Winning in the financial services marketplace for banks and credit unions by becoming on demand

Financial services industry is now at a major changing point

Banks and credit unions are looking for ways to manage their businesses in the face of change and uncertainty to provide better customer service and to react to rapidly changing market conditions. Financial institutions look for ways to provide better, more innovative services and products while increasing profits.

The financial services industry is now at a turning point. In the 1990s, banks relied on three primary value-creation strategies and all three of them have stalled:

- **Revenue diversification** — expanding their revenue base through additional sources of noninterest income
- **Consolidation** — capturing economies of scale and scope through acquisitions and mergers
- **Risk reduction** — securitizing a greater number of the loans they originated, as well as other assets sitting on their books

Although initial results were impressive, the returns from these strategies have now flattened — and a few undesirable consequences have emerged. Alleviating risk through the sale or securitization of assets had the unpleasant side effect of putting even more distance between banks and their customers than before. Further growth in fee-related income through the introduction of service charges worked against the need to cultivate customer loyalty.

And a decade full of mergers and acquisitions left banks with organizational, process and system complexity, which placed enormous strain on operational efficiency and financial performance. With all this change, banks are still largely operating with the same traditional business structures where distribution occurs by product silo and operations are biased toward internally manufactured products. Within this structure, even leading banks can't seem to squeeze out any more cost, and customers generally see very little or no differentiation among banks. Given their financial challenges, banks cannot afford to have capabilities duplicated across product silos, with each product operating its own processes, systems and product-specific channels. And although they offered increased efficiency, vertically integrated supply chains limited customer choice — leaving firms with an undifferentiated value proposition and lower overall customer wallet share.

New direction needed

With the dynamics of the future so unclear, it only makes it more apparent that banks and credit unions will need to change their businesses.

Two primary paths seem clear — one involves the industry as a whole and the other is traveled by individual firms. As an industry, banking is moving away from a set of independent, vertically integrated institutions toward a network of affiliated financial institutions, specializing to become best-of-breed distributors of products and services as well as leveraging first-class financial institutions and business partners. At the same time, financial institutions are breaking out of their silos as they identify and share common processes across business units, integrating to optimize business processes and improve efficiency (see Figure 1). In fact, these two paths are propelling financial institutions to move towards a business structure that supports business processes while being flexible enough to respond rapidly to virtually any customer demand, market opportunity or external threat.

The industry becomes more networked

Although banks and credit unions will still continue to provide core services to their customers, the traditional view that the financial institution must develop, sell and service all or most of the varied financial products within the organization is quickly becoming an unsustainable model. These financial institutions are often finding that they are more responsive to changing customers' needs while maintaining profitability by simply selling the product or service (or both), and then letting other third parties develop or service (or both) the financial instruments. In many cases, the third-party business partners can perform the services required in a lower-cost manner, allowing the financial institution to provide its customers with lower-cost products and services and the owners with more profits.

Unfortunately, poorly defined standards and linkages between financial institutions slows the pace of change. The processing and interface standards that do exist are often created in an ad hoc, one-off fashion, making efficient relationships between the financial institutions, their back office systems, business partners and their distribution channels difficult to establish and maintain.

For example, in the mortgage industry, specialization is now the norm. Most financial institutions that are still in this business concentrate on origination and servicing, while other providers assume responsibility for the remaining activities — credit risk management and interest rate risk management. This separation has, however, come at a price. Communication among companies remains cumbersome with fragmented processes, data moving between firms by fax and phone, and manual reentry as each enterprise boundary is crossed.

At the same time, customers are now demanding access to all the bank's products and services, through the channel of their choice. The problem is that many financial institutions might have back-office systems that are all separate legacy systems that may not integrated, and they might have new partners that are supplying brokerage, insurance, credit cards, and many other products and services that are not integrated either. Customers, though, are still demanding access to all in a seamless manner.

Breaking down the silos

Financial institutions have operated using a siloed approach, where checking and savings, mortgage loans, consumer loans, business loans, trust, brokerage, and so on operated independently. Each silo may have developed its own marketing and sales distribution, managed separate channels, developed products individually, and their processing systems, or its back-office legacy systems, were completely independent. This worked until the marketplace started changing dramatically, and institutions found that a siloed environment would not let them meet the demands of the customers and keep up with the pace of their competitors who were beginning to develop combined products such as integrated checking, savings and investment accounts.

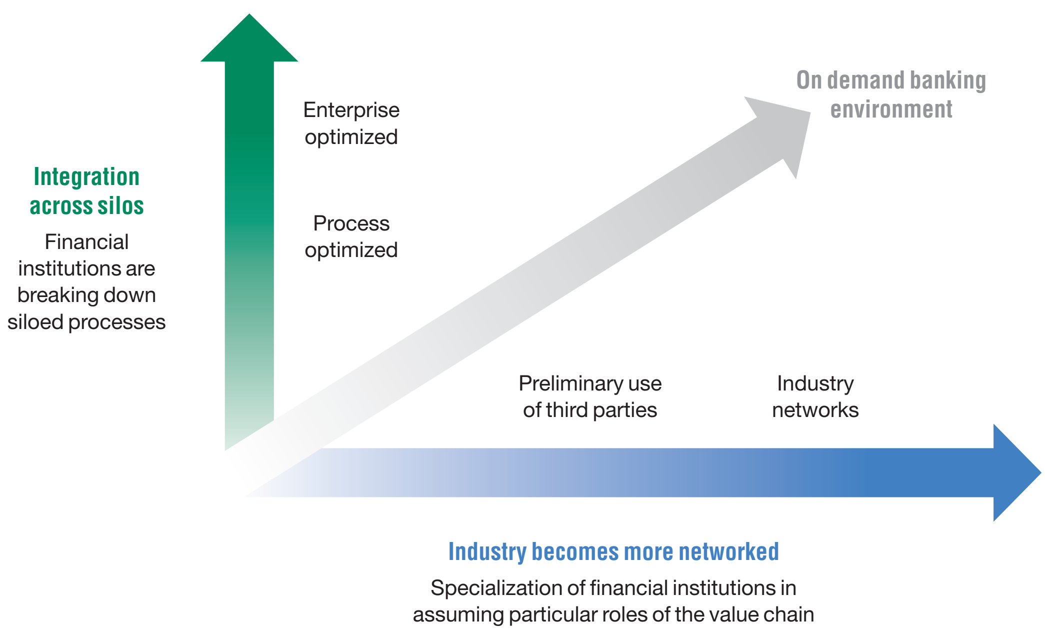

Figure 1. Paths of progression.

Today, financial institutions are beginning to break out their product silos by identifying and sharing common enterprise processes such as procurement, human resource management and accounting. They are also beginning to appoint executives responsible throughout the financial institution for key competencies such as product development, distribution, risk management and transaction processing.

Banks are beginning to create an integrated view of the customer; however, channels are still predominately product-centric and management control remains within business units. With processes that span across business units, banks are struggling with managing their complex operations. Integrating the business units across the financial institution tends to be inflexible and sometimes manual. Without adequate integration, the cost of having a complete view across the entire organization can be cost prohibitive.

Changing the way banking is done

The following case study illustrates how a financial institution has successfully applied IBM and IBM Business Partner solutions to become more on demand.

Tyndall Federal Credit Union

Tyndall Federal Credit Union (FCU), a leading financial institution in Panama City, Florida, prides itself on providing a high level of service to its 80,000 members. Chartered in 1956 to serve personnel at Tyndall Air Force Base, the credit union now includes six branch locations, an operations center and assets of over U.S.$616 million. Tyndall FCU's growing pains have included long waits at branch locations and banking hours that didn't meet members' needs. In working to alleviate these issues, Tyndall FCU wanted to integrate its delivery channels — including ATMs, Web site and call center — to provide a consistent on demand experience across touch points.

Tyndall FCU engaged Wincor Nixdorf and IBM to develop and implement an expansive and integrated next-generation ATM solution. IBM and Wincor Nixdorf clearly conceived of what Tyndall FCU wanted: an Internet-ready ATM with functionality that would replicate the broad array of services available at any of Tyndall FCU's branches.

Indeed, Wincor Nixdorf's compactBANK was designed to deposit and dispense cash and coins; read checks to determine the availability of funds; load and unload an electronic purse; process passbooks; print statements, cashier's checks and other documents; process stop payments; allow "cardless" transactions such as new account funding; deliver targeted marketing; provide call center assistance; accept bulk deposits; and more. This extended functionality — combined with the implementation expertise and industry know-how provided by IBM — rapidly satisfied Tyndall FCU's requirements.

Together, IBM and its Business Partner, Wincor Nixdorf delivered a comprehensive solution — open to modular implementations and overseen by experts working toward a low total cost of ownership (TCO). IBM and Wincor Nixdorf service technicians worked with Tyndall FCU to test, pilot and launch the solution and to phase in advanced ATM services.

The solution is standards-based, allowing for customization and helping to ensure seamless integration with other systems. The ATMs align with the credit union's existing systems, facilitating remote reporting and monitoring, as well as real-time availability of customer data, ongoing services deployments and a consistent interface across channels.

"Our members love the compactBANKs," says Janet Turner, VP of Interactive Services, Tyndall. "They provide fast service during peak hours and are beginning to fulfill Tyndall's vision of 24x7 service." While the initial launch established four ATMs at two locations, Tyndall FCU plans to expand the deployment to other branches soon. Ultimately, the credit union expects to improve response times and the quality of customer care while realizing significant reductions in staffing expenses.

An on demand financial institution

An on demand financial institution is an enterprise whose business processes — integrated end-to-end across the company and with key partners, suppliers and customers — can respond with speed to any customer demand, market opportunity or external threat.

Financial institutions will arrive at the on demand environment only by following two paths of progression to their ends. They will move from a pure siloed environment, to a networked one where they will leverage best-of-breed partners and become best-of-breed distributors, specializing in products and services where they have comparative advantages. Internally, they will begin to integrate across business units, optimize processes and select a best-of-breed solution to reach the state of a component-based business model where they will take advantage of best-in-class components, regardless of source — whether it be internal or external — and be better positioned to react quickly to opportunities and threats.

On demand banks offer their customers a superior service and value as well as customer satisfaction. There are four features that are essential to becoming an on demand bank:

A focused bank:

- Concentrates investment on functions that differentiate it
- Targets those customers best suited to its operating model
- Accesses best-in-class capabilities and leverages scale efficiencies offered by partners

A responsive bank:

- Develops new products and services faster than its competitors
- Integrates new capabilities and acquisitions rapidly, achieving cost savings and operational efficiencies sooner
- Customizes products to fit target customer needs, justifying a price premium
- Aggregates data across the organization, turning it into useful information
- Enables its staff to make fast, well-informed, customer-focused decisions

A variable bank:

- Builds its own capacity required to handle average load
- Supplements internal capabilities with outsourcing to achieve peak capacity
- Outsources non-core transaction processing completely
- Shifts cost structure from predominantly fixed to predominantly variable

A resilient bank:

- Knows exposure to operational, market and credit risk on an as-needed basis
- Effectively distributes risk among strategic partners
- Reduces capital requirements through rigorous risk management
- Recovers quickly from operational disruptions caused by unpredictable, external factors

The way to become on demand

Becoming an on demand bank is not a grand leap to a final destination point — it is a journey that comprises incremental, systematic steps toward on an on demand environment. There is no correct starting point — each financial institution must assess its current processes to determine where it will have greater efficiency gains, achieve differential advantages and grow by becoming on demand, and focus on these areas (see Figure 2).

On demand operations can substantially impact a bank's bottom line

Financial returns from moving toward on demand operations manifest themselves in numerous ways. Consider the economic impact that even incremental steps toward on demand might offer:

- As you move fixed costs to more-variable structures, on demand banks have an opportunity to lower their cost-to-income ratios. We have seen some banks achieve efficiencies of as much as 55 to 60 percent.
- Banks and credit unions only obtain a fraction of their customers' total revenue potentials and often lose a considerable

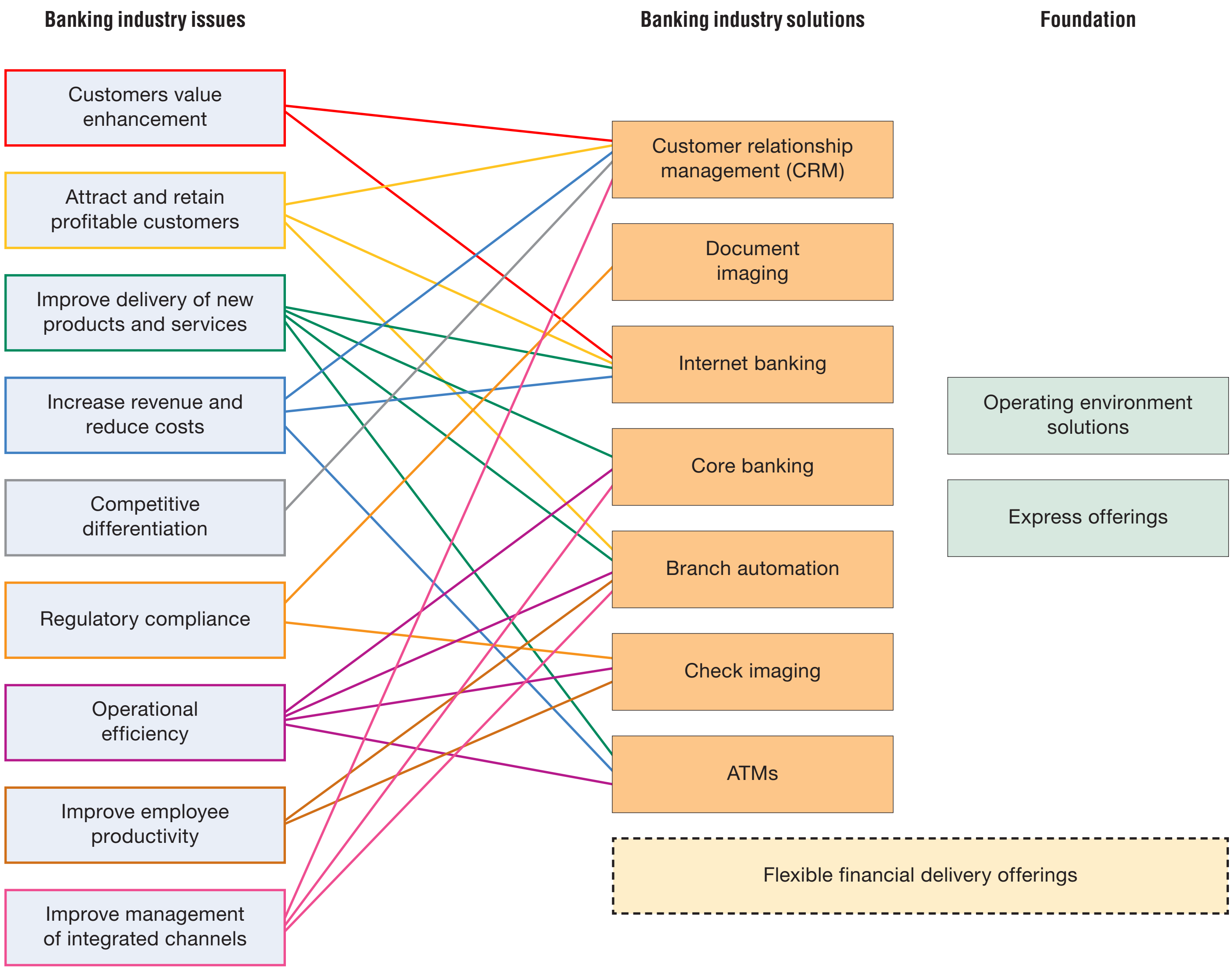

Figure 2. Steps toward an on demand environment.

amount of their customers annually. But, as an on demand bank focuses on retaining customers by becoming more responsive to its customers' needs — on a proactive basis.
- In some financial institutions, transactions and processes like loan origination or account opening may be replicated across several different lines of business.

These functions are not integrated and often have varying degrees of performance across business units. In contrast, an on demand bank would target common processes, striving to eliminate duplication and using its integrated IT infrastructure to have a shared business process.

IBM solutions for midsized banks and credit unions

The following sections provide a path to on demand offerings for midsized banks and credit unions that will address various on demand entry points and will help you in your on demand journey. IBM's reputation and ability for working with the world's largest companies is well-known, but IBM is also helping medium-sized companies succeed in their marketplaces. IBM is committed to delivering solutions — hardware, software and services — with our Business Partners that enable medium-sized companies to address business issues specific to their industries. IBM has midmarket industry professionals dedicated to the Banking industry as well as a network of business partner firms serving companies like yours.

Banking industry solutions

Together with our Business Partners, we offer best practice integrated solutions for midsized banks and credit unions. These solutions are designed to address industry-specific business challenges, as outlined in the on demand roadmap, such as attracting and retaining profitable customers, differentiating from competitors, operational efficiency and improving management of integrated channels among others.

To explore the specific banking industry solution offerings, visit **ibm.com**/businesscenter/us/solutions

IBM Express Portfolio

IBM Express Portfolio offerings were developed as a fast track to maximizing your IT investments — solutions designed, developed and priced exclusively for medium-sized businesses, including hardware, software, services and financing.

Express offerings feature:

- Relevant, scalable technologies that work with your IT infrastructure
- Selected configurations that are easier to acquire, install and manage than traditional offerings
- Competitive pricing and enhanced availability, from IBM Direct or through IBM Business Partners

To explore the specific Express Portfolio offerings, visit **ibm.com**/businesscenter/us/express

IBM operating environment offerings

An on demand operating environment can unlock the value within your existing IT infrastructure to be applied to solving business problems. By developing an integrated platform, based on open standards, your company can enable rapid deployment and integration of business applications and processes.

To explore the specific operating environment offerings, visit **ibm.com**/ebusiness/doc/content/evolvetech/operating_environment.html

IBM offerings for flexible IT delivery

Until recently, if you wanted more computing, you almost always bought more hardware and software. The trouble has always been that the amount you needed was hard to assess. If you bought too little, you could lose sales — and customers — for good. If you bought too much, you squandered precious assets. IBM Flexible Financial Delivery offerings can help you better align your IT resources and spending with business requirements. You can access infrastructure, applications and business processes based on your needs, with the flexibility to scale up or down. And by purchasing IT capabilities as a service, you will enjoy flexible pricing based on usage.

IBM's flexible IT delivery support your evolution to on demand in the following areas:

- e-business Hosting Services
- Application Management Services
- Financing On Demand
- Leveraged Procurement Services
- IBM Managed Hosting Infrastructure Solutions with Server Management
- IBM Managed Application Hosting
- Strategic Outsourcing

To explore the specific flexible IT delivery offerings, visit **ibm.com**/services/e-business/hosting/apphosting/smb.html

Getting started

Do you see a potential benefit to your company? We recommend that you take our Competitive Advisor Assessment; a customized evaluation of your business which leverages the vast intellectual capital of IBM industry experts, in conjunction with the FinListics analytical engine. Get new insight to where you are today, and where you can be tomorrow, with this complimentary assessment.

To request and schedule your no-fee assessment, visit **ibm.com**/businesscenter/us/imc/seas.jsp

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