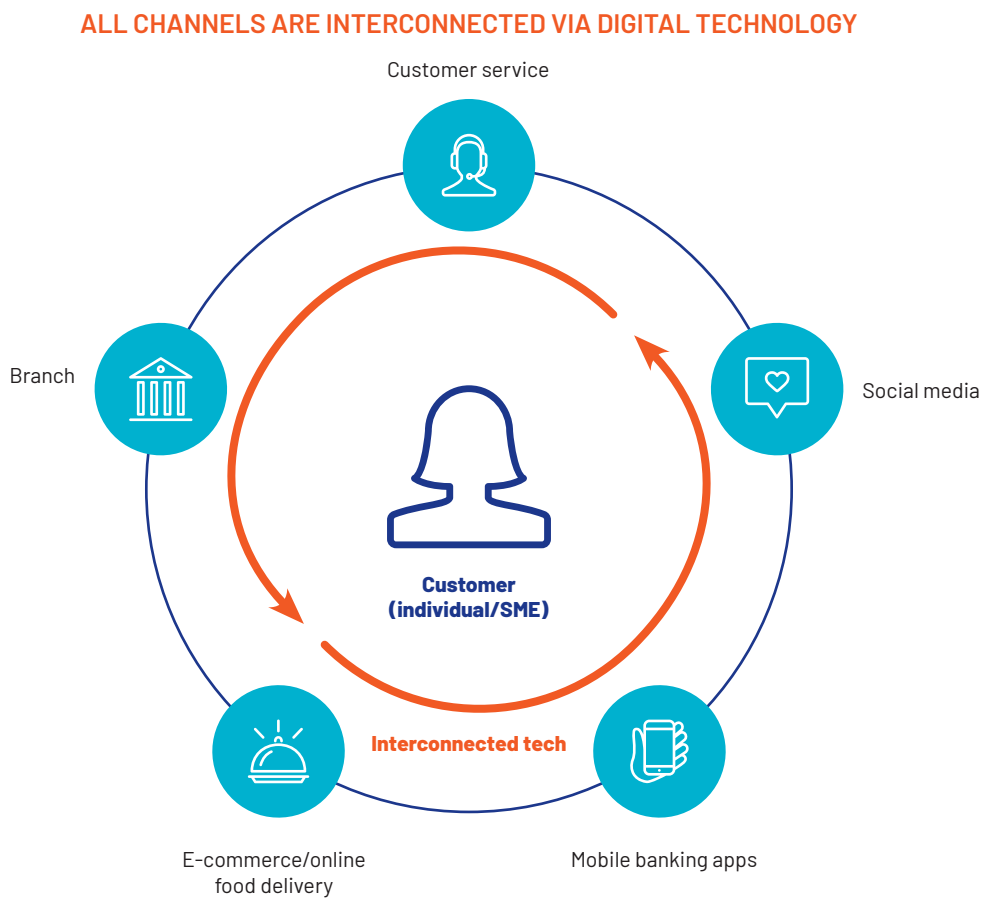


Platform-based, personalised and predictive

Creating a digital ecosystem using interconnected technologies, across product categories

# Omnichannel strategy for an ecosystem bank

Developing a one-stop solution through partner ecosystems:

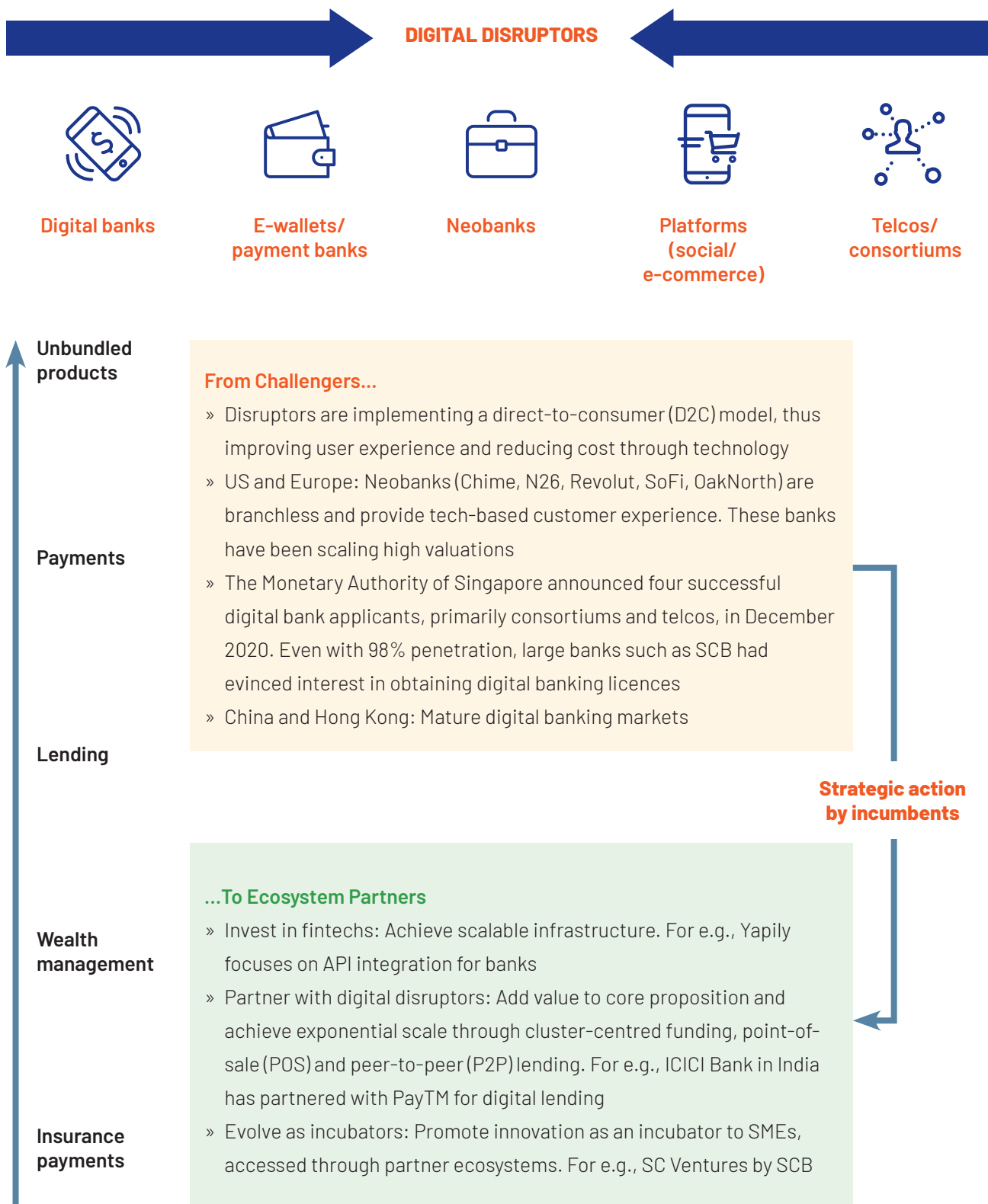


## Integrating digital and physical channels

- » Interconnected: For banks, strategy will revolve around making all existing channels and customer touchpoints digitally connected
- » Platform: Platform-based ecosystems in partnership with other online/e-commerce players
- » Predictive: Data-driven insights on customer spending patterns
- » Personalised: Bespoke solutions based on transaction data, creating a unique customer experience
- » Scalability: Seamless adaptation to smartphone apps and then leapfrog to wearable devices

# Opportunity to convert disruptors into ecosystem partners

For the first time in the history of the financial industry, incumbent banks are being challenged by digital players. Financial products are getting unbundled and facing disruption in nearly every category.



Source: Monetary Authority of Singapore (MAS), HKMA

# Imperatives for sustainable finance and investment



**Commitment to net zero**  
targets, in accordance with the UN's Sustainable Development Goals (SDGs) and Paris Agreement 2015

**Regulatory and investor pressure** to stop financing sectors that have a large carbon footprint, such as coal and thermal power

**Higher ESG returns.**  
Investors are interested in the ESG theme and want banks to demonstrate climate leadership and transition their portfolios

**Climate risks.** 215 of the Fortune Global 500 companies have reported climate risks up to USD1tn, linked to asset impairments, arising out of transition and physical risks



**Investor returns**

**PRODUCT AREAS FOR BANKS**



**Social returns**

## Climate finance

- » Green, social, sustainable and blue bonds
- » Sustainability-linked loans (SLLs)

## Development and multilateral finance

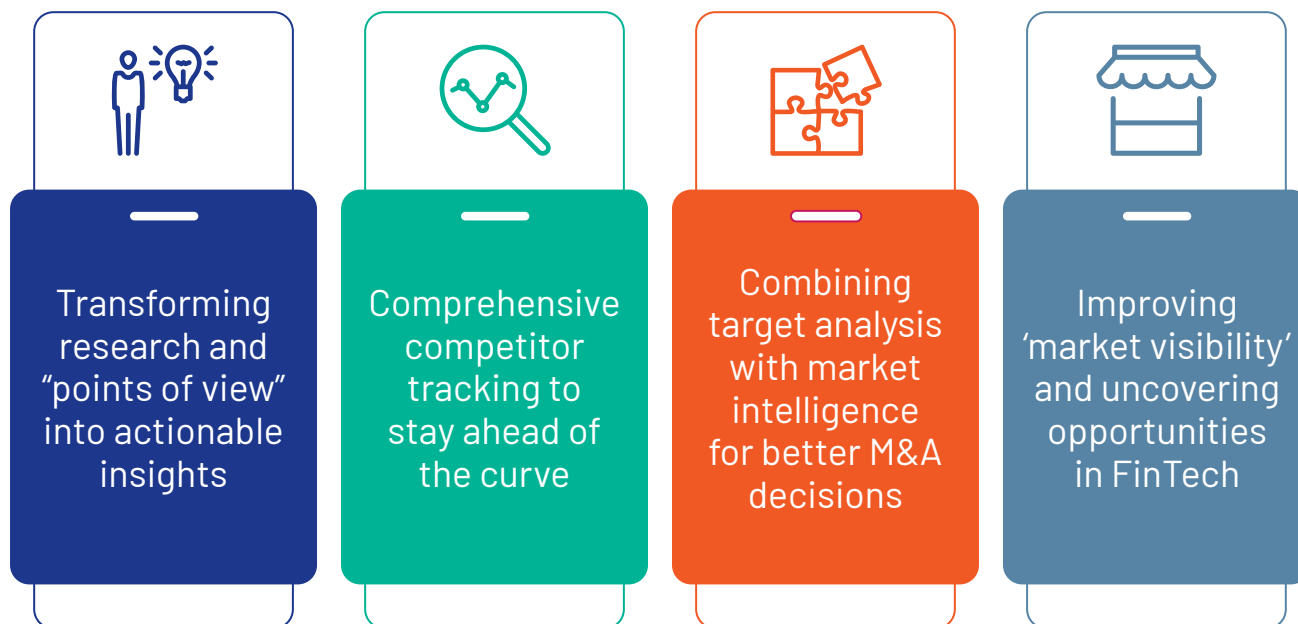
- » Blended finance
- » Supply chain finance
- » Transition finance

## Investment and advisory

- » Sustainable deposits
- » ESG advisory
- » Voluntary carbon offset trading

# The Acuity advantage

Acuity Knowledge Partners' (Acuity's) banking research specialists enable banks, banktechs (banks and banking solution providers), paytechs (providers, processors and networks), fintechs and insurtechs among others, to monitor and respond effectively to disruptions and other market developments. Our bespoke end-to-end research support covers market and competitor intelligence, M&A support, thematic research and analytics.



## Author



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Associate Director

Ankit has over 16 years of experience in Consulting and Research. At Acuity Knowledge Partners, he has led sector and product-specialist pilot teams in Renewable Energy and Environmental Finance, Syndicated Loans - Capital Markets, Sustainable finance, Restructuring, Debt Advisory, Strategy, Corporate Development and M&A Coverage. With McKinsey and Ernst & Young, he has worked on client engagements related to market entry strategy and competitive positioning.

Ankit holds an MBA with a dual specialization in Finance and Marketing from Lal Bahadur Shastri Institute of Management and earned his B.Com (Hons.) from Delhi University.

# About Acuity Knowledge Partners

Acuity Knowledge Partners (Acuity), formerly part of Moody's Corporation, is a leading provider of bespoke research, analytics, staffing and technology solutions to the financial services sector.

Headquartered in London, Acuity Knowledge Partners has nearly two decades of experience in servicing over 400 clients by deploying its 4,000 specialist workforce of analysts and delivery experts across its global delivery network. We provide our clients with unique assistance to innovate, implement transformation programmes, increase operational efficiency, and manage costs and improve their top lines.

## Our expertise includes the following:

- » Investment Banking: origination and trading support
- » Investment Research support: covering all asset classes in terms of ideation, data science, and research support across the buy side and sell side
- » Commercial Lending support: across origination, credit assessment, underwriting, and covenant and portfolio risk for all lending types
- » Private Equity: origination, valuation and portfolio monitoring support
- » Asset Management services support: across marketing, investment research, portfolio management/optimisation, risk and compliance
- » Corporate and Consulting services: market and strategic research; survey work; treasury and counterparty risk support; and CEO office support, including M&A, FP&A and investor relations support
- » Compliance support: AML analytics, KYC, counterparty credit risk modelling and servicing across banks, asset managers and corporates
- » Data Science: web scraping, data structuring, analytics and visualisation These services are supported by our proprietary suite of Business Excellence and Automation Tools (BEAT) that offer domain-specific contextual technology.

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Acuity Knowledge Partners is backed by Equistone Partners Europe, a leading private equity organisation that backs specialist growth businesses and management teams.



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