LEGACY BANKS & INNOVATION

A TALK WITH DION LISLE

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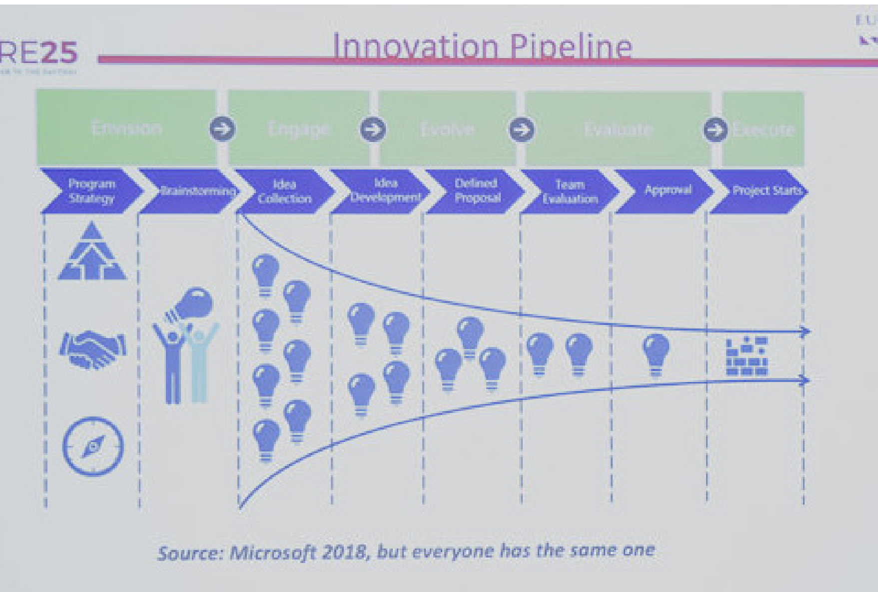
Earlier this year, Eurogroup Consulting France organized an event to discuss the topic of the "Legacy Banks and Innovation". On this occasion, we invited our clients to exchange with one of our experts in Fin-Tech, Dion LISLE, a leading figure in Silicon Valley working with our San-Francisco office. We have now reconciled what had been said during the event in order to provide insights on the relationship between legacy banks, innovation and FinTechs.

Indeed, Consumer friction, Artificial intelligence and Big Data, the three main issues on top of the banking sector's hot list have not changed for a while now, but why is it so? In order to deal with these different issues, legacy banks need to innovate either internally or externally. However, it does not seem to be the case so far. In this note, we will thus identify the main factors that have stopped the innovative process within traditional banks, and define how the way to fix their problems could be right under their noses in the FinTech industry.

I. What are the main reasons legacy banks have been struggling to innovate in the recent years?

1. A lack of R&D spending

When it comes to legacy banks' IT budgets, it is important to keep in mind that a massive part of this budget is allocated to the maintenance and upgrade of their current IT system. Hence, only a small fraction of the budget is finally devoted to actual Research & Development expenditures.
Putting this statement into perspective, the amount that traditional banks claim to be investing into "change projects" is far smaller than what they are truly spending. In fact, average R&D expenditures for the main financial institutions is around three to five percent of their total revenues, while for example, the GAFA (Google Amazon, Facebook and Apple) spend on average more than ten percent of their total revenue on internal innovation. This is not a satisfying picture, and one that has to change for legacy banks to remain relevant in the future.



2.
A wrong approach to innovation

Legacy banks typically fall into the three main pitfalls that can hinder innovation within a company and make the firm allocate its resources inefficiently:

- **"Innovation dead-end":**
  when companies launch a lot of different "innovative" projects but a great many of them never get finalized and thus do not lead to the creation of a proper "innovation" or a new product

- **"Innovation exhibition":**
  when most innovations rapidly end up "in the closet" and are never used on a regular basis, since for most people new technologies only mean new "gadgets" that look cool but cannot be used in real life

- **"Innovation holidays":**
  when to stimulate innovation within their teams, the only solution that companies come up with, is to send their top executives to tour start-ups' headquarters in "tech cities" (such as San Francisco). Unfortunately, this kind of approaches does not make the participants develop any valuable skills or tools and is completely inefficient in fostering innovation within the firm itself

3.
A slow and inefficient procurement process

The procurement process for onboarding technological companies for consultancy or implementation projects is extremely cumbersome within most legacy banks.
For example, how can a legacy bank innovate and be agile if it can take up to three months to get passed all the administrative and juridical steps to begin a single POC (proof of concept)?
It considerably decreases the effectiveness of such tools, as POCs need to be done relatively swiftly and with minimum expenses to prove that the concept itself is viable and then to proceed to the next steps in production.
In the end, such inadequate procurement processes have a negative impact on the banks' capacities to innovate externally. Indeed, they lead to a drastic reduction in the number of FinTechs that are big enough to partner up with legacy banks, as they need to be able to bear the costs both in terms of treasury and allocation of human resources.

4.
A flawed decision-making process for innovation projects

A common denominator to most legacy banks when it comes to investments, is that regardless of the amount of money needed, the decision lies solely within the hands of a few top executives. Is it really a good way to proceed when it comes to small investments in innovative projects, which are numerous and require fast approval? Would it not be more efficient to redefine some of the decision-making processes and delegate at least part of the decisions to more operational managers? Indeed, top executives may not always be the most suited to make the best decisions in terms of investments in innovation projects, as they might lack both the time and the knowledge to understand all the aspects of such projects.

II. How could banks use the FinTech Industry in order to deal with their innovation difficulties?

1. Use the infrastructure that FinTechs have already built to reduce the costs and the risks inerrant to innovation

In the last decade, billions of dollars have been invested in the FinTech Industry through different investment institutions (Venture Capital funds, Private Equity funds, etc.), which enabled FinTech companies to create a vast array of digital infrastructures. It is a real godsend for legacy banks, as they could easily use these ready-made facilities as a base for any new digital product they would like to launch. All this at a minimum cost for them and with almost no risks as the products have already been tested and approved. For example, some American banks have already started to rely on FinTechs infrastructures to launch their new online products, as it is the case with Goldman Sachs and its recent "MARCUS by Goldman Sachs" online bank. In the process, Goldman had to make almost no internal development and was able to launch its product extremely rapidly.

2. Partner up with FinTechs on specific issues to which they are dedicated

One of the main reasons it is so difficult for legacy banks to innovate is that they are generalist institutions that do not focus solely on a specific issue. Indeed, banks try to address the whole spectrum of their client's needs, which makes it extremely complex and costly for them to develop in-house digital solutions as it would require to build all kinds of expertise in very different fields. On the other end, most FinTechs are devoted to only one specific issue and focus all their resources on the creation of a digital solution to tackle it.

Traditional financial institutions could therefore leverage on the expertise that FinTechs have been developing and partner up with them to address their own issues at minimum cost. It would also reduce the amount of investments required as well as the time needed to develop new solutions. Furthermore, such a partnership could easily become a "win-win" for both banks and FinTechs, as the start-up could also leverage on the bank's customer base to gain some vital client traction without having to burn too much of their venture capital cash.

3. Inspire themselves from FinTechs' good practices

There are four main FinTech good practices that a legacy bank could try to replicate in order to increase their ability to internally innovate:

- Put the customer at the center:

In all their decisions, may they be internal or external, FinTechs always try to put their customers at the center. Their aim is to constantly stay in touch with their clients' expectations and thus create products that are at the core of their needs. If traditional banks want to be at the forefront of customer innovation, they should try to do the same and adapt their operating constraints to their clients' expectations rather than the opposite. Though, to change their current mindset, legacy banks may have to entirely rethink the relationship between their project and business teams

- Improve agility and flexibility:

One of FinTechs' main strengths, is their ability to be more agile and flexible when it comes to decision-making, which is a requirement for a company to be innovative. To emulate this trait, traditional banks should adopt the key element to any start-up's agility: working in small teams and delegate more of the decision-making power to these teams. Indeed, working in smaller groups drastically shortens the decision-making process and thus makes the company more responsive to any new product or strategic turnaround

- Develop an owner's mindset:

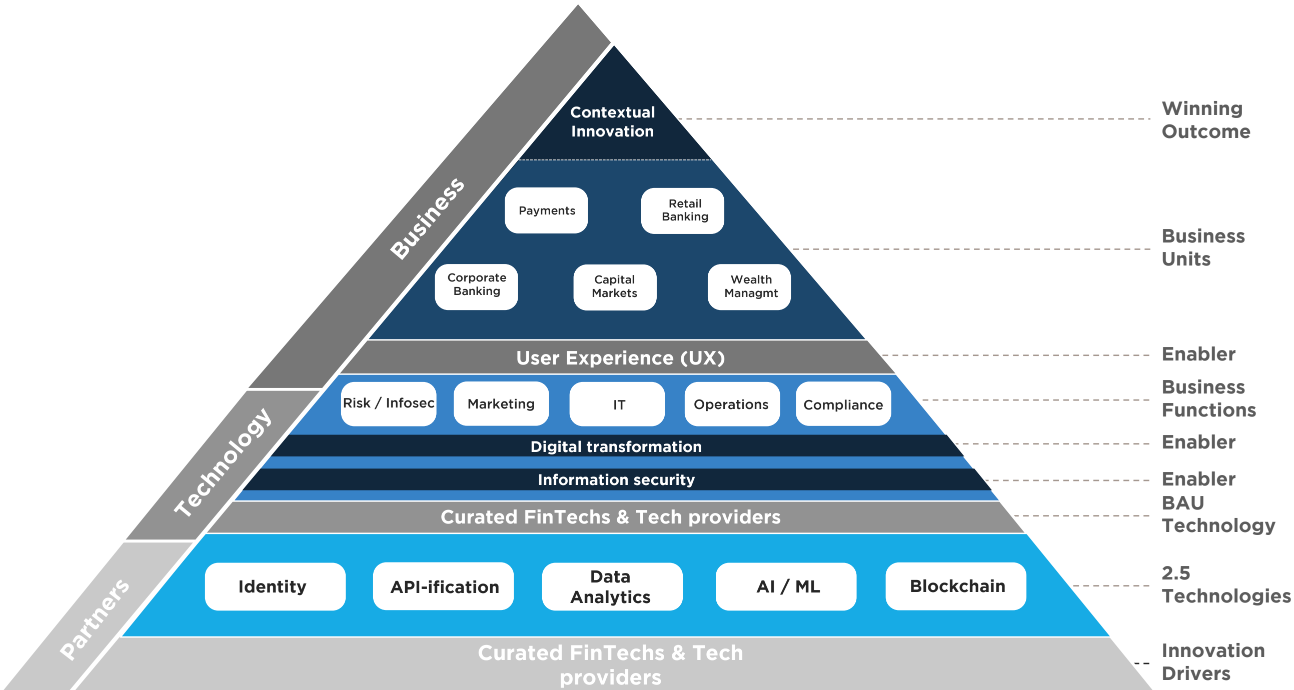
One of the other perks of working in small teams as FinTechs do, is to push employees to adopt an owner's mindset. Indeed, to enhance the company's workers ability to innovate, it is vital to encourage their sense of responsibility and to give them more freedom to create and implement their own solutions. Traditional banks should thus follow the lead and try to foster such a mentality within their own teams

- Be more tech focused:

Being born in the digital era, FinTechs normally put technology at the center of their DNA. Their whole business model is based on it and they put a lot of emphasis on their developers and other tech profiles. This is far from the case for traditional financial institutions. Indeed, one way to easily distinguish between a traditional bank and FinTech, is to compare the salaries between their lawyers and their developers. Hence, if legacy banks want to be more innovative, they need to redefine the role of their IT departments and give them the means to be a driving force for innovation within the company rather than a lame duck

KEY CONCEPT

Contextual Innovation is the concept of working to deliver innovation within the current complex framework of a bank's operations and technology



DION LISLE is a renowned expert who focuses on the future technologies that drives Fintech innovation. He was the 1st Head of Innovation at Citibank building their ecosystem and Venture Investing arm.
He did it again at First Data, in charge on the Venture arm, sourcing and engaging startups in omni-channel commerce, payments and overall technology.
Responsible for engaging the broader Silicon Valley ecosystem with startups, venture investors and innovation leaders, Dion has a very unique ability to remove Friction for Fintechs and Banks. He can lead projects from POC to Pilot to Production delivering Customer Centric Innovation that ignite change and reimagine economic progress within the complexity of legacy banks and FIs.

About Eurogroup Consulting

Eurogroup Consulting is a strategy, management and organization consultancy. Established in 1982, our firm is independent and European by nature, with 55 offices in 37 countries. Through our network Nextcontinent of 1,800 consultants among 5000 professionals and 400 employees in France, we have an established reputation for providing consulting expertise in every field of business in the private, public and social sectors.

Eurogroup Consulting stands out from the crowd because we apply a unique approach to consulting: positive transformation. Our staff and our entire business ecosystem – including our digital business accelerator – work together to offer our clients effective solutions that are adapted to their employees and their corporate culture. Together, we turn each necessary change into a process that is understood and experienced as a useful and sustainable transformation.

Through the Eurogroup Foundation, we work to reaffirm and deepen our commitment to society by helping to improve access to education

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Eurogroup Consulting California

In terms of digital innovation, Silicon Valley sets the pace at a worldwide level. It represents 25% of world investments (53M$ in 2018), 50% of investments in the USA, 2.5 times more than Europe and this in a very geographically concentrated place.

Eurogroup Consulting California's mission is to make a close link between this unique ecosystem to Eurogroup's European clients.

executive boost camp

A 3-to-4 days exploration of the Silicon Valley to open the perspectives, meet the Innovators and build a network and kick off a strategy for a digital world.
For Executives

fast forward

A one-week program to create momentum send one of your challenges in the right direction Confront it best experts and use Design thinking and Agile Processes, to reframe the problems as opportunities, decide, sketch, draw the storyboard, Fake it, and finally double down or kill the idea.
For Project teams

exponential mindset

A one-week immersive program in Silicon Valley designed to empower people, develop their disruptive mindset, make them acquire entrepreneurial skills and methods to lead transformation and innovation programs internally.
For Managers

All these programs will bring you face to face with the best experts of Silicon Valley

plug-in

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disruption studio

A twelve-week program to develop your Minimum Viable Product with an end-to-end process for creating, refining, and bringing your disruptive project to market. Test and Validate each component of the Business Model and Go-to-Market Strategy.