Why Banks Must Become Smart Aggregators in the Financial Services Digital Ecosystem

Amid accelerating digital disruption wrought by fintechs and other nonbanking rivals, financial institutions must embrace a partnership-driven and collaborative approach to remain relevant today, while evolving their capabilities to anticipate and deliver against tomorrow’s market needs.
Executive Summary

Like musicians in a finely tuned ensemble, banks can use smart aggregation to develop a stand-out banking experience that meets and exceeds digital consumers’ expectations. Smart aggregation will allow banks to expand their capabilities by engaging with the highest value partners and accessing the greatest technical capabilities.

By employing a smart aggregation strategy, banks can address three pervasive digital trends that pose an existential threat to their future ability to compete:

- **An ever-shifting consumer base, particularly millennials.** At an estimated population of more than 75 million in the U.S.,¹ and two billion plus globally,² millennials are becoming the largest revenue-driving demographic segment for banks over the next half century. These digital natives favor accessibility, convenience and speed over trusted banking relationships.

- **The onslaught of fintechs and nontraditional financial services providers.** These organizations are focused on addressing the shifting demands of digitally-native consumers. They are adept at applying rapidly advancing digital technologies and benefit from a relaxed regulatory framework. Fintechs and nonbank institutions raised $19 billion in capital between 2015 and 2016, with 90% of the funding aimed at the highly-profitable banking segments of payments, peer-to-peer and consumer lending and wealth management.³

- **New consumer-oriented regulations.** Regulatory shifts are compelling traditional banks to digitize quickly. Governments and regulatory bodies alike are focusing on enhanced pricing transparency and open banking standards across the globe. For example, the European Union-led Revised Payment Services Directive (PSD2)⁴ and similar transparency-driven frameworks require banks to reduce barriers to entry and make data accessible to third parties through secure application programming interfaces (APIs).

Collectively, these factors threaten to strip banks of over $660 billion⁵ in profits over the next half decade. This should be reason enough for them to embrace a smart aggregation strategy in order to accelerate the time to market for new products and services, extend their capabilities and market reach, and simultaneously reduce costs to develop new offers and renovate existing ones.

Very few banks have fully explored the possibilities and opportunities that smart aggregation offers. One concern is that this approach could enable competitors to encroach upon coveted customer relationships and substantially erode margins across services. Other concerns focus on security, privacy and uncertainty over how to monetize and derive value from externalizing data assets.
The tide is slowly changing, however, and we’re seeing a gradual mindset shift within the industry toward smart aggregation. Slow-moving incumbents are moving to the epicenter of digitization by partnering with new, nonbanking entrants to leverage and provision capabilities and data, and take their place in the rapidly expanding open banking ecosystem.

Banks should consider the following guidelines when developing their smart aggregation strategies:

- **Actively pursue and foster respectful relationships with fintechs and nonbanks.** Such partnerships should leverage both parties’ capabilities and create a mutually beneficial digital banking ecosystem. However, banks must also be sure to carve out their own value-add to retain control over the customer relationship.

- **Provide a reliable, trustworthy, plug-and-play platform that enables partners to co-build/innovate and deliver consumable services.** The construct is akin to Android or iOS operating systems, which are crucial to device usage but do not provide or cater to every app or service to fulfill user needs.

- **Evaluate where their true value lies and determine how to re-channel and divide their efforts.** One approach is to increase emphasis on “slow-money” functions (involving long-horizon assets), as “fast-money” (transactional products and services) increasingly become commoditized. Doing so might entail restructuring the business to enhance the slow-money focus on customer relationships, as well as partnering with the broader ecosystem for fast-money offerings to meet the digital consumer’s convenience needs.

- **Own the customer experience and journey by remaining at the forefront of the trust quotient.** Banks can do this by communicating more effectively and consistently through touchpoints. They should also engage the ecosystem through their own infrastructure and/or act as a front-end player to provide support for the aggregated capabilities in the ecosystem.

- **Contend with profitability and insurgent banking challenges while charting their trajectory toward a future state.** Banks need to develop a holistic strategy (covering the customer, channel, product and operating strategies) that can help advance their partner ecosystem, determine the means to monetize and deliver upon new millennial demands.

This white paper defines how banks can compete as smart aggregators, including our guiding principles and collaborative framework for transforming into a bank of the future. Building on our earlier work “How Banking as a Service Will Keep Banks Digitally Relevant and Growing,” we offer banking leaders insights for the digital journey, using a well-defined, comprehensive product innovation lifecycle, from innovation need and design/development, through building a go-to-market digital roadmap.
A look at the key trends

**Coming of age of millennials**

While the baby boomer generation values a relationship-centric experience that hinges on trust and personalization, younger generations are more interested in unlimited accessibility, convenience and speed. This shift in consumer expectations is challenging banks to provision services similarly to how digitally native businesses do, such as the FANG companies (Facebook, Amazon, Netflix and Google).

In a three-year study of over 10,000 millennials, 73% of respondents said they were more excited about new financial service offerings from nonbank entrants such as Google, Apple, Facebook or Amazon than from their own nationwide banks. Meanwhile, nearly half are counting on fintechs to overhaul the way banks work. These findings reveal millennials’ predilection for the latest digital tools and techniques to deliver the experience they expect.

The question for banks is not whether they should aggregate services but which services they should intelligently aggregate.

**Rise of fintechs**

Digital technologies are leveling the playing field and considerably reducing the traditionally high barriers to entry into the banking industry. From rampant growth in smartphone ownership, to a tripled investment

**The fintech factor**

![Figure 1](image-url)
Quick Take

Future of banking through an e-tailing lens

Look no further than the retail space to understand the potential impact of nonbanks entering traditional banking. North American e-commerce sales reached $423 billion in 2016, led by three Internet technology players: Amazon, Apple and Google.

Both Apple and Google have launched digital payment services – Apple Pay and Google Wallet – to spearhead their entry into e-commerce, which is not dissimilar to how many fintechs are approaching banking.

Amazon, on the other hand, has leapfrogged the payments value proposition. Since 2012, the online retail giant has provided short-term loans to Amazon resellers through Amazon Capital Services. These loans are offered at around 14% interest and range from $1,000 to $800,000. Approvals can be conducted in as little as 24 hours, using the Amazon sales history of the loan requestor and a customized algorithm.

Approximately $78 billion has been invested in the fintech market since 2000, empowering these companies to grab a significant share of the total banking pie ($660 billion is at risk, according to Goldman Sachs). In particular, the majority of fintech attention has been laser-focused on the payments and lending segments of the value chain. Lending is of particular concern, as it accounts for 46% of global banking profit. Broader industry estimates show banks could lose 50% to 60% of their profits in this segment over the next decade.

A good starting point for banks approaching smart aggregation is to understand how investment/capital allocation by fintechs threatens them across their traditional value chain (see Figure 1, previous page). As illustrated, business and consumer lending should be the banks’ biggest concern and a major consideration as they move toward the development of a digital banking ecosystem.
**Consumer-oriented regulations**

New regulations are forcing banks to increase the transparency of customer information, improve security and comply with changes in liquidity and capital requirements. The European Union’s open banking initiative is causing banks to rethink their business model in order to capture new revenue streams and fend off fintechs. At the highest level, the Revised Payment Service Directive (PSD2) is meant to increase competition in the banking sector via the XS2A (Access to Accounts) and PISP (Payment Initiation Services Provider) rules, which will require banks to share their clients’ account data with third parties, starting in 2018.\(^\text{13}\)

The banking industry coexists within a very strict regulatory framework, unlike insurgent players that work under minimal constraints. Regulators globally are trying to balance the need to protect consumer interests and unlock the banking capabilities that lay at the heart of competition in the data economy. The XS2A secure API account access services are forcing banks to invest in digital security to ensure that third parties confirm that customers have granted permission to access their data.\(^\text{14}\) Such regulations, in conjunction with an increased focus on pricing transparency and liquidity, are pushing banks to automate key back-office and middle-office functions to reduce risk and improve efficiency.

**Five guiding principles for smart aggregation**

**Take a ‘frenemies’ approach**

When considering smart aggregation partnerships with fintechs and nonbank rivals, banks should follow the adage “keep your friends close and your enemies closer.” While new entrants pose a competitive threat, partnerships between fintechs and banking incumbents still offer formidable advantages (see Figure 2).

**The simmering banking aggregation symbiosis**

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**Figure 2**
Banks must first define which aggregation points/capabilities should be externalized, understand the potential value of externalization and identify the right partners to advance this new value stream.

With their large customer bases, reams of historical data, reliable infrastructure and decades spent establishing consumer trust, banks have many competitive strengths. Banks are also experienced at navigating a complex regulatory environment and are officially chartered to operate a financial business. All of these capabilities make them relevant and attractive to fintechs and nonbanks seeking partnerships.

For their part, well-funded newcomers, backed by renowned brands, offer innovation capabilities and operate with a lean, agile IT infrastructure. Unburdened by legacy systems, this technology architecture significantly enhances their time to market and ability to deliver personalized, engaging digital consumer experiences.

A win-win for incumbents and new entrants alike is to keep pace with the demands of born-digital consumers at a reasonable cost, which they can do by forging symbiotic partnerships through smart aggregation. To do this, banks must first define which aggregation points/capabilities should be externalized, understand the potential value of externalization and identify the right partners to advance this new value stream.

Agreeable aggregation points include the digital distribution networks offered by new entrants, in return for access to the traditional banks' large consumer base and data assets. Along the way, banks must avoid becoming overly reliant on outsourcing innovation to their fintech partners. These organizations need to strengthen their strategic alignment by prioritizing innovations that advance their business objectives and help them retain control of customer relationships.

An example is JPMorgan Chase, which earlier this year established a partnership with online lender OnDeck to launch an online small-business loan platform. The partnership is expected to reduce the loan cycle for JPMorgan Chase’s four million small business customers from weeks to a few hours or days. JPMorgan Chase will retain control over the customer relationship, as these loans will be branded by the bank, while significantly improving the product innovation lifecycle.

The same can be done by smaller community banks in the consumer lending space. Co-branded partnerships with fintech lenders is the optimal path to scaling new consumer loan volume and fully supporting service delivery. For example, Titan Bank offers personal loans directly to customers through the Lending Club platform; such co-branded consumer loan services have helped such banks grow their loan portfolio and generate returns of 6% to 10% on P2P loan portfolios.
**Become the ‘OS’ for future banking**

The ultimate goal for banks is to retain their position as the trusted partner for all consumer banking activities, even as digitization delivers holistic simplicity across the customer journey. API-led smart aggregation can help banks achieve this goal, by establishing them as the de facto “operating system.”

By leveraging a layer of universal APIs to collaborate with fintech and nonbank ecosystems, banks can become a vital player by making available a licensed, regulated platform that services can be plugged into. This will generate new revenue streams and fulfill the consumer experience, while making new entrants reliant on banks for crucial data, processes, services and infrastructure (see Figure 3).

Fidor Bank, for example, has leapfrogged its peers by putting digital technologies at the core of its banking ecosystem. Fidor has developed its own operating system (FidorOS), which is the lifeblood and central nervous system of the bank. Its modular banking platform enables social and real-time functionality through open API services that enable third-party financial services providers to plug and play (see Figure 4, next page). The platform has allowed Fidor to spawn a rich ecosystem of partners, developers and white-label customers, thereby enabling the bank to anticipate customer needs with a continuous stream of innovative products and services.
Telefonica Germany, a provider of broadband, landline and mobile telecommunications, has partnered with Fidor to introduce the first mobile banking app with full banking services. Mobile functions include a MasterCard with a contactless function, customer identification and enrollment via video identification, and an intuitive interface that provides a detailed overview of transactions, as well as small instant loans and push notifications.

Re-emphasize slow money as fast money is commoditized

To succeed in the digital world, banks must radically reshape their business model. Historically, banks have sought revenue growth by cross-selling services/products with the same set of customers or by collecting interest and fees from customers. However, consumers are challenging this status quo as they increasingly demand the same services at reduced or no fees.

By responding to these preferences, fintechs are undermining the historical banking value chain. The resulting disintermediation is impacting fee-based revenue and causing margin erosion. Examples of such disintermediation are plentiful:

- TransferGo offers consumers cross-border payments that are 10 times less expensive and delivered in seconds rather than days.
- Betterment and SigFig employ robo-advisory services and other tools to dramatically reduce fee costs to the average investor while intelligently developing a personalized investment portfolio of funds.
- Instant service segments, such as payments, remittance transactions and other transaction-based
products and services, are under threat of commoditization from new entrants offering innovative, convenience-driven products. Some experts estimate this will result in a double-digit decrease in U.S. banks’ fee margins for consumer finance, payments and asset/wealth management.

To thwart disintermediation in these fast-money segments, banks should identify smart aggregation capabilities that can be externalized through partnerships with fintechs and nonbanks. Doing so would help banks remain relevant by delivering a complete digital experience and meeting consumer demand at reduced costs while still retaining a share of the revenue from such services.

Banks should focus their move-forward strategies on maximizing slow-money segments, such as capital/asset management, investor portfolio management, etc., where they already have an historical advantage. Incumbent banks with these competencies should reaffirm their core capabilities and services in these areas by injecting robotics and/or platform-powered automation into core banking processes and readjusting their strategic advantage as market conditions dictate.

By taking this two-pronged approach, banks can re-center their operating model and serve as a forcing function to reconfigure core in-house services. It will also allow them to maintain control of end-to-end customer lifecycle management for their most valuable segment, and provide them with a golden opportunity to get ahead of the digital competition, further their customer reach and address demand.

**Own the customer experience and journey**

To maintain a central role in the banking ecosystem, incumbents must truly prioritize the digital consumer and preserve ownership of the customer journey. Recent research reveals that for businesses across industries, just a 10 point increase in customer satisfaction can increase revenues by 2% to 3%.

To accomplish this, banks must shift from product to customer centricity. This can be done by taking three actions:

- **Establish a model of consumer engagement** throughout the discovery and awareness segments of the customer journey. This will require banks to break down internal barriers between business functions and drive partnerships with fintechs and others with which they could share information and analytical insights, as well as promote new value streams.

- **Develop an externalized API layer**, wrapped around the banks’ core assets to allow for the integration of smart data-driven capabilities with outside providers. By doing so, banks can deliver a personalized consumer journey outside their own core banking systems and provide the much desired added value to today’s digital customer.
Enable delivery of unparalleled customer service support across the entire customer journey.

According to one study, for example, 78% of millennial consumers expect a customer service agent to know their contact, product information and service history when they contact a brand for assisted service. With their massive datasets and analytics-driven customer service, banks must play to their strengths by provisioning this service across multiple touchpoints.

Case in point, we enabled an omnichannel account opening service for a large UK bank via the development of a mobile iOS interface with a customer support service model that provides retail banking functionality on digital devices (iPad and iPhone). This allowed the bank’s staff to assist with the opening of accounts, both online and offline, by asking customers to validate data via a digital signature.

This capability delivered the convenience sought by millennial customers, as it effectively reduced the average time taken to open an account by 75%, from four days to one day, and resulted in a net increase of 50-plus account openings per week.

Figure 5 illustrates how banks can leverage their vast data assets, smart integration competencies and superior customer support to remain relevant in the consumer journey in a connected, digital ecosystem.
Become the bank of the future

To become a bank of the future, incumbent banks need to evolve through an API-led open banking program and regain a central role in the democratized digital ecosystem. Banks must function as plug-and-play aggregators addressing a plethora of strategic collaborative functions, effectively becoming a distributor of services by enabling the consumer base to access products from fintech partners, or acting as an orchestrator that offers banking-as-a-platform services to a variety of players in the ecosystem.

Figure 6 illustrates the collaborative framework that we believe will underlie the bank of the future. This democratized ecosystem will provide the platform with open APIs, through which fintechs and nonbanks will plug into the banking infrastructure and capabilities as part of a new operating model.

Major banks worldwide have pursued a transformation strategy by doing the following:

1. **Engineering personalized customer journeys as digitization leads to truly personalized, enriched, holistic end-to-end-services**. Wells Fargo has moved forward with secure API externalization to transfer customer data into Intuit programs, including QuickBooks, Mint and TurboTax, to improve convenience for its account holders.24

The open banking ecosystem: the future state

![Diagram of the open banking ecosystem](Figure 6)
Banks must function as plug-and-play aggregators addressing a plethora of strategic collaborative functions, effectively acting as a distributor of services or as an orchestrator that offers banking-as-a-platform services to a variety of players in the ecosystem.
I **Facilitating instant services and reducing time to market.** Canada’s Scotiabank has partnered with Chase on payment technology APIs in merchant services to reduce the time it takes for funds settlement. This is a must for banks as fee erosion continues.

I **Evolving into a lean operator of digital services.** To cost-effectively improve their outreach in highly competitive digital segments such as consumer lending, banks are seeking strategic alliances with new entrants. For example, Santander partners with Kabbage in the EU and UK to use its platform for SME lending, conversely, Lending Club is using Citibank NA’s credit facility to finance loans that qualify under the Community Reinvestment Act.

I **Creating platform-based marketplace for products and services to advance collaboration and revenue generation.** This will force banks to open their data assets and customer-related information to third parties. As digital API offerings mature, banks such as BBVA, N26 and Fidor in particular will offer a complete set of white-labeled software-as-a-service solutions for digital banking.

The evolution into a bank of the future will not be quick or easy; it will require banks to externalize services and aggregate capabilities with new entrants. It will also necessitate vast cultural change. (For more on the changes required, please read our white paper “How Digital 2.0 Is Driving Banking’s Next Wave of Change.”)

**Looking forward**

The digital disruption caused by new entrants will not disappear. And the low interest rates that have persisted over the last few years are likely to remain for the foreseeable future. These external macro forces, along with new regulations that strive for new levels of transparency, will continue to drive banks toward the digital frontier and partake in an enriched democratized ecosystem built around collaboration and smart aggregation.

The task at hand calls for major transformation for incumbent banks if they truly want to become the digital OS of the banking ecosystem. Banks must begin now to identify capabilities that are ripe for open banking, identify business-driven use cases that justify externalization, develop the technology and operating model for implementation, and most importantly, select partners to collaboratively enrich the digital banking ecosystem.

We firmly believe that traditional banks are well positioned to succeed in the digital banking future if they take the right actions now – and establish themselves once again as the most important piece of the financial services puzzle.
Endnotes


17 Fidor website: https://www.fidor.com/.


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