FINASTRA

WHITE PAPER

SMALL BANKS, BIG GOALS

How Community Banks Can Thrive Through Digital Disruption

THE FUTURE OF FINANCE IS OPEN

CONTENTS

EXECUTIVE SUMMARY

Community banks that have built their business on personal relationships need to translate that personal touch into the digital world. A community bank that can layer digital excellence onto its local roots has a strong competitive advantage.

The desire for convenience is cross-generational

The way people think about banking is undergoing a massive change right now. To a baby boomer, a *bank* is a place. To a millennial, *bank* is a verb—an activity conducted through an app. A lot of millennials and a good percentage of Gen Xers have never even set foot inside a bricks-and-mortar bank. Their relationship with their bank is developed through the tools, services, and alerts they interact with through their phones or inboxes. *Customer experience* isn't just a buzzword to these customers; it's the deciding factor on how they choose their banks.

But a lot of community banks aren't preparing for this change. They feel the digital disruption only applies to the big banks, and their unique value proposition as community members will protect them. *Local wins:* it always has, so it always will. And while *local* will always have strong appeal, customers aren't willing to give up convenience for the sake of supporting a local business.

The demand for digital services puts community banks in a tight spot. Smaller banks don't have hundreds of developers on staff to constantly improve the customer experience or costly innovation labs to roll out leading-edge technologies. For smaller banks, building anything more than a basic online system can seem like an impossible task.

Banks tend to focus their resources on serving the customers with the most assets: baby boomers. That's a business reality, but it is unfortunately accompanied by the misperception that boomers are less interested in digital banking than their children and grandchildren. This assumption is why many community banks produce digital banking experiences are so limited in scope that they're minimally useful, and while a bank may feel that the ability to check balances and schedule payments will satisfy its customers, those customers of all ages are likely to feel differently. The desire for convenience and real-time updates is cross-generational; 54 percent of boomers say they can't do their banking without their apps.[1]

Building an engaging digital experience does more than delight customers; it encourages them to have a more active relationship with their bank. They tap their smartphone to pay for groceries instead of digging out cash, they make an early partial payment against a car loan while waiting for an oil change, they respond to a text message about mortgage refinancing during a coffee break. These interactions provide more than a healthy flow of money in and out of the bank; they provide valuable analytics about customer behavior that the bank can use to drive better decision-making in real-time.

To meet the current demands of high-value customers while future-proofing their businesses to serve customers who are still accumulating wealth, community banks may try a multi-channel approach—giving their techno-friendly customers an online experience while continuing to invest in bricks-and-mortar for the face-to-face crowd. Everybody gets what they want, so what could go wrong?

54%
of boomers can't bank without an app

[1] Empowering the Adaptable Generation: Banking with Baby Boomers, Banking.com

02 THE BANKING APOCALYPSE?

Try to please everyone and risk pleasing no one

A multi-channel approach may seem the safest path, but it's actually not safe at all. Step outside the world of banking for a moment and consider the case of Walmart. Five years ago, Walmart knew it was losing market share to Amazon, but the company was confident that people still wanted to shop in person. It multi-tasked, continuing to expand its bricks-and-mortar footprint while building an online shopping experience that turned out to be weak sauce[2] compared the Amazon powerhouse.

The result was a steady loss of market share that was only halted through acquisitions and massive investments in the online shopping experience. Walmart's war chests are bounteous enough to fund a strong competitive push, but many other companies— Sears, Toys "R" Us, Sports Authority, etc.—have already lost the race. Amazon wasn't the only threat these businesses faced, but it delivered the mighty shove that pushed them over the brink.

A quick search for the term *retail apocalypse* will return page after page of disheartening stories. Now, Paypal is a brand as ubiquitous as Kleenex, and Amazon has had meetings[3] with the Office of the Comptroller of the Currency. Will the search term banking *apocalypse* hit the headlines in a few years? There's a good chance it will. But not because failure is inevitable—it most assuredly is not.

In fact, community banks are at a turning point right now, and bankers who commit to giving customers what they want—a great digital experience and products that meet contemporary needs— can not only escape consolidation but can gain competitive advantages over not just big brands, but over other community banks and credit unions as well.

[2]Amazon vs. Walmart: Rest of retail fights for crumbs, CNN Money
[3]Why are Amazon, PayPal meeting with bank regulators? American Banker

Strengthen your tradition of service with a de novo mindset

> **"** Bankers and even their suppliers move too slowly. They need to demand, they need to expect more. **"**

Mike Dionne
Managing Director North America Community Markets, Finastra

Big banks spend big money on big innovation labs. Capital One has about 2000 employees in three locations who spend their days conceiving, building, and testing great customer experiences. The company's chief digital officer once said, "Banks should act more like Apple4," but how can a community bank with just a small IT team act more like Apple? Or, for that matter, how can a community bank act more like Capital One or Bank of America?

Big banks can buy all the technology they desire, but no budget has a line item for "great culture" or "gung ho team". Smaller banks may not recognize that they have an advantage in both of these areas. They have the potential to be more agile than their larger competitors because there are fewer layers of bureaucracy between an idea and its realization; one strong decision-maker can light the spark. And that spark can more easily turn into a fire that energizes the bank's culture; everyone wears many hats in a community bank, so everyone plays a part in an initiative's success. That sense of ownership is a powerful change management tool.

Don't ask *How. Ask Why.*

Even banks that believe in the need to evolve can get stuck on the hurdle of *how*.

• How will we fund this?
• How will we find vendors we can trust?
• How do we adjust our staffing, real estate, and security to make this change?

How matters, but *why* matters more. If a bank believes the market is fundamentally changing, then the reasons to change the why will be clear, and decisions about the path forward will be easier to plan and prioritize.

4Banks Should Act More Like Apple: Cap One's Innovation Chief, American Banker

Technology is not the boss of you

A community bank has to believe it has the ability to innovate. That's not magical thinking; it's the mindset necessary to survive the digital disruption and thrive into the future.

The *how*—the technology—needs to support the *why*. Right now, most community banks are hindered by their core systems. Like the famous frog in a pot, they may not even realize they're in danger.

The data in legacy systems is in silos. Data for commercial loans versus general ledger versus the deposit system are all separate. Data can't be shared efficiently, so more people are needed to aggregate it and make it actionable. In addition, siloed core systems are often difficult or impossible to integrate with new technology. A bank that wants to offer an innovative product must first ask whether its systems are up to the task. The bank is technology-centric rather than customer-centric.

In addition to limiting a bank's ability to innovate and grow, old core systems also create operational inefficiencies. Users must log into multiple systems to perform ordinary tasks, enter data repeatedly throughout the day, navigate through different interfaces, and access databases spread across the environment. Siloed systems can't provide a single source of truth, so banks are forced make decisions based on best guesses instead of accurate, timely data.

The bank itself isn't the only party that feels the pain of legacy systems. Customers suffer along with them. For instance, if a customer calls different branches of a single bank to dispute a transaction, that customer is likely to have a different experience with each branch. The lack of a built-in workflow exposes the customer to uncertainty and leaves the bank unable to track activities or results that should drive better decision-making.

With all of these drawbacks, it seems like every community bank would be hustling to replace its core systems. But changing these systems is a lengthy, complicated process. "It's working for us right now," is a common attitude. Why fix what's not broken?

But these systems are broken. A car with a bent axle and a cracked windshield might run, but nobody would want to drive their children around in it. Yet a lot of community banks are trusting the health of their businesses to inefficient, ineffective, and unmanageable systems.

It doesn't have to be this way. New technologies are available that offer economies of scale, flexibility in product offerings, and leaps

> "
> The community bank is always at the back of the line, watching its larger competitors reap the benefits of improved efficiency and innovative product offerings while its own business languishes."

The Rewards of Changing Core Systems
- Gain access to real-time data
- Update technological relevance to support future growth
- Evolve with trends for greater customer satisfaction
- Accrue cost benefits over time

"Partnership" is a word. "Vendorship" is not.

Open architecture powers scalability and flexibility. As a business or market changes, technologies can be added or removed from the IT footprint. That keeps administration manageable and provides a way to control costs.

The dynamics of the banking technology market have historically worked against community banks. Vendors match their prices to their competitors, and those prices steadily increase while services and functionalities remain unimproved. Vendors penalize their customers for augmenting their bought-and-paid-for core systems with third party products, some vendors charge as much as $25,000 just to discuss that type of integration. Others nickel-and-dime their customers by charging to open data fields so that banks can use data that is their own property. Add poor support into the mix, and it's no surprise banks procrastinate on making a change.

The responsibility for unsatisfactory relationships isn't solely on the vendors' shoulders. Some banks set themselves up for disappointment by focusing only on the contract, not on the vendor's ability to help the bank meet its strategic goals. If the contract is all that matters, then price is the primary concern; and if price is the primary concern, staying with the incumbent will be the least costly option—at least in the immediate future. In the longer term, the inefficiencies and inflexibility of outdated core systems will be quite costly indeed.

Community banks suffer a particular pain in dealing with core system vendors. They often feel they aren't their vendors' top priority because their businesses are just not large enough to get the level of service that regional or large institutions receive. Even though a community bank enters into a 7- or 8-year contract with assurances its needs will be taken care of, it often finds its requests for enhancements pushed back by months or even years. The community bank is always at the back of the line, watching its larger competitors reap the benefits of improved efficiency and innovative product offerings while its own business languishes.

Expect More from Your Core System

Comprehensive customer views
Most core platforms only display an account number, name, address, and balance. But customers are not numbers; they are people who have a history with the bank and expect personalized service. A core system should show the entire relationship on a single screen so bank staff can provide consistent service and see sales and service prompts, cross-sell prompts, accounts serviced by outside systems, and more.

Dynamic workflows
Workflows should be built in and accessible through interfaces that are easy for every team member to use with no special training. A bank-defined set of procedures dynamically controlled by written policies ensures that changes can be instantly pushed to the entire organization. The bank benefits from operational efficiency and customers get a consistent experience, no matter which branch they contact.

A single source of truth and powerful reporting
The core system should be built on a single database that accommodates general ledger, customer relationship management, teller, workflow, contact history, customer information, deposit and loans, deposit origination, external accounts, sales and service, and total contact history management.

Data stored in a single location is easier to access, manage, and secure. A single database also makes it possible to pull highly customized reports on the fly for better decision-making and improved productivity.

Open architecture
Some vendors limit access to data or charge extra to open data fields. An open architecture ensures that the bank controls access to its data, as is proper—after all, that data is the bank's property, not the vendor's.

Open architecture powers scalability and flexibility. As a business or market changes, technologies can be added or removed from the IT footprint. That keeps administration manageable and provides a way to control costs.

05 THE STRATEGY OF CHOICE

A lack of attention from an incumbent vendor is often the catalyst that spurs a community bank to seek a new provider.

This reactive approach is understandable. Changing core systems is a lengthy and complicated process, and there's a lot at stake. If a bank has already has a history of unsatisfactory experiences with vendors, why would it expect better from the next one?

Be picky about your partner
Finding the right partner is more complicated than writing the biggest check. The size of the spend does not guarantee a successful relationship.

Price always matters, of course, but return on investment matters more. During the first contract period, employees will be more focused on converting to the new system instead of growing the business, but that lost ground will be made up in the second contract period as the bank becomes more efficient. Over time, greater economies are achieved as the bank is able to add services and improve the customer experience without hiring staff or paying add-on fees.

A good cultural fit is the baseline requirement. The partner is going to spend months digging to the bank's strategic objectives, processes, and workflows, and that's just the beginning of the relationship. The value of a new system won't be realized until the second contract period, so this will be a marriage of many years.

The economics must make sense for both bank and partner. If the balance of exchange is too uneven, the partner won't earn enough to invest in its products and both the partner and the bank will suffer; if the vendor is overcharging, the bank won't be able to manage the cost of its business so it won't be able to grow.

These risks are not forces majeures that just happen out of nowhere. They can be controlled, and that control is mostly in the hands of the bank doing the buying.

Imagine product

Provision technology

Execute processes
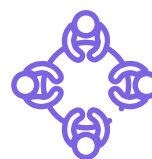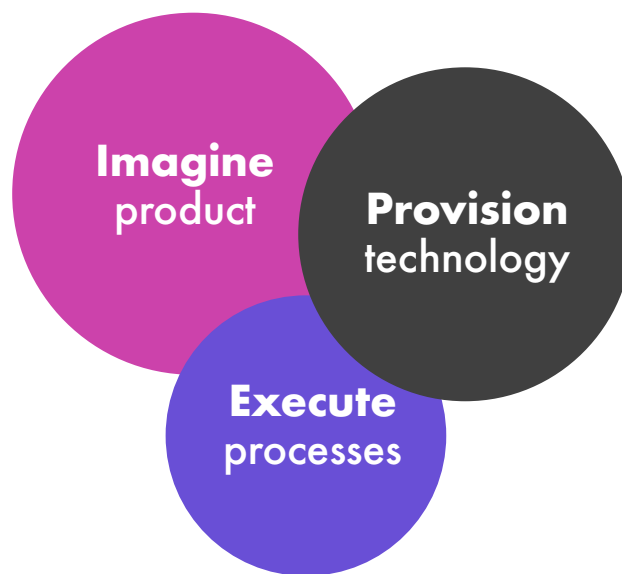
Portrait of a Perfect Partner
• Product mix meets your needs
• Easy to work with
• Pricing makes sense

How to make a happy marriage

Responsibility for a happy partnership starts with the bank, and it starts before the evaluation even begins. Banks need to come to the table with a clear picture of their strategic goals. They don't need to worry about the how; that's the partner's job. Instead, the bank should make sure the partner believes in the bank's plans for innovation and is willing and able to dig in and do the work to bring those plans to market.

The bank needs to understand that its processes are going to have to change. A lot of banks rely on processes that were created in the 1960's to meet the requirements of first-wave financial technology. Those first-wave technologies are now cluttering up museums, but the processes they birthed live on. Community banks try to force their modern technology to fit those processes, which is a backwards approach. Potential efficiencies are never achieved and return on investment is frittered away.

How to think like an innovator

Serving customers with products that help them meet their financial goals should be the chief concern. Customer first should be second nature for a community bank, yet many find themselves taking the opposite approach; they investigate what their core system can do and try to build products around those capabilities.

Questions about technology come after questions about customers. The ability to offer a new type of loan, for example, shouldn't be shelved because the technology can't handle its demands. Find a solution flexible enough to adapt to changing needs.

Processes should be the last consideration. Banks that let processes determine the viability of new products are robbing themselves of efficiencies and opportunities. To compete, they must be willing to replace the phrase, "This is just how we do things," with, "We can find a way to do this new thing."

Key Points

Digital isn't just apps and interfaces. The core systems that power the exchange of data are the foundation that supports the teller line, the smartphone, and everything in between.

Fundamentally, the business of retail banking is changing. Community banks that want to stay relevant and grow need to think of an investment in their core systems as an immediate need, not a future improvement. Along with that technology, they need a partner that knows the community banking space, can service all software platforms, and invests in innovation so the bank is able to address evolving challenges without losing its focus on building relationships with its customers.

If you can dream it, your partner should be able to help you do it. Find a provider that will treat your community bank with the same consideration and commitment it would give to a JPMorgan Chase or a Bank of America.

Finastra is community-minded

Finastra knows the community bank market. Our products are specifically built for banks with assets between $300M and $2B that need a caring partner with the expertise to help you grow. You are free to focus on building relationships while Finastra focuses on giving you the technology you need to remain competitive.

• An award-winning core and other supportive channel software delivers a completely automated experience to your bank, employees, and customers

• A complete solution means you don't have to negotiate with and manage multiple vendors

• A heavy investment in R&D ensures you will always be provisioned for innovation

• Controlled costs through the use of commodity servers and Microsoft technology that lowers IT Infrastructure and IT staffing costs

• Agility, scalability and flexibility that lets you move workload as needed for the greatest efficiency at the lowest cost

About Finastra

Finastra unlocks the potential of people and businesses in finance, creating a platform for open innovation. Formed in 2017 by the combination of Misys and D+H, we provide the broadest portfolio of financial services software in the world today—spanning retail banking, transaction banking, lending, and treasury and capital markets. Our solutions enable customers to deploy mission critical technology on premises or in the cloud. Our scale and geographical reach means that we can serve customers effectively, regardless of their size or geographic location—from global financial institutions, to community banks and credit unions. Through our open, secure and reliable solutions, customers are empowered to accelerate growth, optimize cost, mitigate risk and continually evolve to meet the changing needs of their customers. 90 of the world's top 100 banks use Finastra technology. Please visit **finastra.com**

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