



WHEN VISION AND VALUE COLLIDE



**THE NEED TO INVEST
AND BUILD THE FIRM
OF THE FUTURE
IS PRESSING. THE
WINDOW TO DELIVER IS
GRADUALLY CLOSING.
A RECKONING
IS INEVITABLE.**

A collision is taking place in financial services between the vision mindset and the value mindset.

Many firms have backed their vision mindset over the last few years, and as our research shows the need to change quickly remains pressing. However, with persistently low revenue growth and a deteriorating macro-outlook, the clock is ticking on investment.

How firms resolve this conflict – between the desire to reimagine the business for the long-term and the need to remain disciplined and profitable in the short-term – will define the shape of the industry in the coming years.

The winners will be the firms that most successfully unite the vision and value mindsets, agree on what is critical to thrive long-term, and invest with discipline. The losers will lurch too far in either direction and will fail to survive today or thrive tomorrow.

The timing and magnitude of the reckoning depend on segment and region. For European banks facing negative interest rates, smaller US banks getting squeezed, and some asset managers, the collision will be pretty violent. Consolidation in these segments is likely to be part of the outcome.

Our findings, which come from discussions with industry leaders, analysis of investment levels and progress, and gauging of investor sentiment, point to several key attributes that winning financial services firms will share:

- **A surgical approach to investment portfolios:** Successful firms will exhibit great discipline, with investment in me-too functionality, capability building, and regulatory reform managed down quickly and tech investment becoming much more modular.
- **Fewer, bigger, growth plays:** Many firms have spread growth investment across numerous small initiatives. We anticipate this will change, with emphasis on a smaller number of well-funded, CEO-backed initiatives.
- **Clarity on productivity gains from investment in technology:** Winners will be clearer on the use of technology as a route to drive net headcount costs down significantly, drive up productivity, and thus increase returns.
- **Better science on how to measure and manage change:** This is one of the industry's greatest challenges: new metrics and management techniques are needed that can steer progress in large scale initiatives, uniting the objectives of both the vision and value mindsets.
- **Better external communication:** Investors will reward firms that provide clarity on what drives performance and allow progress on long-term change to be tracked.

Collisions can be creative as well as destructive. They can lead to balance, reinvention, and growth. In our annual report on the *State of the Financial Services Industry* this year, we explore how this collision is playing out, and how we believe winning firms will manage it. We hope you enjoy the research as you navigate the change ahead.



Ted Moynihan

Managing Partner, Financial Services

INTRODUCTION

THE MINDSET COLLISION

Financial institutions face a big challenge: creating the business of the future from the legacy they have today.

There is considerable investment and activity underway to make this transformation. Firms have set up incubators, accelerators, and innovation teams, often consuming considerable management attention. They have hired chief digital officers and teams, and rolled out new ways of working. Some breakthroughs are occurring. Yet positive impact on the bottom line has been rare, and no firms we speak to are happy with the rate of change. Until recently, this has been a concern but not a crisis.

Pressure is now building. Investors, analysts, and management teams in the past year have begun asking questions about the lack of progress from the considerable investments being made. The outside threat is growing, not receding, with the big technology companies positioning themselves in financial services. The industry also faces difficult macroeconomic conditions that will put investment budgets under strain.

In short, financial institutions are struggling to make and deliver on the investments they need to be successful in 10 years' time, while delivering value for shareholders in the short-term. This is now revealing a major tension in the industry between two opposing mindsets:

- **The vision mindset** is focused on building the firm of the future. It foresees structural changes to the industry driven by new technology, changing value chains and ecosystems, new rules of competition, and disruptors setting those rules. A full transformation effort is seen as necessary, with a three- to seven-year investment horizon and a growth narrative that emphasizes customer value.
- **The value mindset** is focused on delivering financial returns. It sees an industry that has adapted to successive waves of technology and focuses on cost and capital responses to slow growth. Investment should be made only where concrete returns are expected, with an impact in the next one to three years.

The industry needs a mix of both mindsets. But in many cases, one or the other has come to dominate.

When the value mindset dominates within firms, the result is myriad small changes with known but low-impact outcomes. Short-termism leads to increasingly outdated legacy technology, which holds back future productivity improvement, and new growth opportunities rarely amount to anything substantial.

Exhibit 1: The Mindset tension



Years	Planning horizon	Quarters
Spend on strategic and transformational themes without constraint of near-term financials	Investment philosophy	Spend only where financial returns can be reasonably predicted
Proof points that support overall narrative and progress of initiatives	Key metrics	Financial (cost and revenue change, ROI) and operational (progress against plan, RAG)
Competition from rivals with stronger capabilities, structural disruption	Concerns	Cyclical downturn driving portfolio prioritization and reduction
	∨	
Wasted resources from lack of discipline or vision proving to be incorrect	Risks	Failure to invest in unpredictable but highly disruptive themes
Potential of breakout growth along with radical business model transformation	Rewards	Rigor, transparency, controllability, and continuous elimination of failing investments

Source: Oliver Wyman analysis

When the vision mindset dominates, aggressive amounts of spending can go into transformation efforts that don't yield results. Top-down priorities – to be customer-focused, data-centric, agile, or innovative – get interpreted by every business or function, and projects proliferate. Value disciplines around business impact are missing or ignored, with spending justified by the top-line strategy, weak stage-gating, and limited results.

This tension is playing out in all segments of financial services. Many firms that backed the vision mindset heavily over the last few years are now taking a hard look at what is working, what will deliver value in the future, and how to reduce spending. Other firms that took a highly pragmatic approach, or had no bandwidth to consider the long-term future, are now worried about sustainability and where growth will come from.

In this year's report we present new findings from the financial services investor community, alongside insights from our work with clients in 2019. We explore the progress of change programs, the rising tension between vision and value, and what the winners will do to get the balance right.

Investor pressure building: In the first section, we look at spending on change programs and the investor perspective. It is clear investors are highly skeptical about existing change programs and do not feel they understand what firms are investing in, or why.

The closing window to deliver: In the second section, we look at the changing environment and why it is becoming increasingly critical to deliver on investment. Value creation has fallen in financial services, progress on productivity is slow, and the outside threat is growing, not receding. Investment is not being efficiently allocated or tracked and will come under strain if the cycle ends.

Making the collision work: In the third section, we explore five areas where vision comes into conflict with value, and what firms are doing to unite the two – reassessing the investment portfolio, truly committing to growth plays, making the business trade-offs needed to get the benefit of technology, building delivery around better metrics, and positioning themselves to get on the front foot with investors.

“WE KNOW WE NEED TO CHANGE QUICKLY, BUT WILL THE INITIATIVES BEING PUT IN FRONT OF US GET US THERE? OR COULD THEY BE A BILLION DOLLARS OF WASTED MONEY?”

– Global bank board member

SECTION 1

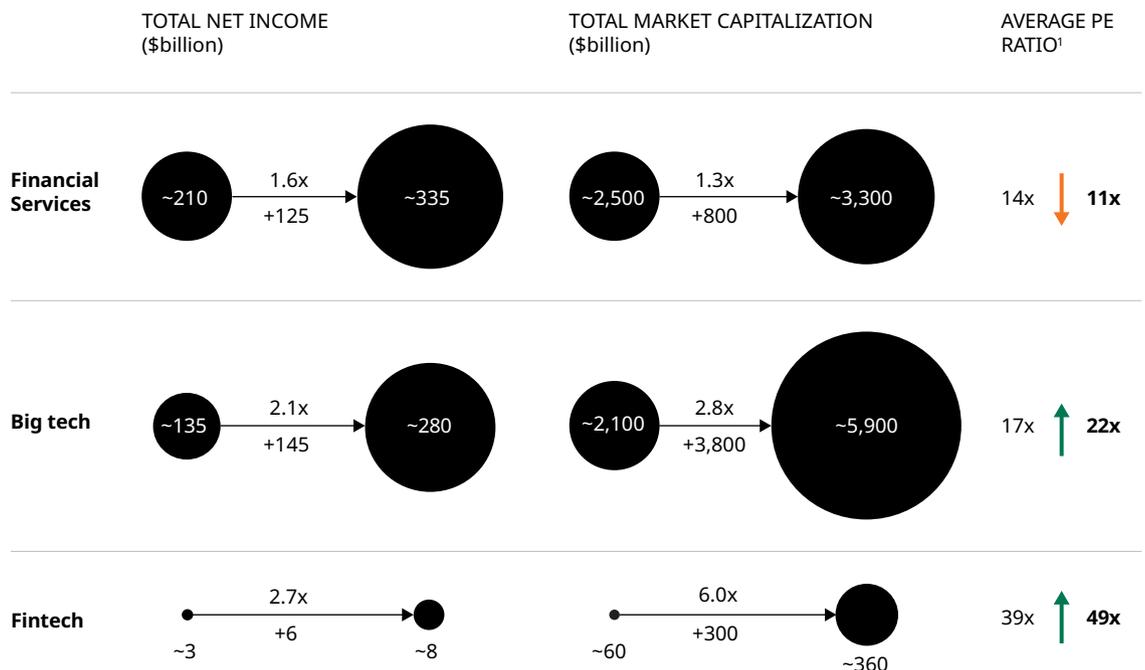
INVESTOR PRESSURE IS BUILDING

Investors are voting with their feet.

Growth in the market capitalization of the financial services industry has been eclipsed by big tech and fintech. The 20 largest financial services firms are worth \$800 billion more today than in 2010, compared with \$3.8 trillion more for the 20 largest technology companies. The top fintechs, while smaller, saw six-fold growth over the same period, compared with 30 percent for financial services.

Technology stocks may be at or approaching valuation highs and greater regulation of the sector is likely. Nevertheless the valuation change relative to financial services is dramatic. Since 2010, the big tech price-to-earnings ratio has steadily risen, with multiples now twice those of financial services. Financial services have seen the price to earnings multiple fall from 14 times to 11 times, driven by banks, with a widening gap to insurance stocks.

Exhibit 2: Financial services valuation growth eclipsed (top 20 firms)
2010 vs. 2018



1. Median price-earnings-ratio
Source: Datastream from Refinitiv, Oliver Wyman analysis

**ONLY 25 PERCENT
OF INVESTORS ARE
CONFIDENT DIGITAL
TRANSFORMATION
STRATEGIES WILL
BE EFFECTIVE.**

- Oliver Wyman and Procensus investor survey,
November 2019

We conducted a survey and a series of interviews to find out what investors think about the financial services industry, its response to digital, and current investment programs. This is what we found.

Expectations are unclear

Many financial services firms have announced ambitious, large-budget transformation programs. In practice, while absolute numbers quoted for transformation programs can be in the billions or even tens of billions, investment levels are not all always what they seem. The average transformation program being announced calls for spending of 5 percent of revenue per year. Programs can include not just transformation spending but a host of other changes that are necessary but not transformative, including IT maintenance

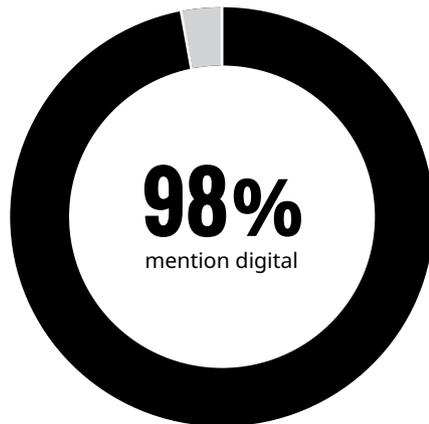
and regulatory compliance. Spending on real transformation can be far smaller, reflecting organizations engaged in incremental change, albeit across a broad front.

With no comparable datapoints, investors understandably struggle to make sense of digital transformation, technology, and investment. As one fund manager put it to us, "It is all jumbled up – IT replacement, automation, customer journeys... There seem to be some wins but it's anecdotal." Investors end up being outright skeptical, or discounting change programs and the long-term benefits of digital technology. In the first half of 2019, European banks mentioned "digital" in 98% of their external communications, compared to only 27% of analyst research reports.

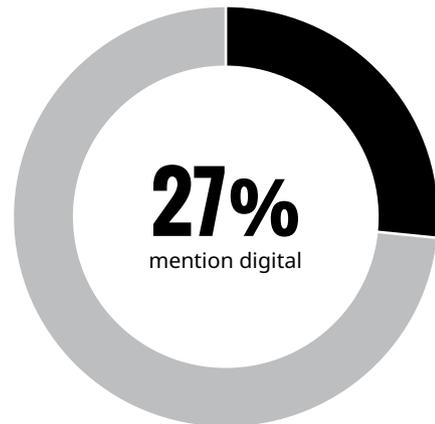
Investors believe digital is hype, or they cannot analyze the value impact and are ignoring it.

Exhibit 3: Investors focus far less on digital than the firms they analyze

BANK PUBLICATIONS



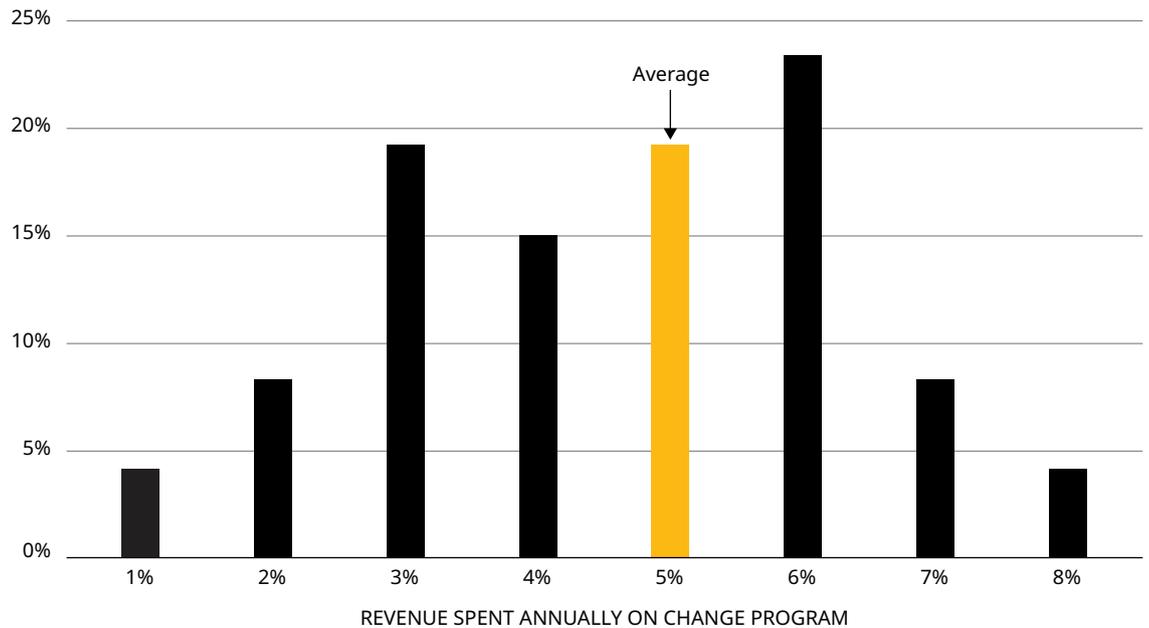
ANALYST RESEARCH REPORTS



Sources: Eikon from Refinitiv, Oliver Wyman analysis of market communications of 30 European banks: 80+ bank communications, 280+ broker reports (June 2019)

Exhibit 4: Financial services investment program spend varies widely

DISTRIBUTION OF SPEND FOR ANNOUNCED PROGRAMS



Sources: Datastream from Refinitiv, company investor presentations and press releases, Oliver Wyman analysis

Confidence in digital programs is low

Financial services firms are struggling to make the case for investment to shareholders. As one major fund manager put it, “There is very little evidence of investments improving banks’ operating profitability.” Only a quarter of investors are confident digital transformation strategies will be effective, and hardly any believe plans are well articulated.

Investors do not feel they understand what firms are investing in, or why – be that for efficiency, growth, or operational resilience. They often don’t know what transformation encompasses or what the endgame looks like, they don’t see any useful metrics on progress, and they are largely distrustful of the cost-benefit case of significant technology investments.

Financial services firms are seeing their investment initiatives heavily discounted, with skepticism on the likelihood of delivering return on investment or material business change. Patience may be running out.

Optimism exists on productivity

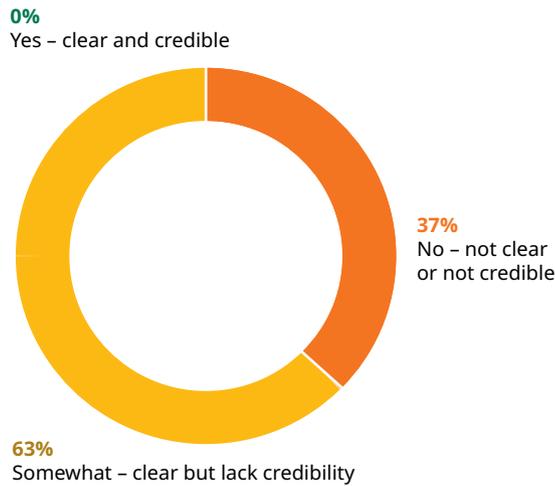
Investors might be skeptical about the likelihood of current programs delivering, but 80 percent still say transformation is critical or important in their investment appetite. There is some optimism among investors that digital does have the potential to drive earnings improvement. Nearly 60 percent of investors believe digital will impact profitability positively over the next five years. This is seen as coming through productivity: “some cost savings can be achieved, but it is not a massive revenue opportunity” is the common view.

Concerns around implementation costs and the likely transfer of most of the benefits to customers are also common themes among investors. This could drive a growing belief in scale – the largest institutions have the firepower to sustain a large portfolio, make

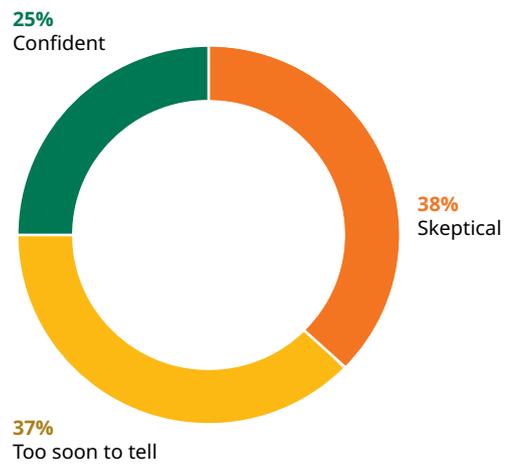
the investments required, strike global partnerships, and tap into larger datasets. Feedback from investors supports this sentiment, although there is not a discernible correlation between size and price-earnings multiples today.

Exhibit 5: Investors are unconvinced about investment plans

Do you feel that most banks have articulated clear and credible digital transformation agendas when it comes to costs, benefits, and timelines?



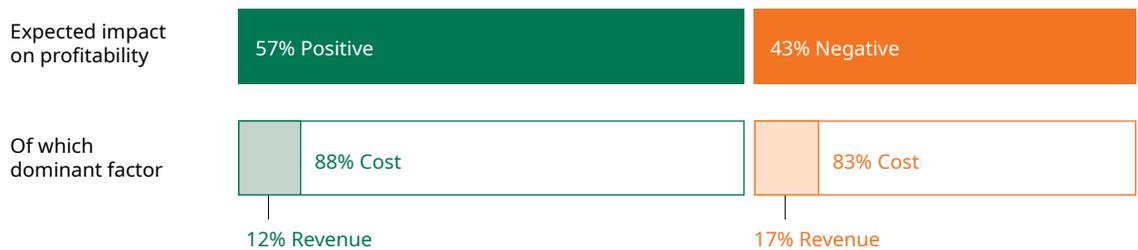
How confident are you that banks' digital transformation strategies will be effective?



Source: Oliver Wyman and Procensus investor survey, November 2019

Exhibit 6: Investors see some upside from digital, mainly through cost

EXPECTED 5-YEAR IMPACT OF DIGITAL INVESTMENTS ON TRADITIONAL BANK REVENUES AND COSTS
% survey respondents



Source: Oliver Wyman and Procensus investor survey, November 2019

SECTION 2

THE WINDOW TO DELIVER IS GRADUALLY CLOSING

Investors are right: it is becoming increasingly critical to deliver on investment. The good news is that the financial services firm of the future is emerging. The bad news is that progress has been relatively slow, the outside threat is growing, not receding, and investment budgets will come under strain as the cycle turns.

The firm of the future is emerging

For all the noise and debate of the 2010s, a broadly shared vision for the industry gradually took shape. Oliver Wyman's articulation of that has been punctuated by our *State Of The Financial Services Industry* reports in the last five years.

The industry structure is becoming more modular, with new technology making it easier for customers to buy from multiple product providers. Financial services firms are using third party suppliers to create a more flexible, lower cost operating model. The industry is shifting toward being customer-need-oriented, competing for customer attention, data, and to deliver on jobs-to-be-done. Firms are building platforms and integrating into ecosystems, aggregating demand, distributing product, or offering their capabilities to outside firms. Companies are also choosing to accelerate this process by building brand new "greenfield" propositions with significantly lower run costs.

The ambition is to leverage the inherent advantages of incumbency – brand, customer data, loyalty, know-how – with the latest technology and ways of working. Costs will be

reduced, eliminating some of the overcapacity in the industry, and the customer will come first. The emphasis will vary between an Asian asset manager or a Canadian bank or a global insurer, but the fundamentals are the same in all regions and sectors.

Breakthroughs are occurring across this agenda. Financial services companies in growth markets such as Russia, South Africa, and Singapore are succeeding in building alternative revenue streams. Product partnerships and third-party marketing to their customers have added revenue of 5 percent to more than 10 percent and growing for many players. In China, this trend is even further advanced, with the line between financial services companies and tech companies blurring.

Under significant earnings pressure, a more modular industry structure is emerging in capital markets, for instance, with outsourcing of FX market-making taking place and internal risk management platforms being opened to clients. New cloud-based services are being adopted across the value chain.

"Digital" has become better understood, broken down into its parts – new channels, customer-centric design, the use of modern technology, automation, new analytical techniques – and being gradually absorbed into business as usual.

The reality, however, is that a huge amount of work is still needed to build the financial services firms of the future.

Progress on productivity and investment is slow and hard to track

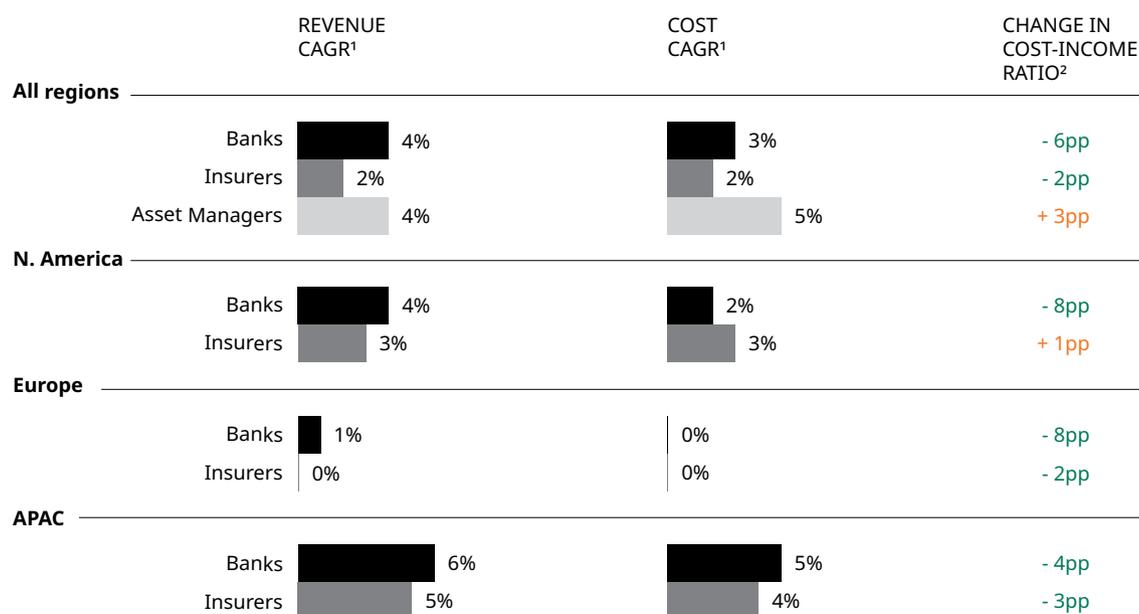
Cost take-out has been a perennial objective, with many financial firms in efficiency mode for a decade. There has been some margin improvement since 2010, with cost inflation held below revenue growth as most of the industry recovered (see exhibit 7). The largest cost savings have come from making major participation choices or capacity withdrawals. These reductions, however, have typically been offset by increased costs in other areas, notably meeting new regulatory requirements and dealing with growing risks such as cyber and anti-money-laundering. Margin improvements of a few percentage points have rarely been enough to compensate for increases in capital, with banks' average tier one capital ratios rising from 8.4 percent to 13.4 percent globally since 2006.

Greenfield players have shown what level of cost is possible. A comparison can be made in UK banking, where payment and current account costs among the major banks run

at £150 to £200 per customer. For the at-scale neobanks, operating costs are now at £30 per customer and continuing to fall. Only some of this difference is accounted for in higher service levels, product range, and branches. Neobanks may still be in build-mode and their route to profitability uncertain, but they have laid down the gauntlet on productivity.

Management teams tend to acknowledge disappointment on what has been achieved so far from innovation and investment in technology and productivity. Many innovations have improved the customer experience, but not the economics of the bank. Mobile banking has been transformative for customers but revenue is relatively unchanged. The overall cost to serve customers has generally increased, with a new set of costs layered on top of existing systems, and in many institutions constraints on generating savings from cuts to the physical network. Responsibility for delivery of innovation and cost reduction are fragmented across the institution, and the savings that should follow from investments are often not realized.

Exhibit 7: Revenue growth challenging with some margin improvement (earnings 2010-18)



1. Compound annual growth rate – change in aggregate revenues and costs of listed firms with market capitalization greater than \$5 billion (~210 institutions), constant FX rates

2. Percentage point change

Sources: Datastream from Refinitiv, Oliver Wyman analysis

**“I KNOW 50 PERCENT
OF MY DIGITAL
TRANSFORMATION
SPEND IS WASTED -
I JUST DON'T KNOW
WHICH 50 PERCENT.”**

- Global bank CFO

The vision challenge: the outside threat is growing, not receding

A three-way wrestling match is underway between financial services firms, fintechs, and technology companies.

Incumbents have gotten comfortable about copying or collaborating with fintech start-ups, treating them as participants in their innovation labs and accelerators. Scale and marketing cost challenges have limited the inroads of fintechs into core businesses. Nonetheless, the threat is death by a thousand cuts as much as disruption, with newcomers cherry-picking profitable activity and eroding margins.

With the big technology companies, there is little room for complacency. The size of these firms' customer networks and "data gravity" can pull apart entire industries.

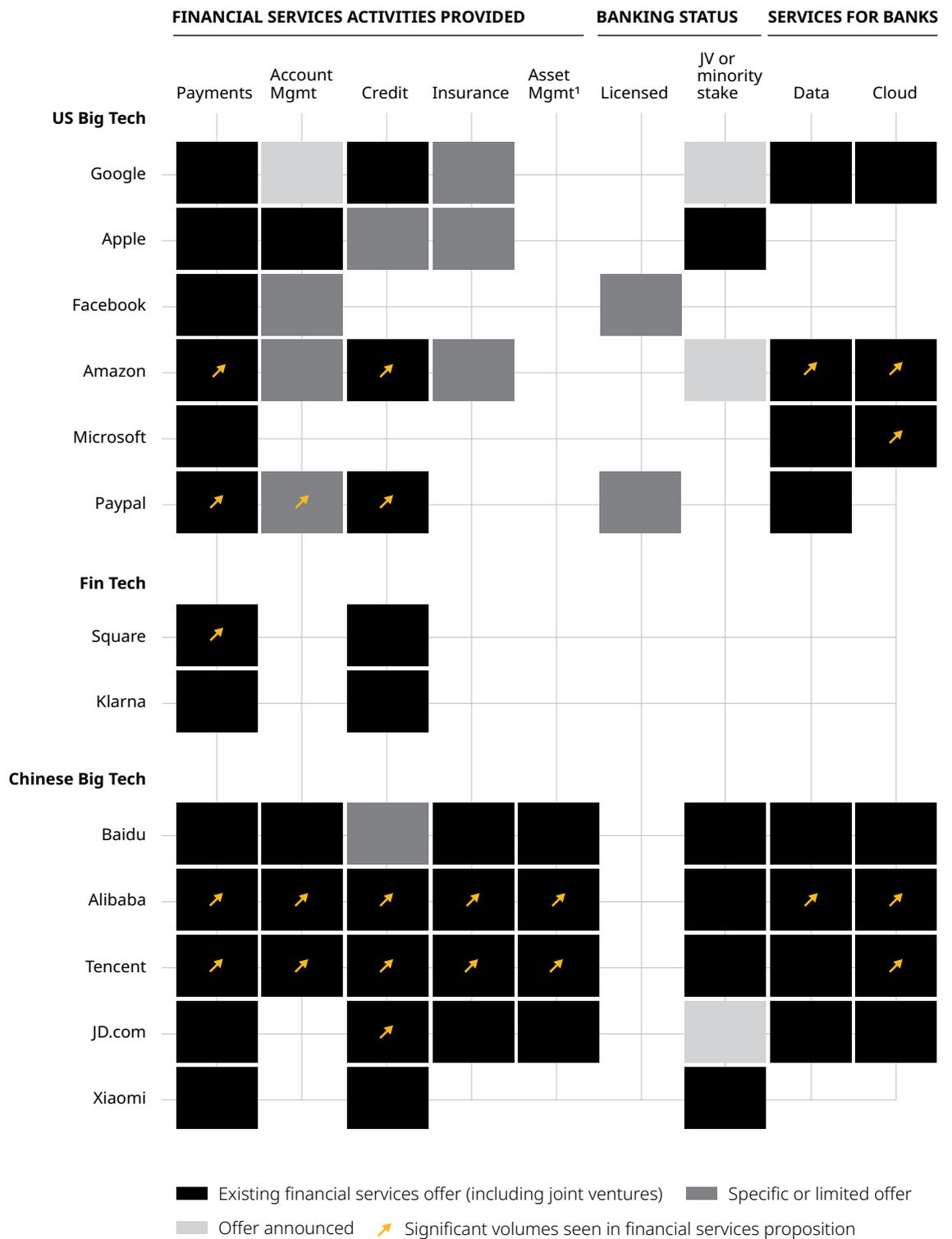
All the US technology companies are positioning themselves in financial services, and Chinese tech giants already have extensive involvement. Payments is typically the starting point, converting existing relationships into financial ones, increasing touchpoints, and obtaining additional data about customers. This is being followed by expansion into other areas, already occurring in small-to-medium-

size-enterprise financing (Amazon Lending), consumer finance (PayPal Credit), banking-like relationships (Calibra), asset management (Ant Financial has around \$250 billion of assets under management), and insurance (dominated by technology companies in China).

Financial services firms are caught between seeking partnerships and making defensive moves. Deals to act as an infrastructure, balance sheet, or distribution partner are being struck. For individual institutions the temptation is irresistible – as a major bank CFO puts it, "It took us more than a hundred years to get to 10 million customers. A deal with a big tech company could double that overnight." Amazon Card is provided by JP Morgan, Amazon Lending is partnering with Bank of America Merrill Lynch, and Goldman Sachs is the behind-the-scenes provider for the Apple Card.

Defense is also required, to avoid becoming a "dumb utility." This could require significant spending and shared industry approaches in areas like payments or digital ID. For instance, iDeal in the Netherlands, Swish in Sweden, and Zelle in the United States have all been set up by bank consortia and have gained substantial market share.

Exhibit 8: Emerging presence of big tech in financial services (November 2019)



1. Includes fund distribution businesses

Sources: Company websites, press and research articles, Oliver Wyman analysis

The value challenge: a threat to investment funding as the cycle turns

The cycle remains critical. Where revenue growth has been challenged, for instance in European banking, the shift of revenue within the industry to new fintech and big tech players has played a part, but so far has been secondary to macro and regulatory factors (see Exhibit 9).

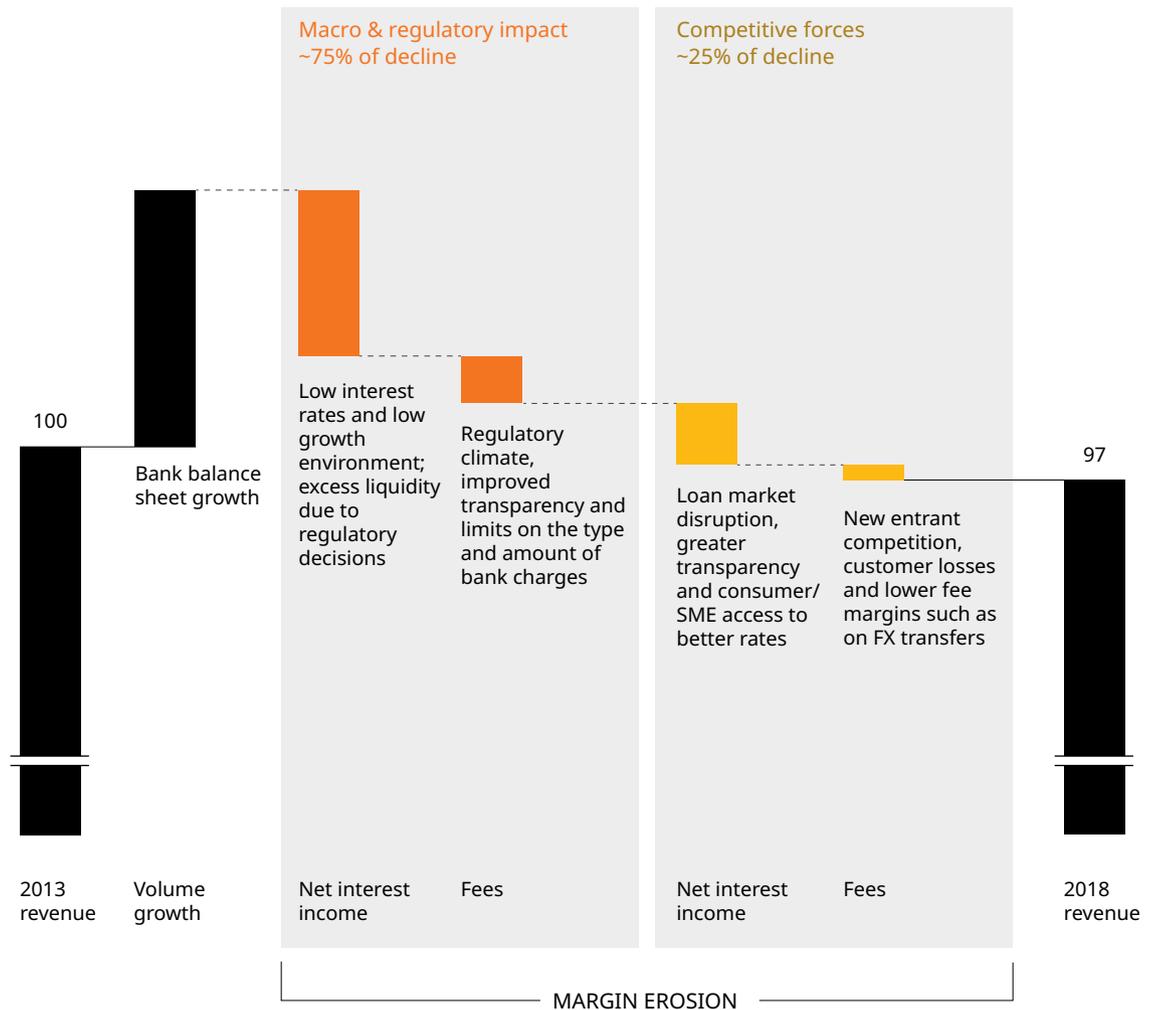
The industry is now facing difficult conditions – and no one is sure just how difficult. With all-time-high valuations of both debt and

equity instruments, a soft landing might not be possible.

In mature markets, low interest rates have already delivered cyclical revenue declines that are worse than any digital disruption. Any further downturn could have a severe impact on investment budgets. The major recessions and financial crises of the past 30 years have coincided with single-year losses for banks of up to -50 percent of revenue, far eclipsing the average of 5 percent spent on transformation programs (see Exhibit 10).

Exhibit 9: Growth erosion driven more by macro conditions than disruption

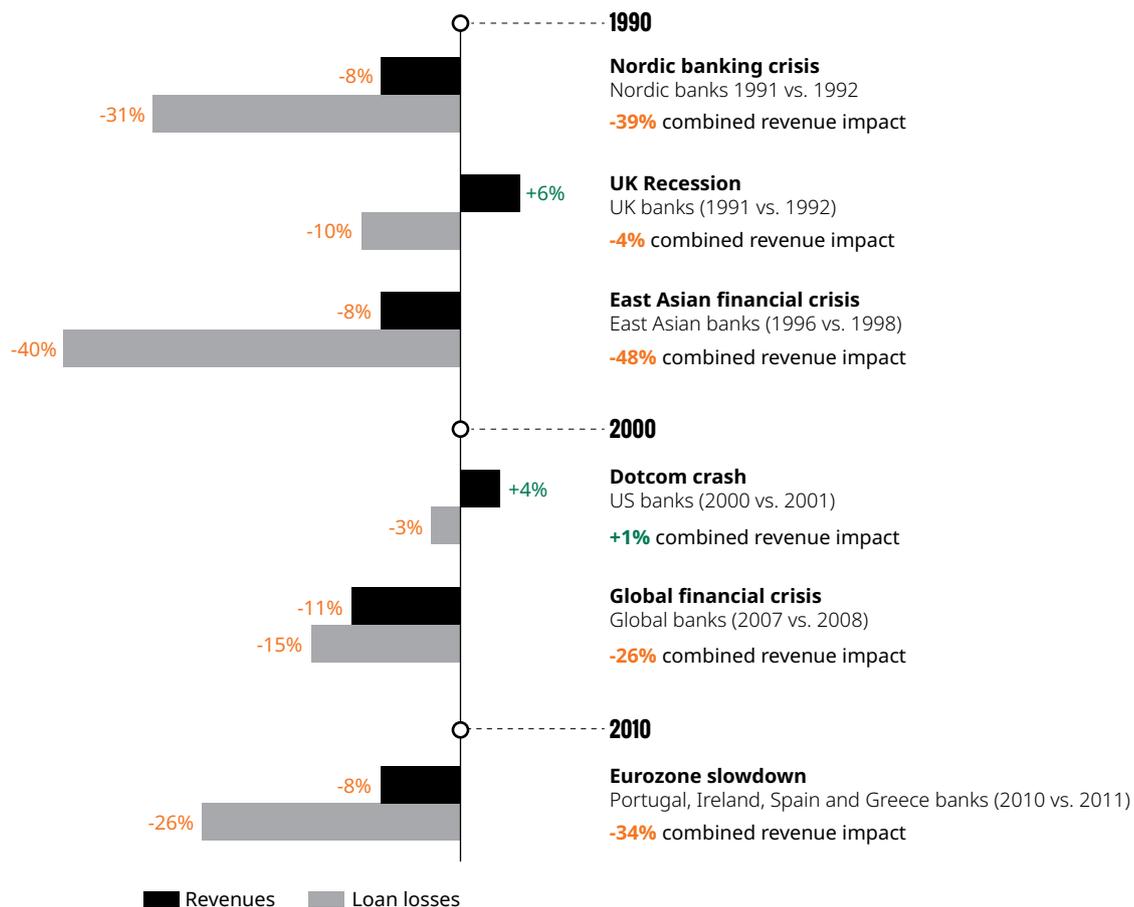
Germany, France, UK, Spain and Italy, indexed to 100 (2013 = 100), 2013-18



Source: Oliver Wyman analysis

Exhibit 10: Banking economics during downturns

YEAR-ON-YEAR CHANGE IN REVENUES AND LOAN LOSS PROVISIONS
(% revenue, sample of impacted banks)



Note: Local currency impacts. Loan loss impact is the change in loan loss provisions divided by prior year revenue; East Asia excludes Peoples' Republic of China and Indonesia

Sources: Datastream from Refinitiv, Oliver Wyman analysis

Starting point matters

The market in which a firm operates drives much of the vision and value agendas. Investors in European and Japanese banks, European insurers, and squeezed regional US banks are looking at the current return outlook and focusing on value. They need to know there is an immediate plan to improve financial performance, by reducing costs or reallocating balance sheet.

However, they also need to know there is a viable path to long-term earnings growth.

For larger US, Australian, or Canadian banks, as well as asset managers, investors have given more runway for investment to drive growth before asserting the value mindset.

The starting point of the institution within its market also matters. Investors want firms to prioritize core business improvement when the institution still has legacy technology issues, a complex and costly operating model, and overcapacity. It is not credible to articulate a major innovation agenda when the institution has no proven track record for fixing the core.

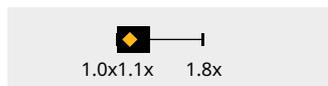
Exhibit 11: The vision and value agendas

BANKING

INDUSTRY

US globals
(e.g., JPM, GS, MS, Citi, BoA)

PRICE/BOOK VALUE (RANGE)



INDUSTRY DYNAMICS

Recent focus on revenue growth with new business launches. Efforts switching to cost cutting, getting value out of (extensive) technology investments, closing any obvious gaps in market share

Europe/Asia globals
(e.g., HSBC, Barclays, UBS)



Repositioned post-crisis with exits from business lines, intense pressure from low interest rates. Repeated waves of cost cutting, looking to find capacity to invest in technology modernization

N. America & Australia
(e.g., Wells Fargo, RBC, NAB)



Strong post-crisis performance, now facing emerging growth challenges and legacy conduct issues

Europe
(e.g., BBVA, ING, Santander)



Extremely challenging revenue environment; most focused on cost reduction and financial resource optimization to drive higher RoE

Japan
(e.g., SMFG, MUFG)



Growth and profitability lagging with a weak macro environment, with banks focusing on growing fee income, scrutinizing balance sheet commitments, and cutting costs

China
(e.g., ICBC, CCB)



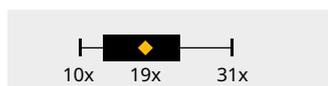
Balance sheet growth overshadowed by persistent concerns over credit risk, shadow banking, US-China trade disputes – need to compete with technology firms building strong ecosystems including financial services

INSURANCE, ASSET MANAGEMENT, MARKET INFRASTRUCTURE

INDUSTRY

N. American Property & Casualty
(e.g., Allstate, Travelers, Progressive)

PRICE/LAST 12 MONTHS EARNINGS (RANGE)



INDUSTRY DYNAMICS

Macro forces, insufficient reserves amid higher claims, and plaintiff-friendly litigation environment are overhanging valuations. A long-awaited increase in premium rates may prove a positive counterbalance

US Life & Health
(e.g., Prudential, Great-West Life)



Capital returned to shareholders with returns disappointing, focus of large players on cost/efficiency, however attention also turning to growth engines with big opportunity to serve unmet consumer needs for certainty and protection, financial wellness

European composite insurers
(e.g., AXA, Aviva, Munich Re, Generali)



Low interest rates, regulatory uncertainty and the soft cycle have impacted returns and restricted investment. Approaches to technology remain mostly incremental, with some larger innovation efforts being scaled back

Asian regionals
(e.g., China Life, Ping An)



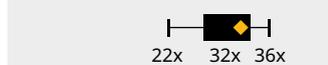
Positive earnings outlook with increasing insurance penetration and maturing regulatory frameworks. Chinese investing heavily, highly customer centric, with insurance part of a broader offering. SE Asia scaling up relatively simple product offerings

Asset management
(e.g., Blackrock, KKR, Schroders)



Persistent structural pressure impacting returns and risk of a major asset price correction. Focus on sharpening propositions, re-engineering cost bases, legacy technology investment

Market infrastructure & data
(e.g., CME, ICE, S&P Global)



Strong growth with a supportive regulatory and macro environment, expansion into new business lines, data solutions. Focus on growth with acquisitions, innovation efforts around product enhancement, client experience

◆ Median ■ 1st-3rd quartile —|— Min-max

Note: As of 17 December 2019

Sources: Datastream from Refinitiv, company announcements, investment analyst reports, Oliver Wyman analysis

Consolidation as an outcome

There has been little consolidation in most subsegments of financial services for a decade. Regulators have poured cold water on creating larger financial institutions through their supervisory stance and through the capital costs of climbing the G-SIFI buckets. Firms themselves have been reluctant to chase the promise of revenue or cost synergies given it would require overcoming yet more complexity.

As firms look to the longer term, the ability to deliver value while finding the capacity to invest is likely to become a strong motive for consolidation. The tone from regulators has changed – where the concern used to be “too big to fail” increasingly it is “too small to survive.”

The subsegments where consolidation (as opposed to bolt-on or even mid-sized acquisitions) is most likely are the same where the vision and value collision is most dramatic. Continental European banking, the middle tier in US banking, and asset management are all strong candidates. The consolidation thesis will include more investment firepower, but will also be supported by more modular technology and the potential for more efficient consolidation. One example would be combining firms in asset management and rolling both onto the Aladdin platform, rather than creating a larger mess of different proprietary legacy systems.

As consolidation increases, the new digital challengers and fintech players are likely to be involved. Many of these players have not been through a full economic cycle yet. Some are pivoting from transaction solutions, such as payments and credit services, and this will inevitably result in a shakeout if credit conditions deteriorate.

SECTION 3

MAKING THE COLLISION WORK

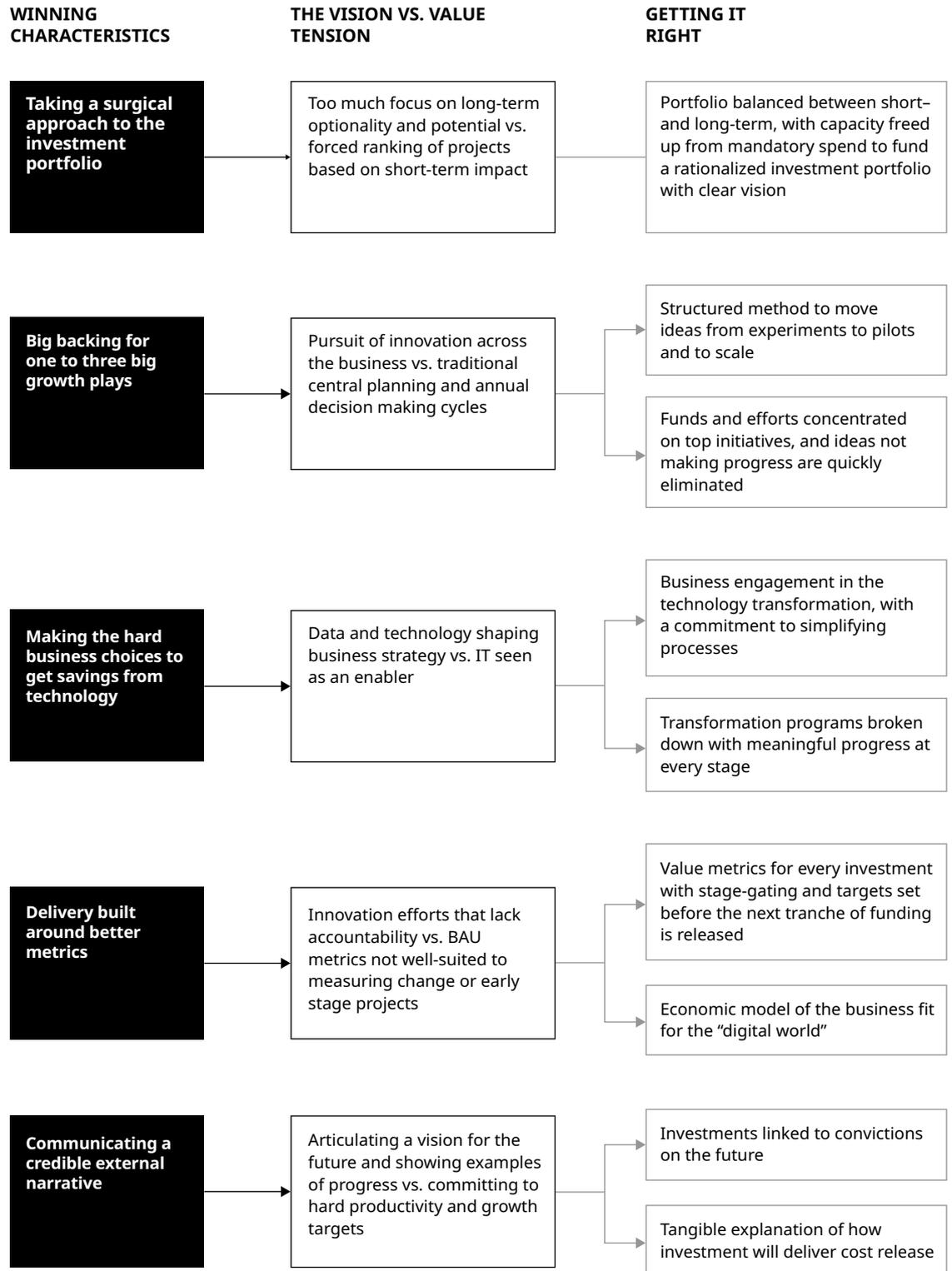
The collision between vision and value can be badly handled or avoided altogether, leaving organizations to swing between undisciplined over-investment and focusing on incremental changes – and putting their long-term competitive position at risk.

Getting the balance right takes an open-minded approach and the surfacing of difficult choices.

We see five characteristics that will set the winners apart: a surgical approach to the investment portfolio, a smaller number of bigger growth plays, a willingness to make the business trade-offs needed to get the benefit of technology, delivery built around better metrics, and getting on the front foot with investors.

Each of these requires difficult choices to be taken – trade-offs between vision and value – that we explore in this section.

Exhibit 12: Where vision and value collide



Source: Oliver Wyman analysis

01

Winning Characteristic

TAKING A SURGICAL APPROACH TO THE INVESTMENT PORTFOLIO

The challenge

Firms struggle to get meaningful investment to their strategic priorities. The high-level strategy – to be customer-focused, data-centric, agile, innovative – eventually must be left to product-line heads and function leaders to interpret. Projects get designed and proposed bottom-up, and the resulting portfolio can lack focus.

Programs often have low transparency, with information asymmetry on status and impact. A high level of interconnectedness reduces the ability to challenge individual components.

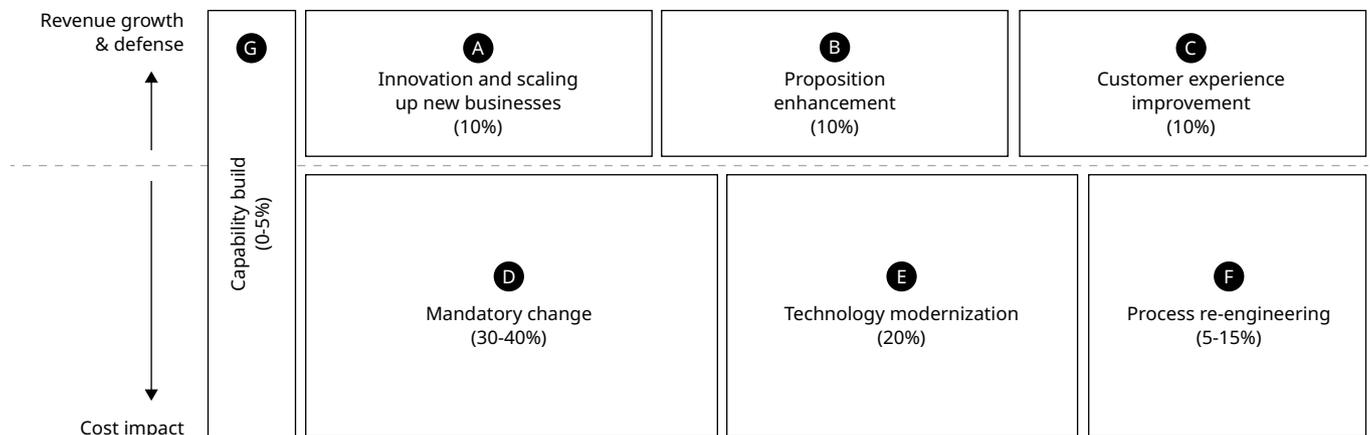
What we see working

Light-touch management of digital initiatives is coming to an end and a more disciplined, interventionist approach is emerging. Leaders are disentangling their portfolios and building a common fact base on the objectives and status of each project component. That is sparking robust discussion of each part of the portfolio, examining both short-term value and long-term impact on competitive advantage.

The result for businesses that over-indexed on the vision mindset is a rationalizing of portfolios, as it becomes clearer that some initiatives are merely creating marketing buzz. Institutions previously focused on survival are seeking to free up capacity from regulatory reform and other “mandatory” initiatives to commit to selective growth and productivity investments.

Exhibit 13: A surgical approach to the change portfolio

AVERAGE PORTFOLIO BREAKDOWN OF AN OBSERVED SET OF FINANCIAL INSTITUTIONS



- A. Embed a disciplined approach to innovation that scales up successful ideas and halts others quickly
- B. Avoid proliferation of systems and process complexity from new products
- C. Avoid me-too innovation and apply skepticism to business defense arguments (where cost can exceed the value of lost business)
- D. Don't overload the regulatory program unnecessarily – be disciplined about delivering requirements, not “nice-to-haves”
- E. Avoid big-bang re-platforming, insist on value release throughout the journey, embrace modularity
- F. Redesign processes end-to-end, not piecemeal, so systems can be decommissioned and headcount released
- G. Ensure ownership of capability building is captured within other initiatives – otherwise they are likely to be unaffordable in today's environment

Source: Oliver Wyman analysis

02

Winning
Characteristic

BIG BACKING FOR ONE TO THREE BIG GROWTH PLAYS

The challenge

Only a handful of new businesses achieve escape velocity and, today, most financial services firms are not disciplined enough in innovation or bold enough in scaling up their promising growth opportunities.

Many financial services firms have invested in incubation and accelerator platforms, in some cases spending more than \$100 million annually. Nonetheless, few of the big new businesses to emerge in financial services over the last cycle were built by incumbent firms. In a study of roughly 15,000 financial services business launches, we identified 80 breakout successes that reached valuations of more than \$1 billion. Major financial services companies invested in only a quarter of these before the unicorn stage and built only two.

What we see working

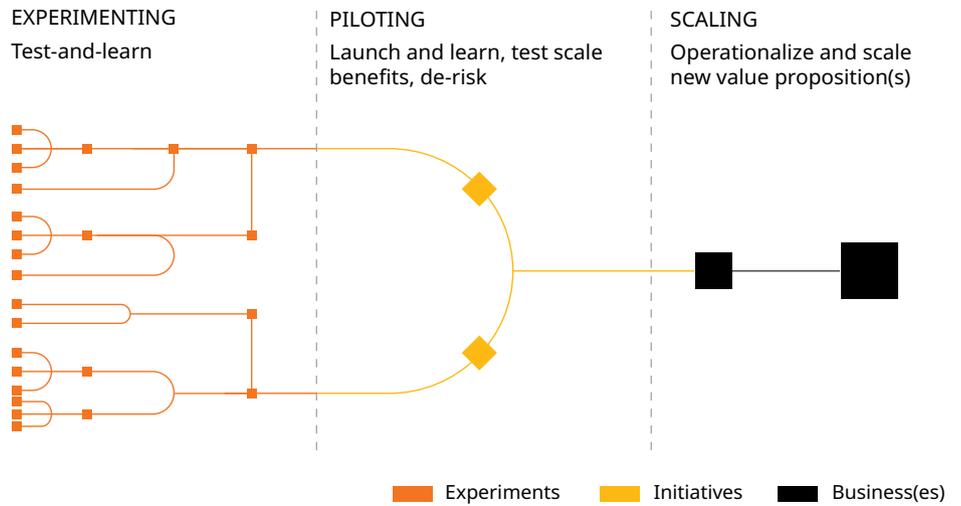
Leaders are setting the bar high. A big growth play means establishing a target of reaching 10 percent of total firm revenue within five years. The ability to make true “big bets” requires a structured development process, with different management disciplines at each stage, rigorous gating, and rapid review cycles (see Exhibit 14).

A small number of firms are leading the market in making growth plays. A successful approach has some common characteristics:

- **Structured development process:** There are different management disciplines at each stage, rigorous gating, and rapid review cycles
- **Learn fast:** The goal is not to “fail fast” but to experiment rapidly, unearth and test growth opportunities. Initiatives that are not achieving expectations are course-corrected, or retired, and the learnings and teams folded into other projects
- **Sound evidence base:** Before scaling up, data around customer demand, competitive landscape, and value generation potential are in place
- **Plays that have optionality:** Priority is placed on investments that can move down different paths. Business cases are supported by both value aspects (such as new sources of deposit funding), and vision aspects (such as building a new customer base)
- **Significant resources ringfenced and deployed:** Priority opportunities receive the concentrated funding, CEO-level commitment, and business-building apparatus needed, often running outside of the business-as-usual line management

The winners end up with a smaller number of bigger bets, with the leadership focus, investment, and perseverance to succeed.

Exhibit 14: Bridging the mindset gap with disciplined innovation



Vision imperatives

Ensure clear success criteria

Course-correct projects quickly against expected OKRs (objectives and key results), or retire and re-allocate investment

Establish customer pull by co-creating with customers early and often, based on the "jobs to be done" approach

Move toward value accretion rapidly

Obtain CEO backing

Focus on one major proposition at a time, to provide enough bandwidth and expertise in scaling up businesses

Value imperatives

Course-correct against strategic imperatives

Clarify the beachhead, i.e. how to get into the market, and the size of the prize

Refine go-to-market, including operations, organization, culture, and talent

Optimize across the new and existing businesses: avoid slowing growth but capture the broader benefits

Connect growth of new initiatives with external shareholder narrative to deliver a growth premium on the core business

Source: Oliver Wyman analysis

03

Winning
Characteristic

HARD BUSINESS CHOICES TO GET THE SAVINGS FROM TECHNOLOGY

The challenge

The next generation of technology is maturing – cloud-based infrastructure and microservice-based solutions are increasingly available and well-tested, with tools available to smooth migration. Firms are struggling, however, to use this new technology to streamline processes, improve data flows, and make the transition.

When efforts have focused on digitizing existing processes, the results have underwhelmed. Large-scale technology transformation programs commonly fail to deliver on time or on budget. Automation programs have led to piecemeal savings and often a more complex systems architecture. Costly new capabilities, such as enterprise data lakes, are having a limited impact. The combination of legacy technology estates, capabilities, methods and tools has contributed to slow and unpredictable progress, with firms struggling to shift to new technology.

Fearful of the complexity and risks of systems replatforming, many insurers and banks persevere with outmoded, costly legacy IT. The vision mindset sees this is a dead-end, burdening the business with high technology and operations costs, resilience risks, and a lack of agility to pursue new services.

While technology's role in financial services has been deepening for at least 30 years, IT in many firms has been treated as an enabler, a cost of doing business, or the function to battle with to get preferred projects prioritized.

What we see working

Firms that are capturing the full benefit of technology are beginning with the business itself. Leaders in this area are willing to make painful trade-offs and simplify processes and services, making upfront decisions whether to migrate, transfer, or exit each service aspect. Rather than recreating the existing customer services, propositions, or products, they imagine what the end-state could be if it were truly different and better. A platform can then be built that retains complexity where it is valuable in the business and is streamlined elsewhere.

Where we see excellence in delivery and the business working with technology side-by-side, it has not been achieved overnight. Issues around culture, talent, and capability have had to be addressed and the hollowing-out of technology functions reversed. Delivery is seen as a core skill, not a commodity. The senior team are builders, not just controllers managing risk and subcontractors.

Business ownership and leadership time is dedicated to all big technology projects, helping the teams to make difficult execution choices. A “just-do-it” mentality is communicated from the top – with less red tape, straightforward messages about what teams should deliver, and a relentless focus on execution. Teams feel like they are part of an enterprise-wide effort with shared deadlines. The basics are done right every time, with continual improvement as teams build their experience with new technologies and transition away from legacy platforms.

04

Winning Characteristic

DELIVERY BUILT AROUND BETTER METRICS

The challenge

The tools used to measure the return on investment of change programs are often fragmented, missing, or obsolete. Management teams get left with inconsistent metrics which cannot be aggregated or shared with investors. As a bank CFO put it, "I feel old-fashioned when I ask why we haven't seen any return from digital investments yet."

Vision-type metrics typically focus on intermediate measures, such as customer acquisition and retention, channel usage, and the quality of technology delivery. These are necessary but insufficient, creating little sense for the progress toward the bottom line.

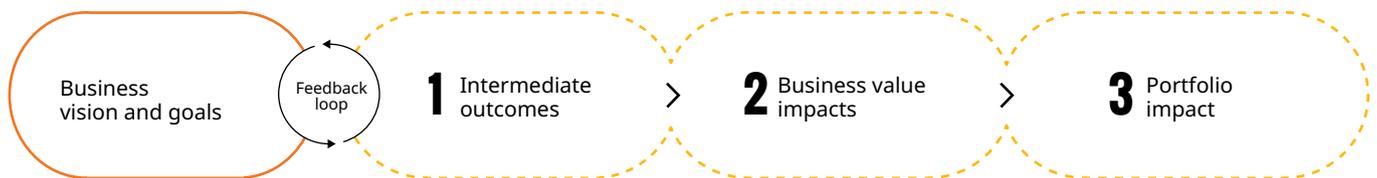
Value-type metrics focus on business cases, but often have an illusion of precision. Dependencies between initiatives are difficult to break apart and the responsibility for making the cost savings targeted often sit outside of project teams. This leads all too frequently to a new set of costs layered on top of existing systems and processes.

What we see working

Firms are making progress and while few would claim to have cracked this fully, a fit-for-purpose approach is emerging:

- Value metrics for every initiative: Intermediate targets such as adoption, delivery, and capabilities developed are used to track progress, but an end outcome anchored in cost, revenue, or efficiency is put in place for all projects. Accountability for savings built into many business cases is present even if they are delivered outside the project

Exhibit 15: Measuring impact in the investment portfolio



MEASURING IMPACT IN THE INVESTMENT PORTFOLIO

What needs to be tracked

Delivery progress, adoption, volumes, changes in customer and internal behavior

Revenue and cost outcomes, return on investment of individual initiatives

Overall value creation without double counting

Measurement capabilities required

Deep insight into customer behaviors and flows

Granular transparency on cost and drivers

Consistent metrics and understanding of dependencies, overlaps

Source: Oliver Wyman analysis

- An economic model of the business fit for the digital world: Transparency on costs and the cost drivers of each customer process, how these differs by channel, and how the cost base would respond (or not) to changes in volume is created
- Insistence on stage-gating: Specific outcomes required before the next tranche of funding. Funding to multi-year programs is not committed unconditionally, forcing monolithic initiatives to be broken down into more modular components
- Mapping and management of interdependencies: Projects are grouped to prevent double counting of benefits and ensure accountability is clear
- Real-time transparency around progress: The latest tools and objectives and key results (OKR) provide accurate views of trajectory and outcomes, not just RAG reporting by project managers
- Selection of balanced overall metrics: The top-level view of progress and success includes business value delivered and some critical intermediate measures. A very small number of targets that will deliver most business value are rolled out internally and externally

05

Winning Characteristic

COMMUNICATING A CREDIBLE EXTERNAL NARRATIVE

The challenge

Given the substantial investments needed to build the business of the future, and the long-term nature of many of the projects, the support of major investors will be crucial.

Firms need to find the right balance when it comes to shareholder communication and investment programs: between committing to detailed long-term plans vs. maintaining optionality in an uncertain world, sharing specific targets vs. the risk to the share price of not delivering, and demonstrating investment for the future vs. delivering as much cash as possible today.

Value-oriented metrics are far easier to absorb and feed directly into projection models in a time frame that gives modeling confidence. Vision depends more on a supporting narrative – “why do we need to build this” – to gain buy-in from investors.

What we see working

The firms that have been successful in communicating around digital and technology investment are focused on returns, have a plan that delivers upside along the way, and can evidence execution. They are providing investors with confidence that the management teams understand the future landscape, how the business can be more profitable in that landscape, and that the firm has the tools and data to manage the investment program rigorously.

Exhibit 16: Telling the vision and value narrative

OUR RECOMMENDATIONS

WHAT WE HAVE HEARD FROM INVESTORS

Stop the smoke and mirrors	"It's all jumbled up – IT replacement, automation, customer journeys"
Communicate convictions on the future industry landscape, openly link priorities and the breakdown of investment to these	"It's about setting the path and communicating where you are going" "It is not clear at the outset of initiatives what the banks are trying to do"
Be clear on the big growth initiative	"Digitization is a major competitive threat... Those taking it most seriously will likely capture significant market share."
Show the groundwork and evidence providing the confidence to scale up growth bets, avoid one-off announcements never revisited	"Banks shouldn't be innovating in all directions. They need a clear image of where they want to put their money, with a clear direction"
Be concrete about the what and the how	"I am yet to see a five-year plan that shows how cost will come out"
Avoid hype and buzzwords on future technology, tangibly explain the way investment will deliver productivity improvements and cost release	"Buzzwords are insufficient – it isn't enough to say "modular, agile, API" etc." "We recognize digital as a strategic imperative, but will value it at zero without clear evidence of the shareholder value created"
Quantify progress	"Banks should be able to connect the investment to returns"
Show success through the journey, breaking down milestones, share the key metrics being used internally to track progress	"What investors need are more numbers – it is hard to find even anecdotes on what the benefits are and what costs are coming out" "On IT we can't measure it... I have no idea who is doing a good job or not. It is extraordinarily difficult to see what they are doing"
Build credibility that you can deliver	"Transformation plans generally continue to disappoint"
Simplify and deliver value in stages	"Shareholders have a deep cynicism on digital that needs to be won around" "Prove that you can invest without destroying value, to transform the plane whilst flying"

Source: Oliver Wyman interviews and analysis

CLOSING REMARKS

Vision and value are colliding in financial services. Many firms will get the balance wrong. Some may chase too many new opportunities and change initiatives without laying the foundations for success. Some may grind to a halt, choking off investment and change to preserve earnings now at the cost of future market positioning. In either case those firms will fail to capitalize on the opportunities available as the industry continues to evolve at a rapid pace.

Managing the collision does not mean picking sides between vision and value. It means bringing the two mindsets together to agree on the change portfolio, growth plays, productivity objectives, and metrics used. It means communicating a clear narrative and consistent, authentic messages internally and externally.

Embrace the creative tension – it will lead to balance, reinvention, and growth.

LEAD AUTHOR

Chris Allchin

CONTRIBUTING AUTHORS

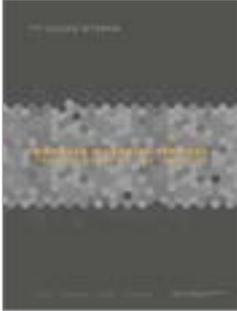
Anthony Bice, Rick Chavez, Dan Cole, Javier Garcia, Mike Harding, Dov Haselkorn, Claudio Lago de Lanzos, Ted Moynihan, Lindsey Naylor, Deborah O'Neill, Chris Rigby, Dan Rosenbaum, Johaan Wiggins, Barrie Wilkinson

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BUILDING THE INDUSTRY OF THE FUTURE

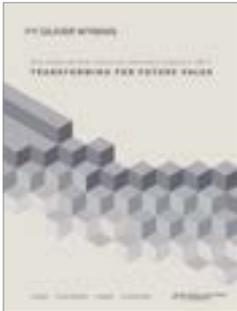
During the 2010s, a broadly shared vision for the industry took shape. Oliver Wyman's articulation of that has been punctuated by our *State of The Financial Services Industry* reports in the last four years, all of which are available on oliverwyman.com



INDUSTRY STRUCTURE (2016)

A more modular, variable and efficient industry

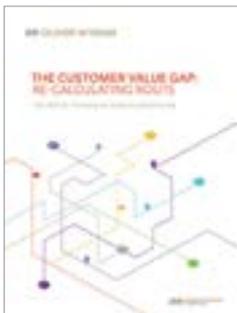
Breaking out what were once one-stop-shops and using advantaged third parties to create a more flexible and lower cost-base



BUSINESS MODELS (2017)

Ecosystem participation

Integrating into ecosystems in different ways depending on strength – aggregating customer demand, providing core industry platforms, or “plugging in” to ecosystems with specific offerings



NEW CUSTOMER VALUE PROPOSITIONS (2018)

Customer first

Shifting toward customer-need-oriented proposition design to compete for customer attention and loyalty, powered by data and algorithms that ensure that the experience and products are what the customer wants, when they want, as they want



DELIVERING CHANGE QUICKLY (2019)

Starting again with a greenfield approach

Given the ability to quickly incubate and build new businesses with dramatically lower operating costs, using greenfield techniques to build digital-first offerings and in time transition existing products to a new, low-cost platform

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For more information, please contact the marketing department by phone at one of the following locations:

EMEA
+44 20 7333 8333

Americas
+1 212 541 8100

Asia Pacific
+65 6510 9700

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