THE ASIAN BANKER
STRATEGIC BUSINESS INTELLIGENCE FOR THE FINANCIAL SERVICES COMMUNITY

IBM

# On demand business: The future of mid-sized financial institutions

As Asian banks and financial institutions emerge from a series of jolts to their stability, in the form of scandals, consolidations, declining consumer confidence and price wars, the industry is forced to rethink, re-strategise and reengineer processes and business plans.

In an environment of volatile interest rates and squeezed margins, the focus is shifting to new emerging areas to generate fee income. Numerous opportunities abound in areas such as credit cards, the massive mortgage market, wealth management, unsecured lending and Islamic banking.

At the same time, there is a greater premium being placed upon enhancing customer service, diversification of revenue sources and cross-selling. While banks and financial institutions struggle to meet rising targets quarter after quarter, year after year, in an increasingly challenging and competitive environment, good corporate governance and sound risk management have often fallen by the wayside.

As an industry, the financial sector is moving away from a set of independent, vertically integrated institutions towards a network of affiliated financial institutions that not only specialise in delivering best-of-breed products and services, but also partner with first-class financial institutions and business partners for additional products and services. This can be seen in the emergence of large banks that leverage their experience and global network to provide a range of services to domestic banks such as cash management, clearing, continuous linked settlements, trade finance and treasury management. It can also be seen in banks utilising their channels to market new products like bancassurance or wealth management, for the high net-worth clients – services that have traditionally not been regarded as banking products or services.

The past few years have also not been good for investment banking and asset managers – fees from mergers and initial public offerings (IPOs) have plummeted, broker-dealer commissions seem to have bottomed out and asset managers are finding their assets shrinking. To position themselves to thrive, despite the cycles and inherent volatility of their industry, financial services firms need the ability to operate on demand – the capability to respond rapidly to virtually any opportunity or threat.

**The silo problem**

Pressured by falling margins and increasing competition, banks are looking inwards, attempting to cut costs and optimise their processes. However, they are finding that most of the opportunities in these respects may have been exhausted. Differentiation is a prerogative, banks appreciate, but once again as banks attempt to do this – by gaining a single view of customers, delivering consistently excellent service over multiple channels or delivering new services as quickly as clients demand – they find that they are being hampered by inflexibilities and complexities of their operational structure.

In the current silo-based organisations, opportunities for process-optimisation have largely been exhausted. Indeed, the whole silo-based approach to process-optimisation can often prove to be counter-productive to the enterprise as a whole. As each area of the business makes a major change – from the business, through the applications and down to the technology – it may make that particular silo more effective, but it does so at the expense of the enterprise, which actually becomes more complex overall.

Although the initial results from the industry restructuring were impressive, we are reaching a stage where to drive the next growth phase, financial institutions need to look inwards at their own systems and processes. For example, the mergers and acquisitions of the nineties and early part of this decade left banks with organisational, process and system complexity, which placed enormous strain on operational efficiency and financial performance. One of the biggest hurdles for banks is that their departments, which were already operating in a silo mode in the pre-merger era, became even more disintegrated in the post-merger era.

In an environment of squeezed margins, banks simply cannot afford to have their capabilities duplicated across product silos, with each product operating its own processes, systems, and product-specific channels. In addition, although vertically integrated supply chains offer increased choice, they also limited customer choice – leaving firms with undifferentiated value propositions and lower overall customer wallet shares.


Although banks still continue to provide core services to customers, the traditional view that the financial institution must develop, sell and service all or most of the varied financial products within the organisation is quickly becoming an unsustainable model. In many cases, third-party business partners are able to perform the required services in a lower-cost manner, allowing the financial institution to provide the core services in which it is more experienced.

Unfortunately, a problem emerges when poorly defined standards and linkages between financial institutions slows the pace of change. In many cases, the processing and interface standards are 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.

Today's customer demands access to all the bank's products and services through the channel of his choice. The problem is that many financial institutions have back-office systems that are separate legacy systems that may not be integrated, and which 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.

Financial institutions across Asia have operated in a silo mode for decades, with checking and savings, mortgage loans, consumer loans, business loans, trust, brokerage and other services operating independently. Each silo was likely to have its own marketing, sales and distribution channels, individually developed products, and back office legacy systems that were completely independent. This worked until the marketplace started changing dramatically, and institutions discovered that silo environments hampered banks' ability to meet customer needs in a time-to-market fashion. As new banks set up operations from scratch in the region, many of the legacy-mired banks found themselves at a distinct disadvantage when competing with these banks, who were able to offer integrated checking, savings and investment accounts, among other things.

**Cross-selling**

The most effective customer segmentations have often been achieved by monitoring the transactional behaviours of customers – through analysis of data to reveal the recency, frequency and size of transactions. A critical prerequisite to achieving this lies in bringing down the silos that separate business units in banks.

Fortunately technological advances over the past few years have substantially improved connectivity, facilitating heightened collaboration within and among firms and a greater range of possibilities when responding to market shifts. Banks and financial institutions now have at their disposal better business process modeling tools and templates to ease the task of corporate reconfiguration.

**The insurance potential**

With per capital premiums as low as $30 in some markets, compared to $3,000 in the US, the potential for growth and product diversity in Asia's insurance industry is considerable. Still the industry has come a long way in the last decade. Ten years ago the industry was characterized by traditional life insurance products that were designed mainly for protection, with the insurance companies' agents functioning as the main distribution channel. Today, banks, brokers, independent financial advisors and the Internet have emerged as important distribution channels, while unit or investment-linked products and single-premium insurance products are becoming increasingly popular.

The competition in the insurance industry is fierce. With consolidations, globalisation and the convergence of services, it is becoming more and more difficult for the traditional insurance service provider, especially as more banks and financial firms aggressively enter this market. Banks also have the advantage of using their existing customer base to cross-sell.

The insurance industry is also grappling with new issues – the Asian tsunami of late 2004, which resulted in hundreds of thousands dead and millions more losing their homes or properties, terrorist attacks in several countries in the region that led to significant underwriting losses and other catastrophes manmade or other have heightened the focus on this area.

Indeed, this heightened attention has brought a new awareness to the need for insurance or rather the lack of it. Consider that non-life insurance in areas affected by the recent Asian tsunami is around 1 percent or lower, compared to 5 percent in the US.

The potential for growth in Asia is enormous. However, success depends on a plethora of factors ranging from customer service, multi-channel integration, innovation and cost efficiencies. There are also opportunities to understand and satisfy the needs of the more sophisticated or demanding customers.

To make the most of these opportunities, insurance firms need to be able to move information quickly and consistently across the lines. Insurers are recognising the importance of a multi-channel strategy to better serve their markets, but this also implies the need to better integrate them. Innovation and the creation of new products and services are key to remaining competitive. Time to market is a critical area differentiating the winners from the losers.

Product cycles need to be reduced drastically to gain market share and stay ahead of competitors. As in the case of banks, insurers are also looking inwards and examining their processes and operational efficiencies.

**The on demand financial institution**

The on demand financial institution is one in which business processes are integrated end-to-end not only across the enterprise but with its key partners, suppliers and customers as well. The net effect of this is that it can respond speedily to any customer demand, market opportunity or external threat. Speed is an increasingly important differentiator between the winners and losers among Asian financial institutions, as customers become sophisticated and demand faster satisfaction of their needs.

Financial institutions need to evoke change at two levels to transform themselves into on demand enterprises. Internally, they need to transform themselves from silo environments into networked enterprises, integrating across business units and optimising processes. Externally, they need to leverage best-of-breed partners, allowing them to specialise in products and services where they have the comparative advantages, and tying up with best-of-breed partners where it makes sense.

Asian banks in particular are in the midst of a profound transformation, providing products and services beyond what is traditionally regarded as their function – such as insurance, investment linked products and payment facilities. Increasingly, financial institutions are also tying up with partners in the retail segment. Some of the most successful products have been achieved on the back of very close relationships with strategic partners – Banco de Oro's cashcard product in partnership with retailers in the Philippines is one example of this.

**Importance of an integrated view**

Today, Asian financial institutions are beginning to break out of their product silos. Banks are beginning to create an integrated view of their customers. However, the channels are still product-centric and management control remains within business units. With processes that span across business units, banks are struggling to manage their complex operations. Without adequate integration, banks face a major hurdle in having a complete view of the entire organisation.

A single view will enable the organisation to provide superior customer service. Different people accessing data from different areas within the company will all have the same updated information about the status of a particular customer. Internally, this will have a positive impact on process efficiency as in the case of a person performing different roles at different times – he or she will have the same familiar interface despite the change in function, whether they are dealing with the customer at a branch or performing a support role at the call centre.

An integrated view will also have a positive effect on an organization's assessment of risk profiles, especially given the ongoing focus on Basel II compliance. A single enterprise view will allow the company to assess its total risk position, through a single, cohesive way of calculating and stating financial exposure.

A centralised model, with a single consolidated view to enterprise data is increasingly relevant and beneficial to banking. In manufacturing and retail, a 'just-in-time' and 'point-of-sale' orientation lends itself to a dispersed operational structure, but in banking, with information-based products rather than physical ones, a centralised operational structure is far more appropriate – after all it's not just the branch that owns the customer, it's the bank as a whole (across all its channels) and as such it is the bank as a whole that owns the risk as well!

On demand banks are able to offer customers superior service and value, as well as customer satisfaction.

**The four main characteristics of an on demand institution:**

***Focus:***

- An on demand institution strategically invests in functions to differentiate itself.
- It targets customers that are best suited to its operational models.
- It aims to obtain best-in-class capabilities; leverages on the scale efficiencies offered by partners.

***Responsiveness***

- A responsive institution is able to develop new products and services faster than its competitors.
- It integrates new capabilities and acquisitions rapidly, achieving cost savings and operational efficiencies sooner than other institutions.
- It customises products to fit target customer needs and is able to justify and charge a price premium.
- It aggregates data across the organisation, turning them into useful information that can help extend its business.
- It empowers its staff to make fast, well-informed, customer-focused decisions.

***Flexibility***

- A flexible bank builds its own capacity to handle average loads.
- It outsources non-core transaction processing.
- It supplements its internal capabilities with outsourcing to achieve peak capacity.
- It shifts its cost structures from predominantly fixed to predominantly variable costs.

***Resilience***

- A resilient bank is fully aware of its exposure to operational, market and credit risks at any point in time.
- It also effectively distributes risk among strategic partners.
- It reduces capital requirements through rigorous risk management.
- It recovers quickly from operational disruptions caused by unpredictable, external factors.

## The way to becoming an on-demand enterprise

Becoming an on-demand bank is not a grand leap to a final destination point – it is a journey that involves taking incremental, systematic steps. There is no correct starting point – each financial institution must assess its current processes to determine where it can attain the greatest efficiency gains, how it can achieve differential advantages and focus on these areas. (See figure below)

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

The financial returns of an on demand operation manifest themselves in numerous ways. Consider the economic impact that even incremental steps taken toward an on demand environment might offer:

- Banks across Asia are only beginning to realize the true potential of their customer relationships. There is increasing focus on cross-selling to maximise these relationships, but for banks to truly achieve this, there needs to be a movement away from silo-based operations, towards an organisation where all employees share customer data. This would enable banks to proactively sell products and to be more responsive to customer needs. This in turn will allow the institution to lower the costs of new customer acquisition and increase revenue per customer, with the net effect of an overall improvement in customer profitability.

- By moving from fixed cost structures to variable cost structures, banks have an opportunity to lower cost-to-income ratios.

- Across many financial institutions in Asia, transactions and processes like loan origination or account opening may be replicated across several different lines of business. By eliminating duplicative processes and systems, banks can lower their overall transaction processing and back-office costs. These functions are not integrated and often have varying degrees of performance across business units. By contrast, an on demand bank would be able to review common processes, eliminate duplication and use its integrated IT infrastructure to achieve shared business process.

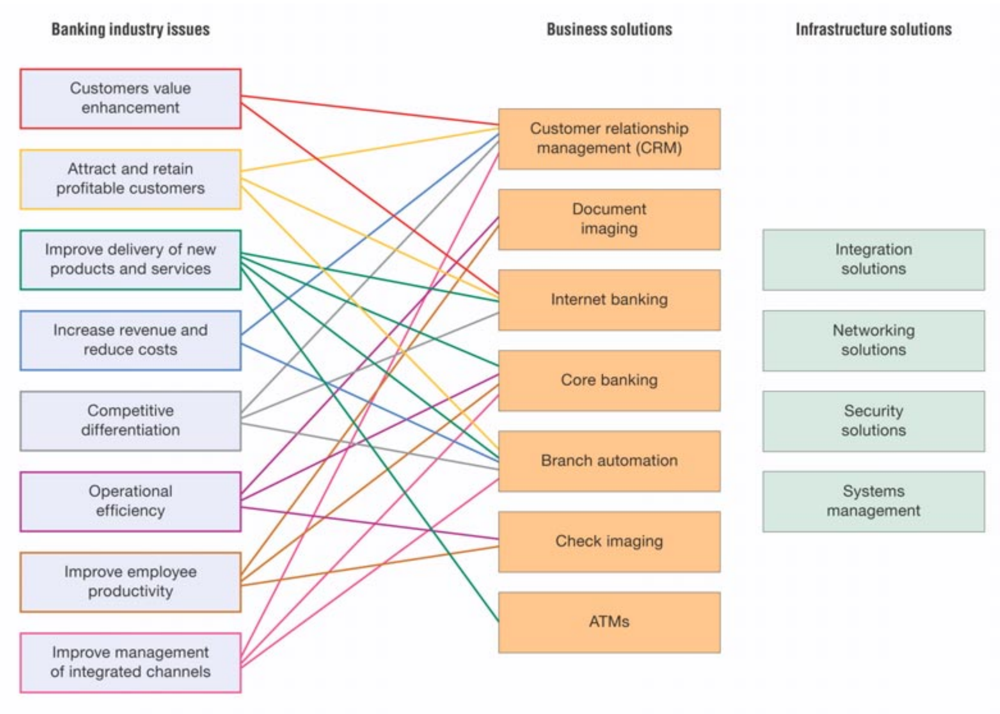



*Figure 2. Steps toward an on demand environment.*

**IBM's answer to addressing hurdles faced by Asian financial institutions**

IBM has a strong reputation and track record in helping Asian financial institutions solve their problems and achieve their business goals. In particular, IBM is well-equipped to address the needs of the mid-sized financial institution. IBM has mid-market industry professionals dedicated to the banking industry, as well as a network of business partner firms.

***Banking industry solutions:***

Together with IBM's business partners, IBM offers integrated solutions to address industry-specific business challenges as outlined in IBM's on demand roadmap. These are geared towards attracting and retaining profitable customers, providing tailored solutions, increasing operational efficiency and improving the management of integrated channels, among others.

*To understand more about IBM's specific banking industry solutions, visit http://www.ibm.com/businesscenter/sg/industries/fs.html*

***IBM Express Portfolio***

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

***Express offerings include:***

- Relevant, scalable technologies that can be seamlessly integrated within your IT infrastructures.
- 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 understand more about the specific Express Portfolio offerings, visit http://www.ibm.com/businesscenter/sg/express/index.html*

***IBM operating environment offerings***

An on demand operating environment can unlock the true potential of your existing IT infrastructure, to solve business problems. Through an integrated platform based on open standards, your financial institution can rapidly deploy and integrate its business applications and processes.

To understand more about specific operating environment offerings, visit ibm.com/ebusiness/doc/content/evolvetech/operating_environment.html

***IBM's 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 banks better align their 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.

Through the following services, IBM can help to transform your financial institution into an on demand organisation:

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

CASE STUDY

# IBM helps Thailand's rural bank fulfill vision

***Strategic core banking implementation allows Bank for Agriculture and Agricultural Cooperatives (BAAC) to extend range of services and bring products to farmers in faster time-to-market.***

The Bank for Agriculture and Agricultural Cooperatives (BAAC) was established in 1966 by the Ministry of Finance as a state bank, to provide farmers with financial services and facilities. The bank was part of a government plan to support farmers and promote farming as a viable and essential activity for economic development.

The bank offers lending and deposit facilities, issuing, buying and selling of bills of exchange or other transferable instruments. It also purchases government bonds and other savings services. In addition to these, BAAC acts as a guarantor to farmers, liaises with farmer groups, agricultural cooperatives and other sources to provide loans or farm credits.

The bank's motto "BAAC provides more than loans to improve rural areas" depicts its vision of extending its leading initiatives and services in developing rural areas. BAAC's mission is to promote a better way of life for farmers and uphold the protection of environmental and natural resources.

**Evolving business needs**

Recently, the bank expanded its core business to provide total banking solutions to the agricultural industry. BAAC today aims to help farmers grow their businesses by an extending its range of lending and other financial products services.

BAAC President Mr Thiraphong Tangthirasunan, elaborates: "We are a bank that is under transformation. We need to strengthen our competitive edge. At the same time, we need to carry out the very modern tasks assigned by the government. At the heart of our business are our customers – the farmers – whom we need to take very good care. With 5.3 million households, 10 million credit accounts and 20 million savings accounts in our service network, the scope of our operations is huge. In addition, we need to be focused on the quality of the service. Farmers' expectations for fast and good customer service are increasing and we need to keep pace with that to maintain our market leadership."

Mr. Thiraphong regards IT as critical to achieving the bank's business objectives: "IT infrastructure investments are very important in our strategic plan to shape up the bank, integrate our departments and in ensuring that products and services are delivered in a better time-to-market."

*BAAC's mission: provide a better life for farmers, protect the environment.*


*BAAC president Thiraphong - leading the tranformation effort at the bank.*

Mr. Thiraphong says: “We are dealing with the farmers, and we have a lot of customers. It was important for us to choose a reliable solution provider. We can’t afford on a daily basis, to be in a problem-solving mode. We looked around and saw several banks using the IBM series. We felt that IBM’s servers would be able to handle the number of customers and transactions we expected to run.”

To ensure 24-hour business continuity, IBM installed a data recovery center for BAAC. The data recovery center is hosted on a mainframe environment, with real time, 24-hour back up of data. IBM's eServer xSeries server processes data across the different branches throughout the country, as well as the main branch.

IBM also developed a core banking solution to enable BAAC to provide its customers with better and broader services. Farmers will be able to access many different types of service channels such as counter services, ATMs, telephone banking and Internet banking, providing them with ‘anytime, anywhere’ banking convenience.

**IBM – the trusted partner**

BAAC turned to IBM as its trusted business advisor, to design and oversee the project implementation for BAAC's core banking system. The bank invested 1,202 million baht ($31.2 million) in a new core banking system that will enable it to do product definition in a quicker timeframe and also improve service conditions and processes through an integrated database system, loan system, savings system and customer service system.

The core banking system will connect the data resources across 600 BAAC branches throughout the country, enabling faster response time to customer queries and transactions, thereby improving customer satisfaction. BAAC's core banking system will run on IBM's eServer zSeries, its treasury application on the pSeries, and the data recovery center on the IBM Storage Enterprise Server.

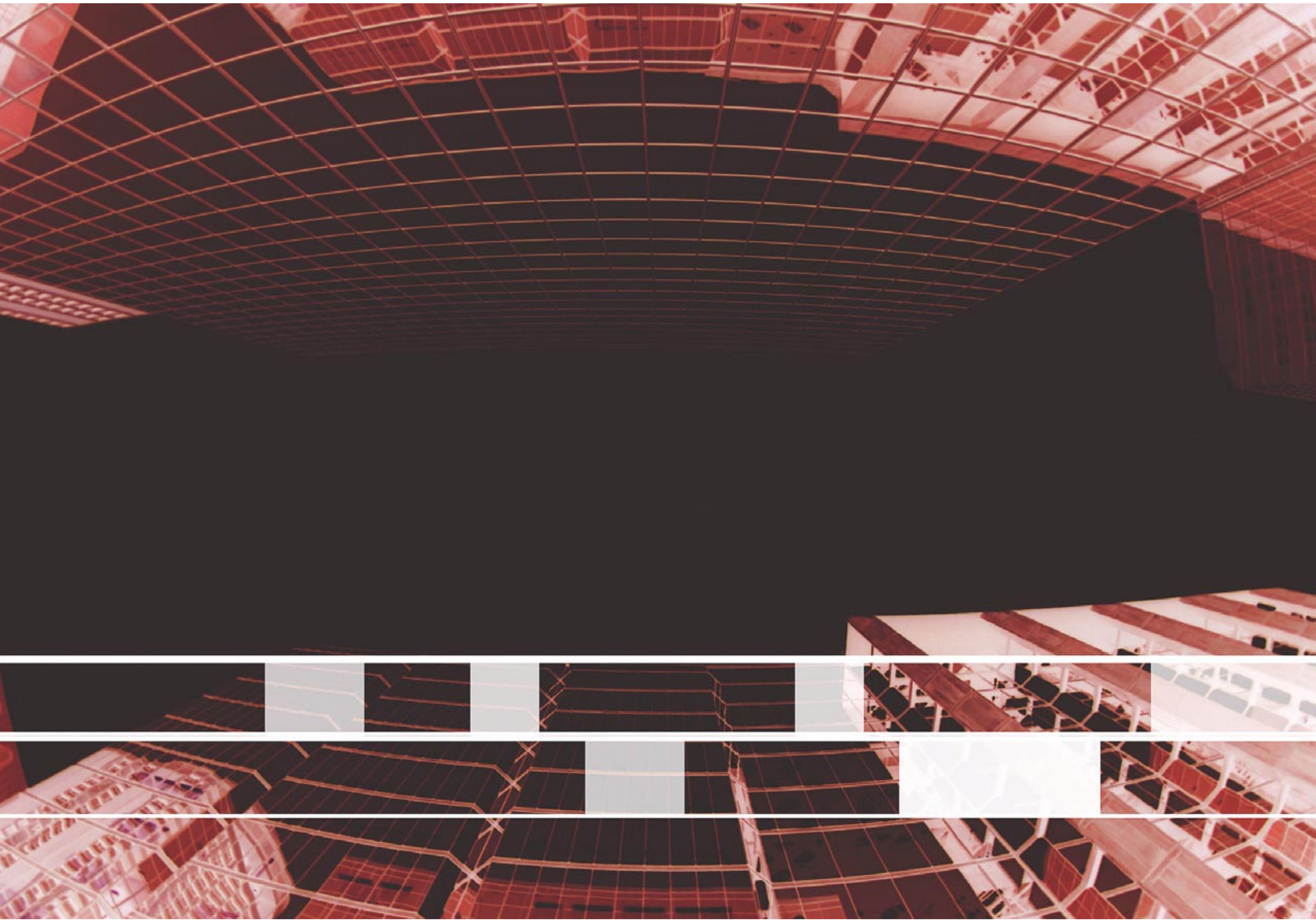
**BAAC's on demand transformation with IBM**

BAAC believes that the core banking revamp, which includes a Temenos system, has improved its time-to-market. Mr. Thiraphong says: “With the new system, we believe we will able to create a new product in a matter of days. Previously, with the old system, we needed several weeks to create a new product. And data capture was not centralised, which made it difficult.”

"We are transforming our core banking system in order to provide the best service to customers, especially farmers, a key engine of the nation’s economy. This is in response to the government’s vision and policy of providing readily available services through a variety of channels to the nation," Mr Thiraphong adds.

Working in tandem with IBM, BAAC is planning to finish the three phase project within 24 months, by the end of 2006. Mr. Thiraphong believes that the core banking system will be able to respond to the bank's plans for aggressive expansion: "We are confident of the scalability of the system. It would be no problem for the next five to eight years, even if we have double digit growth. But in addition to that, we are also expanding the services to our customers – and we believe that this system would be able to respond to that."

"BAAC is embarking on a remarkable transformation of its core banking system, in line with its goal to become one of the top banks in Thailand and in the region. BAAC can use its optimised IT systems to drive new opportunities for growth and help it to deliver world-class financial services to its customers,"" says Ms. Suphajee Suthumpun, Country General Manager, IBM Thailand.



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