Global banking outlook 2018

Pivoting toward an innovation-led strategy
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Ten years after the global financial crisis, the banking industry has regained its health and the mood of bankers is more buoyant. They should enjoy it while it lasts.

With 85% of banks citing implementation of a digital transformation program as a business priority for 2018, investment in technology to drive efficiency, manage evolving risks and benefit from growth opportunities will be critical for sustainable success.

Our Global banking outlook survey of 221 financial institutions across 29 markets reveals that bankers are positive about their ability to improve their financial performance in 2018 and beyond.

However, recent constructive conditions are unlikely to be permanent. It is far from clear whether banking returns on equity are able to withstand the impact of an unexpected cyclical downturn, let alone the potential effects of the well-telegraphed unwinding of quantitative easing.

Banks must do less themselves and make extensive use of an ecosystem of industry utilities and a diverse range of partners to support investment, deliver better services, drive out costs, manage risks and protect their organizations.

As banks seek to improve their performance they must reflect on some key questions about their strategy and readiness to advance their own digital maturity:

- Does my strategy account for rapidly changing revenue and profit pools?
- What is my role in the ecosystem and how do I innovate efficiently?
- How do I implement strategic change in a rapidly evolving digital environment?
- How do I change my talent to support a more digital business?
- Am I sufficiently considering new risks and the need to embed cybersecurity in my strategy?
- How do I transform my technology and the technology organization?

We believe that banks must act now to prepare for a future led by innovation and technology and to build scalable, digitally enabled business models that will help them weather the performance challenges that lie ahead.

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85% of banks cite implementation of a digital transformation program as a business priority for 2018.

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1 North America: Canada, the United States; Europe: Austria, Belgium, France, Germany, Ireland, Italy, the Netherlands, Nordics (Norway and Sweden), Poland, Spain, Switzerland, the United Kingdom; emerging markets: United Arab Emirates (UAE), South Africa, Nigeria, Russia, Turkey, Brazil, Mexico, China, India, Indonesia, Malaysia; developed Asia-Pacific (APAC): Australia, Hong Kong, Japan, Singapore. Respondents account for at least 50% of the assets in each market.
The global banking sector is considerably healthier now than it was 10 years ago, at the start of the global financial crisis.

The largest banks in the world have significantly improved their capital position in the years since the crisis. While there is lingering debate in some corners that banks are still not sufficiently capitalized, it is undeniable that the dangerously thin buffers of the pre-crisis era – where the Common Equity Tier 1 (CET1) capital ratio was below 4% for some banks – are gone as banks have raised additional equity over the last decade to almost treble their capital. Resilience has also been supported by the development of recovery and resolution plans (RRPs) as mandated by regulators globally.

While it is true that the cost of compliance has risen dramatically since the crisis, at the start of 2018 we believe the industry has crested the peak of regulatory-driven investments in systems and talent. Although compliance costs are set to remain elevated from their 2007 levels, we believe the cost of adapting to the post-crisis prudential regulatory framework has stabilized and is set to decline.

Further, most banks have resolved the vast majority of legacy conduct issues. Litigation expenses are falling (Figure 2), and although banks continue to reshape their footprints (Figure 3), they are also signalling that the associated restructuring costs will soon peak².

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The progress banks have made in strengthening their balance sheets and moving past legacy conduct matters is reflected in expectations for financial performance. Our Global banking outlook survey finds that the vast majority of bankers expect revenues and profitability to improve over the next 12 months to 3 years, despite rising costs. In fact, 12% of respondents expect more than 9% revenue growth in the next 12 months, rising to 31% over the next 3 years (Figure 4). Similarly, 7% of respondents expect more than 9% ROE growth in the next 12 months, rising to 23% over the next 3 years (Figure 5).
Bankers’ expectations for growth are supported by EY’s annual review of the publicly stated strategies of 30 major banks around the world. Controlling risks and protecting against internal and external threats remain important, but the greatest emphasis is on improving financial performance through growth and optimization.

Combined, the growing optimism of bankers and the notable shift in strategic focus would seem to suggest that a stronger global banking industry may be headed for a period of sustainable double-digit ROEs. We believe that without a significant change in the industry, this is unlikely.

**Figure 4:** Most banks expect revenues to increase in the coming three years

**Q:** By how much do you expect your bank’s revenue growth to increase or decrease in 2018 and over the coming three years?

![Bar chart](image)
Figure 5: Globally, most banks anticipate return on equity will continue to improve over the next three years.

Q: By how much do you expect your bank’s ROE to increase or decrease in 2018 and over the coming three years?

Source: Global banking outlook survey 2018
We believe the global banking industry still faces material challenges to delivering sustainable profitability.

**Cost pressure:** Evidence that banks’ cost bases are more flexible or scalable than they were pre-crisis is not compelling. Our analysis of the world’s largest 200 banks shows that while their aggregate costs have fallen by a little more than 10% in the last five years, they are still more than 25% over their 2008 cost base (Figure 6). Average cost-to-income ratios have barely budged in the last decade, reflecting impacts from factors such as higher compliance costs, the burden of maintaining legacy systems, and elevated restructuring and litigation charges.

Further, our Global banking outlook survey reveals that most bankers anticipate that costs will continue to increase over the next three years, as the moderate savings in regulatory change programs are reallocated to growth initiatives and cybersecurity spending. On average, bankers expect a 2.1% cost increase over the next three years (Figure 7).

**Figure 6:** Costs remain elevated and efficiency has not substantially improved in the last decade for the top 200 global banks

<table>
<thead>
<tr>
<th>Fiscal Year</th>
<th>Aggregate Costs (US$b)</th>
<th>Average Cost-Income Ratio</th>
</tr>
</thead>
<tbody>
<tr>
<td>FY08</td>
<td>1000</td>
<td>0%</td>
</tr>
<tr>
<td>FY09</td>
<td>1200</td>
<td>25%</td>
</tr>
<tr>
<td>FY10</td>
<td>1400</td>
<td>50%</td>
</tr>
<tr>
<td>FY11</td>
<td>1600</td>
<td>75%</td>
</tr>
<tr>
<td>FY12</td>
<td>1800</td>
<td>75%</td>
</tr>
<tr>
<td>FY13</td>
<td>2000</td>
<td>75%</td>
</tr>
<tr>
<td>FY14</td>
<td>2200</td>
<td>75%</td>
</tr>
<tr>
<td>FY15</td>
<td>2400</td>
<td>75%</td>
</tr>
<tr>
<td>FY16</td>
<td>2600</td>
<td>75%</td>
</tr>
<tr>
<td>FY17*</td>
<td>2800</td>
<td>75%</td>
</tr>
</tbody>
</table>

* Annualized figures

Source: SNL Financial database, EY analysis

Source: Global banking outlook survey 2018
Figure 7: Over the coming three years costs will continue to rise for most banks

Q: By how much do you expect your bank’s cost base to increase or decrease in 2018 and over the coming three years?

Source: Global banking outlook survey 2018
Figure 8: 2017 ROE may hit a post-crisis high, but is unlikely to be sustainable.

Note: ROAE - Return on Average Equity, COE - Cost of equity

* Annualized figures

Source: SNL Financial database, EY analysis
At an industry level, should banks be unable to contain costs and improve capital efficiency, we estimate that revenues would need to increase by 2.4% by 2020 to maintain 2017’s average ROE of 11%.

**Subdued income prospects:** It is widely perceived that an increase in central bank interest rates will solve the industry’s weak revenue growth problems by boosting interest income, but this may just be palliative.

Estimates suggest that following three US Federal Reserve rate hikes in 2017 and an expected three additional increases in 2018, net interest income for the largest US banks could increase by 5% in 2018 and 2019. Similarly, the European Central Bank’s recent stress test found that a 200-basis-point rise in interest rates would provide a 10.5% boost in net interest income by 2019. All else remaining equal, we calculate that this would lead to ROE increases of 6.4% and 3.1% for US and European banks, respectively.

However, rate increases do not take place in a vacuum, and “all else” is unlikely to remain equal. For example, higher interest rates would also naturally lead to a rise in defaults and loan losses, increasing the cost of credit and offsetting improvements in net interest income. In addition, it is doubtful that the comparatively benign economic environment of 2017 will last, and should major economies enter a cyclical downturn as central banks are tightening, it is reasonable to expect loan losses to be more pronounced.

**Accelerating competitive challenges:** Banks are facing increased competition from a range of new market entrants, including digital banks, FinTechs, institutions offering high-touch and high-tech branch services, e-commerce and telecommunications firms, and in some markets, platform banking providers. Such challengers have emerged in response to rapidly changing customer expectations and behaviors, and are forcing banks to invest in customer technology to prevent customer leakage and preserve their value chain.

**EY’s FinTech Adoption Index** highlights that “consumers are drawn to FinTech services because propositions are simpler, more convenient, more transparent and more readily personalized.” This is especially the case in what have been traditionally profitable parts of the banking value chain. For example, adoption of FinTech as providers of money transfer and payment services rose from 18% in 2015 to 50% in 2017, with 65% of consumers anticipating they would use such services at some point in future. Such disruption is not restricted to emerging markets that lack traditional banking infrastructure. Banks in developed markets are equally at risk. Critically, banks also need to realize that the competitive threat will continue to evolve and that only striving to match today’s challengers means they are not sufficiently anticipating future banking disrupters.

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4 EY FinTech Adoption Index 2017, EYGM Limited.
In recent years, the ability of banks to maximize financial performance through growth and optimization has been hampered by regulatory change programs and compliance demands. However, our Global banking outlook survey reveals a remarkable shift.

Today, it is evolving risks that are preoccupying banks.

**Cyber risk is the top evolving risk.** Our Global banking outlook survey reveals that enhancing cybersecurity has become the top priority for banks in the coming year (Figure 9). However, as bank leadership teams focus on investing in people and technology to enhance cybersecurity, they are likely to face an array of new problems, such as how to find the right talent when there is a cybersecurity skills shortage and how to integrate cyber experts into their organizations. Hiring people with the right cyber skills is one thing; helping them develop the right business and risk skills for a banking environment is another.

Artificial intelligence (AI) and advanced analytics will play a key role in the prevention of cyber attacks, reducing conduct risk and improving monitoring to prevent financial crime. Mitigating such external and internal threats is critical to both business continuity and limiting operating losses. However, unless banks collaborate more with their peers, or make better use of the ecosystem, the required investment in advanced technologies to address these issues will be substantial and could strain banks’ ability to invest in improving financial performance through optimization and growth initiatives.

**Managing reputational and conduct risk remains a high priority.** As EY’s most recent Global Regulatory Network executive briefing observes, “on the bottom line, culture does indeed count,” and improving culture is critical for limiting the sizable downside risks of poor organizational behaviors.

Banks are also looking for new ways to manage the risks associated with financial crime and anti-money laundering compliance and are increasingly using advanced technologies, such as advanced analytics, machine learning, robotics and automated intelligence, to support these efforts.

**Shifting regulatory priorities.** Although policymakers have finished rewriting the rules in response to the crisis, banks should not expect compliance requirements to loosen. In fact, pressure on banks is likely to increase, as regulators around the world each implement their own particular version of the Basel reforms, and as regulators set the rules under which banks must deal with the challenges posed by new technologies.

In addition, the post-crisis global regulatory alignment is fragmenting as certain jurisdictions begin to consider varying degrees of regulatory relief. This is particularly evident in Europe, where some structural reform proposals have been rolled back; in the UK, which is currently negotiating the terms of its exit from the European Union; and in the US, where the Trump Administration appears poised to repeal large parts of the Dodd-Frank Act. Additionally, increased regulatory scrutiny because of incidents such as the Panama Papers and Paradise Papers are leading to tax reform across jurisdictions to mitigate tax evasion.

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1 EY Global Regulatory Network executive briefing, Culture Counts, 2017.
Enhance cyber and data security: 89% | 90% | Up
Implement a digital transformation program: 85% | 82% | Down
Recruit, develop and retain key talent: 83% | 82% | Up
Gain efficiencies through technology adoption: 82% | 82% | Down
Invest in technology to reach and service customers: 81% | 86% | Down
Manage reputational, conduct and culture risks: 79% | 82% | Down
Comply with consumer regulations: 78% | 77% | Down
Optimize the balance sheet: 78% | 82% | Down
Manage the threat of financial crime: 78% | 76% | Down
Meet compliance and reporting standards: 77% | 67% | Down
Improve risk management: 77% | 73% | Down

*% respondents represents banks that indicated ‘important’ or ‘very important’.
Source: Global banking outlook survey 2018
See EY Global banking outlook 2017 for a detailed analysis of these five strategies.
Greater digital maturity is critical to future success

To successfully insulate themselves against the impacts of future downturns on financial performance and business continuity, banks must complete the transition from regulatory-driven transformation to innovation-led change.

This will require banks to avail of the ecosystem externally and become more digitally enabled. They will need to make meaningful investments in end-to-end processes and infrastructure aimed at driving real efficiencies across the entire organization, as opposed to spending their innovation dollars on tactical projects and front-end customer interfaces. In other words, they will need to become more digitally mature.

Figure 10: Most banks cite growth as a key driver for their investment in technology

Q: What are the main reasons behind your organization’s plans to invest in technology over the coming three years?

<table>
<thead>
<tr>
<th>Reason</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Strengthen competitive positioning and build market share</td>
<td>70%</td>
</tr>
<tr>
<td>Expand ability to acquire, engage and retain customers</td>
<td>67%</td>
</tr>
<tr>
<td>Generate cost savings and operating efficiencies</td>
<td>62%</td>
</tr>
<tr>
<td>Mitigate growing cybersecurity threats</td>
<td>58%</td>
</tr>
<tr>
<td>Drive digital transformation program</td>
<td>51%</td>
</tr>
<tr>
<td>Open new distribution channels to grow business</td>
<td>50%</td>
</tr>
<tr>
<td>Allow for more effective risk mitigation</td>
<td>50%</td>
</tr>
<tr>
<td>Automate regulatory and compliance procedures</td>
<td>49%</td>
</tr>
<tr>
<td>Streamline compliance procedures</td>
<td>46%</td>
</tr>
<tr>
<td>Gain access to new business models and monetization techniques</td>
<td>46%</td>
</tr>
<tr>
<td>Heighten employee engagement and productivity</td>
<td>46%</td>
</tr>
<tr>
<td>Benefit from FinTech partnerships, utilities and collaboration</td>
<td>37%</td>
</tr>
<tr>
<td>Improve financial resource management</td>
<td>35%</td>
</tr>
<tr>
<td>Facilitate global expansion and ability to scale the business across countries</td>
<td>33%</td>
</tr>
</tbody>
</table>

Source: Global banking outlook survey 2018
See EY Global banking outlook 2017 for a detailed analysis of these five strategies.
Have innovation initiatives materially driven new growth?

While banks cite growth as the most common reason to invest in technology (Figure 10), we believe they tend to overestimate the power of technology in driving business growth. As highlighted in EY’s Global Consumer Banking Survey, technology is undoubtedly a critical tool that can help banks tailor better products and deliver improved customer experiences, which in turn can help them to win greater wallet share from their existing client base. Banks’ investments in customer technology to date have largely been focused on front-end interfaces, reflecting their response to changing customer behaviors and competitive pressures. However, there is little evidence that such tactical initiatives have materially grown the business, as opposed to simply stemming customer leakage. New channels and products can often be replicated, and in many instances being a fast follower may be better than being a first mover.

Figure 11: Attitudes related to investing in different technologies are mixed

**Q:** In which of the following technologies are you investing now and in which do you plan to begin, reduce, or increase investment in over the next three years?

<table>
<thead>
<tr>
<th>Technology</th>
<th>Not investing now …</th>
<th>Investing now …</th>
</tr>
</thead>
<tbody>
<tr>
<td>... and don’t plan to over the next 3 years</td>
<td>... but will begin over the next 3 years</td>
<td>... but will reduce investment</td>
</tr>
<tr>
<td>Artificial intelligence</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Augmented and virtual reality</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Blockchain</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cloud technology</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cryptography/cybersecurity technology</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Data and analytics</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Identification software based on biometrics</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Internet of Things (IoT)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Machine learning</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Mobile technology</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Omnichannel customer experience</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Open platforms/API architectures</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Robo-assistants and advisors</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Robotic process automation</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Smart contracts</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: Global banking outlook survey 2018
Banks’ digital maturity ambitions are strengthening

Our survey asked bankers to assess their organization against five stages of digital maturity:

1. **Not pursuing** — no active investments
2. **Beginning** — considering how digital technology can transform the business, building internal support and developing the business case
3. **Transitioning** — exploring the application of new technologies and starting to digitize some elements of the business
4. **Maturing** — optimizing middle- and back-office processes via new technologies as part of a coherent digital investment plan
5. **Digital leader** — integrated front-, middle- and back-office operations and supported by data that flows across functions and geographies

Responses reveal that few banks currently consider themselves as either maturing or a digital leader; however, more than 60% — particularly G-SIBs — aspire to be one of the two by 2020. Interestingly, banks based in the Americas and Europe view themselves as more mature than their counterparts in developed Asia-Pacific do. We believe that this may indicate that American and European banks are benchmarking themselves against traditional competitors, while the Asia-Pacific banks are comparing their maturity with that of emerging competitors that have more digital business models.

62% of global banks expect to be digitally mature in 2020, compared with just 19% in 2018.

**Figure 12:** The banking industry aspires toward digital maturity

*Q: Which stage of digital maturity best describes the progress made by your organization to digitally transform its strategies, processes, products and business models to date? Which stage best describes where you expect to be in 2020?*

![Bar chart showing digital maturity stages for different regions and G-SIBs](chart.png)

Source: Global banking outlook survey 2018
Have investments sufficiently improved efficiency?

While we acknowledge that banks appear to appreciate how advanced technologies can lead to more efficient operations, only a handful of banks are consistently delivering cost-income ratios below 50%. In the future, particularly as revenues come under further pressure from emerging competitors, we expect banks would need their cost bases to be about 30% lower than they are today.

EY’s experience shows that implementing robotic process automation (RPA) programs could reduce the costs of manual processes by up to 40%, if they are business-led, supported by a strong proof of concept and initially targeted at low- to medium-complexity processes. However, our survey found that almost 40% of banks are not yet investing in RPA.

Figure 13: Banks’ technology investment budgets are rising

Q: By how much will your organization’s technology investment budget change over the coming 12 months, across all markets?

Source: Global banking outlook survey 2018
Our Global banking outlook survey also reveals that almost two-thirds of banks anticipate that their technology investment budgets will rise by more than 10% in 2018 (Figure 13). Investing in technology to better serve customers, drive efficiency and implement digital transformation programs all feature in the top 10 priorities for banks globally (Figure 10). The increase in budgets is also expected to positively impact most functions, with more money available for investments in a range of areas, including compliance, risk, finance, IT, operations and product development.

Despite these encouraging results, we still expect that most banks will struggle to become more digitally mature over the next three years unless they develop coherent strategies and investment plans and address legacy concerns related to poor data and disparate risk and control processes.

Rather than investing in every new technology individually, digitally mature banks will develop a deep understanding of how collectively and in combination these new technologies benefit the business, operations and organizational strategy. It is imperative that banks then adopt a problem-based approach to technology implementation rather than an IT-centric approach. The former will see numerous technologies strategically applied to problems such as transaction monitoring, in an integrated approach, while the latter would see individual technologies applied broadly across the organization in a disaggregated and untargeted manner. They will then be able to allocate meaningful budgets to the technologies that can drive end-to-end digitalization and sustainable efficiencies, such as AI, cloud, mobile technology and RPA.

As technology is the fundamental lever to drive down costs, and therefore to drive future profitability, we believe that banks must phase their technology investments realistically, so that early savings can help fund future digitalization and reinvestments in other less mature technologies.

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**Has cybersecurity been adequately considered in the development of new applications?**

Banks’ leadership teams recognize that cybersecurity is a critical priority, particularly as it relates to protecting against external attacks. However, our Global banking outlook survey indicates that the business may not have the same level of focus on this, which could be a problem as banks ramp up investments in advanced technologies. Specifically, pressure to improve ROE can result in accelerated timelines for launching digital applications and inadequate oversight from risk personnel with the right cyber skills in product governance and development. In other words, there is a risk that speed to market can override attention to protection. It is imperative that banks focus on cybersecurity before they innovate because of the added layer of risk that new technologies can bring.

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**Technology investment budgets are not the only lever to becoming digitally mature**

Our Global banking outlook survey also reveals that almost two-thirds of banks anticipate that their technology investment budgets will rise by more than 10% in 2018 (Figure 13). Investing in technology to better serve customers, drive efficiency and implement digital transformation programs all feature in the top 10 priorities for banks globally (Figure 10). The increase in budgets is also expected to positively impact most functions, with more money available for investments in a range of areas, including compliance, risk, finance, IT, operations and product development.

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**New approaches to technology adoption will drive greater efficiencies**

We believe that digital maturity is not simply a function of the types of technologies in which banks choose to invest, particularly when few organizations have the resources to invest in all technologies across all functions. Instead, digital maturity also means that banks have a clear ambition for the type of organizations they want to become, a plan to get there and, critically, enough self-awareness to understand that they can’t do it alone. Implementing this ambition requires banks to step outside both traditional lines and agile lines of project management, and define new best practices for bringing about innovation-led change in their organizations.

Our Global banking outlook survey reveals that many banks continue to adopt traditional approaches to innovation. We believe more dynamic approaches such as partnering must become more prevalent (Figure 14) as banks begin to recognize that they do not have the money, or capabilities, to drive all innovation internally.
We believe that the rapid evolution of new technology means many banks will struggle to keep up in an innovation arms race. Further, the risk of getting big bets on new technologies wrong is high, and failure will prove costly. As such, banks need to do more to embrace the shift from innovating in a silo to participating in an innovative ecosystem and collaborating with partners and peers.

A banking ecosystem will be more important than ever.

Leading organizations will seek internal simplification aggressively and increase their use of external utilities, platforms and managed services where possible. We believe that a component-based architecture, resembling a set of interoperable building blocks, will be most efficient. A banking ecosystem – a network utility, managed service and innovation partners – will be more important than ever.

As banks increasingly turn to third-party providers and partners in the ecosystem to support work previously done in-house, they will need to hold them to the same standards as their own employees, and new models for sharing risk will need to be developed. But, by availing themselves of a new ecosystem of technology providers, incumbent banks will benefit from nimbler innovation.
Are banks ready for innovation-led change?

Despite improved performances, many banks have significant work to do to deliver sustainable long-term profitability.

Banks continue to struggle to materially change their cost base. Opportunities for revenue growth are limited. Evolving risks, particularly cybersecurity, demand increased attention. And critically, banks lack the resources to keep up with the rapid pace of technology advances.

Banks that successfully embrace innovation-led change will be better positioned to address all these issues and deliver sustainable ROEs even when the economic cycle turns. However, in executing this shift, it is crucially important that banks don’t try to drive all technology and process innovation internally.

As our survey reveals, 85% of banks cite implementation of a digital transformation program as a business priority for 2018; to achieve this we believe firms must ask themselves six key questions to ensure they are ready for innovation-led change.

Does my strategy take into account rapidly changing revenue and profit pools?

Implementing new technology independent of strategy is ineffective. Banks need a clear strategy that defines their operating model as well as focus markets, customers and products, while also ensuring protection against nonfinancial threats to business continuity, to enable them to prioritize investment decisions. This strategy should be effectively articulated to internal and external stakeholders, including ecosystem partners, to ensure commitment to the innovation initiatives that will support it. The strategy should be frequently reassessed, particularly in light of the speed of technological change.

70% of banks will invest in technology to strengthen their competitive positioning and build market share over the coming three years.
What is my role in the ecosystem and how do I innovate efficiently?

As banks reduce the number of functions they retain in-house, and seek partners to help drive innovation, it is critical they have a deep understanding of their competencies and deficiencies. Conversely, they must also have a clear view of which processes a partner may be able to do better, at a lower cost or both. Critically, procurement departments must focus on quality and risk of third-party contracts, in addition to cost. This marks a radical shift for many procurement teams, but a narrow focus on cost will leave many banks trying to do too much in-house, often unsuccessfully.

The most successful banks in the future will be those that are more flexible and efficient through their participation in a strong ecosystem. These banks will be stronger and leaner, augmented through external collaboration with FinTech firms, utilities, managed service providers and even competitors. The technology landscape will be modular, interoperable and, ultimately, simpler. The culture will be one of collaboration, not protectionism. Success for banks will be based on building a better ecosystem, not a bigger bank.

Many banks are involved in accelerators, incubators and training programs to gain early access to technology and talent, to improve customer reach capabilities, and to test new ideas and business models. However, all too often they struggle to implement new and innovative technology successfully. The sooner innovation is embraced at all levels of the organization, the faster sustainable change will occur. Banks should carefully evaluate various engagement models and choose a mix that supports their innovation model and long-term growth strategy. At the same time, bankers will need to engage with regulators to convince them that banks are taking a sensible approach to partnering and can guarantee that third-party providers and partners can offer the same level of resilience and assurance of processes as banks themselves.

[37% of banks on average expect to develop new technologies in-house.]

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How do I implement strategic change in a rapidly evolving digital environment?

New technologies and solutions should not drive a need to use them — there is often a limited advantage to being a first mover. Further, any advantage can be quickly eroded by fast followers who learn lessons from, and gain greater efficiencies than, first movers.

Banks typically spend approximately 75% of their IT budgets on maintaining legacy architecture, often on tactical patches that may embed poor processes. This presents a dual challenge to a bank’s ability to become fully digital — insufficient funds to invest and imperfect processes. For example, RPA can radically reduce costs, but applying robotics to existing procedures may just reinforce inefficiencies and make them harder to fix in the long run.

Today, wholesale digitalization is not a significant feature of the banking landscape because of the associated costs. However, banks should seriously consider a variety of alternatives, ranging from whether they are able to launch a greenfield digital bank to which they can migrate customers over time to re-platforming to revitalizing the core. A key challenge in doing this is management’s reluctance to consider strategies that will be costly in the short term, even if they will drive long-term success.

Banks appear to be comfortable with cost increases during growth years, as long as jaws also widen. The flaw is that when the cycle turns, banks can be left with structurally high expenses as revenues decline, and embark on expensive, top-down transformation programs with challenging cost reduction targets.

Banks can achieve greater efficiency and scalability by focusing on continuous change rather than large-scale transformation, and by integrating a digital perspective into their business strategies. They should focus throughout the cycle on cost optimization and, crucially, develop cost-driven (as opposed to purely revenue-led) reward structures that apply throughout the organization, to ensure that all employees are looking for opportunities to improve efficiency.

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85% of banks cite implementation of a digital transformation program as a key business priority for 2018. While,

62% of banks expect to become digitally mature or digital leaders by 2020.

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4. How do I change my talent to support a more digital business?

Banks will need new talent and a well-communicated innovation process to move from regulatory-driven transformation to innovation-led change.

The stars of the future might well be internal entrepreneurs as opposed to those who excel at in-house development. This has implications for talent acquisition at all levels of the organization. Opportunities to develop people in the retained organization will arise as new capabilities will be required, existing skill sets must be converted and new, more agile ways of working must be introduced. Automation will free people up to perform more value-added tasks. Talent may also migrate from banks to technology firms and service providers.

To support the talent shift, banks must also establish and communicate an innovation process. It must be driven from the top, encouraging innovation and building lessons learned into the process.

A heightened focus on internal cost reduction may seem threatening to the retained organization. Will software robots eliminate my role? Will my experience and skill set be relevant and cherished in the new world? Banks must bring the retained organization along on the journey to prevent a “them versus us” mentality that will result in a demotivated workplace and a struggle to retain top talent. Regular communication and participation in innovation will foster and drive collaboration.
Am I sufficiently considering new risks and the need to embed cybersecurity in my strategy?

As the pace and scale of technological change reaches hyper innovation, banks must handle increased levels of complexity that blur the perimeters between internal and external risk. In addition to cyber risk, technological change risk expands as new technologies are onboarded and brought to scale, while financial crime risk, and reputational and conduct risk become increasingly mired. Managing these developing risks is key to maintaining high levels of digital trust.

By infusing cybersecurity concepts and practices throughout the innovation process, banks will be better able to identify and mitigate digital risk. Cycle times can be reduced by designing security from the start, and greater value is generated when the rationale for cybersecurity shifts from preventing breaches to enabling innovation and growth.

How do I transform my technology and the technology organization?

As banks move to become digital leaders, they must be able to measure the success of innovation and be aware that achieving digital maturity is not an endpoint goal. Maturity is a moving target—a bank can be viewed as a digital leader until the next advance in technology, and then it will need to reassess the organization’s operational alignment, capabilities, targets, strategies and investment plans. The most successful banks understand where emerging technologies support strategic objectives but don’t get caught up in the hype about new and unproven technology. The marks of a true digital leader are organizational flexibility, agility and an ability to execute change and demonstrate success.

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Firms will need to demonstrate to regulators (and other stakeholders) that they understand the risks associated with technological innovation and transformation and pursue them in a way that not only manages those risks, but also enhances (or at least maintains) operational and financial resiliency. Banks should engage with regulators to explore a more efficient supervisory dynamic that facilitates swifter adoption of new technologies where appropriate.

58% of banks are planning to invest in technology to mitigate cyber threats although enhancing cyber and data security is the number one priority for banks.

42% of banks expect rising technology budgets to have a very positive impact on IT, more so than any other banking function.
Today, banks are optimistic about the outlook for their financial performance and increasingly confident in their ability to deliver sustainable double-digit returns. This stance is supported by benign economic conditions and anticipation of a boost to interest incomes from rising interest rates.

Banks should enjoy this while it lasts. Because it won’t. We believe many banks remain exposed to a cyclical downturn.

Banks can defend against these vulnerabilities. This is a moment of opportunity. Banks that act now to embrace an era of innovation-led change and deliver leaner, more scalable and digital business models can deliver sustainable double-digit returns, even through the gathering storm.

Further reading

EY FinTech adoption index 2017

Unleashing the potential of FinTech in banking

2017 bank risk management survey

An integrated vision to manage cyber risk
The EY 2018 Global banking outlook survey asked senior executives at 221 banks across 29 markets about their views regarding their bank’s financial performance, strategic business priorities and technology adoption plans over the next 12 to 36 months. The survey was conducted between November and December 2017. The survey data cited throughout this report is weighted on a regional assets basis with all ‘don’t know’ responses removed from the calculations.
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