

The Critical Role for Cloud in the Transformation of Retail Banks

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Executive summary

The merits of cloud technology in retail banking have been hotly debated over the last 5 years, creating a huge amount of marketing hype in the process. While some continue to see this as principally vendor noise, what is undeniable is that IaaS, PaaS, and SaaS do form an important part of retail bank IT sourcing strategy.

The unfortunate consequence of the years of debate is that attention has been drawn away from the developments in cloud, and the real benefits it delivers to the banks that have successfully adopted it.

Ovum believes the retail banking industry would benefit from a clearer picture of the current reality in terms of cloud adoption in the industry. This includes where cloud is being used, and how the role of cloud will develop over the next three to five years. To achieve this, Ovum has undertaken an independent and in-depth study with 200 senior CIOs from the global retail banking sector, conducted on behalf of SAP.

Key findings of the survey are

- Cloud is 'business as usual' for the majority of retail banks and continues to grow in importance
- Far from being restricted to horizontal services, SaaS is increasingly supporting the whole business ecosystem
- Cloud is no longer just about cost reduction, as retail banks use it to drive organizational agility
- Cloud is poised to transform the retail banking industry, driving increased levels of competition
- Regulatory compliance remains the biggest inhibitor to cloud adoption within the retail banking industry, but the issue is being resolved
- All banks must have a cloud strategy, with the focus on long-term business transformation

A breakdown of the panel of retail bank IT decision makers interviewed is given in the 'Cloud study demographics' section at the end of the document.

What is cloud?

In part, some of the uncertainty surrounding the role and adoption of cloud technology in the retail banking sector stems from the differing understanding, both on the part of IT groups and wider business functions, of exactly what cloud is. To ensure consistency and accuracy in the study, Ovum provided respondents with a concise definition of cloud and its components prior to the interview. Ovum definitions used in the study are:

- IaaS (Infrastructure as a Service): IaaS offers computing, storage and network resources and associated services usually from a virtualized environment.
- PaaS (Platform as a Service): PaaS provides a platform to develop and run applications, delivered via a public or private network and includes operating systems, development environments and tools supported by the PaaS provider.
- SaaS (Software as a Service): SaaS combines application functionality delivered via a web browser and open published APIs with data encryption, transmission, access, and storage services. The deployment of SaaS is usually supported by underlying IaaS and PaaS elements.

- Cloud: 'cloud' technology, services or solution is defined as the combined use of IaaS and SaaS, and possibly PaaS, to provide required business functionality delivered via a public network (such as the internet), private network or a combination of both.

A number of questions in the study are specifically focused on the adoption and use of SaaS rather than referring to the more general 'cloud'. The use of SaaS-specific questions ensures that respondent organizations are broad users of cloud technology as SaaS deployments, in most cases, are enabled and supported by underlying IaaS (and possibly PaaS) components.

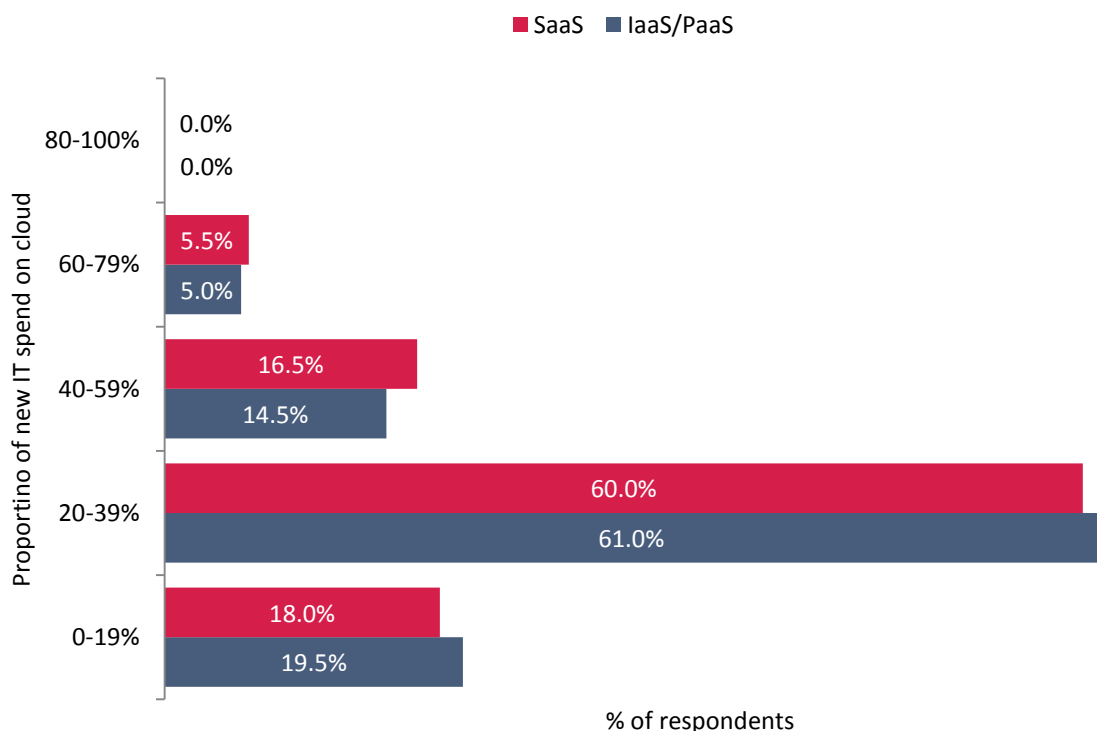
Cloud is 'business as usual' for the majority of retail banks and continues to grow in importance

The use of cloud in retail banking today is widespread. Almost all of the retail banking IT decision makers interviewed for this study reported the use of at least some cloud technology, with only relatively minor differences in take-up across banks of all sizes and in all regions.

This broad level of adoption is reflected in the degree of new IT spend accounted for by cloud technology components. Respondents were asked what proportion of their organization's current new IT infrastructure spend was allocated to IaaS/PaaS versus on-premise infrastructure. They were also asked what proportion of total new application spend (including license, maintenance and services costs) was allocated to SaaS versus traditional packaged, or in-house developed, software.

Over 60% of banks currently utilize both SaaS and either IaaS or PaaS for between 20% and 39% of the relevant budgets on cloud technology or services (see Figure 1).

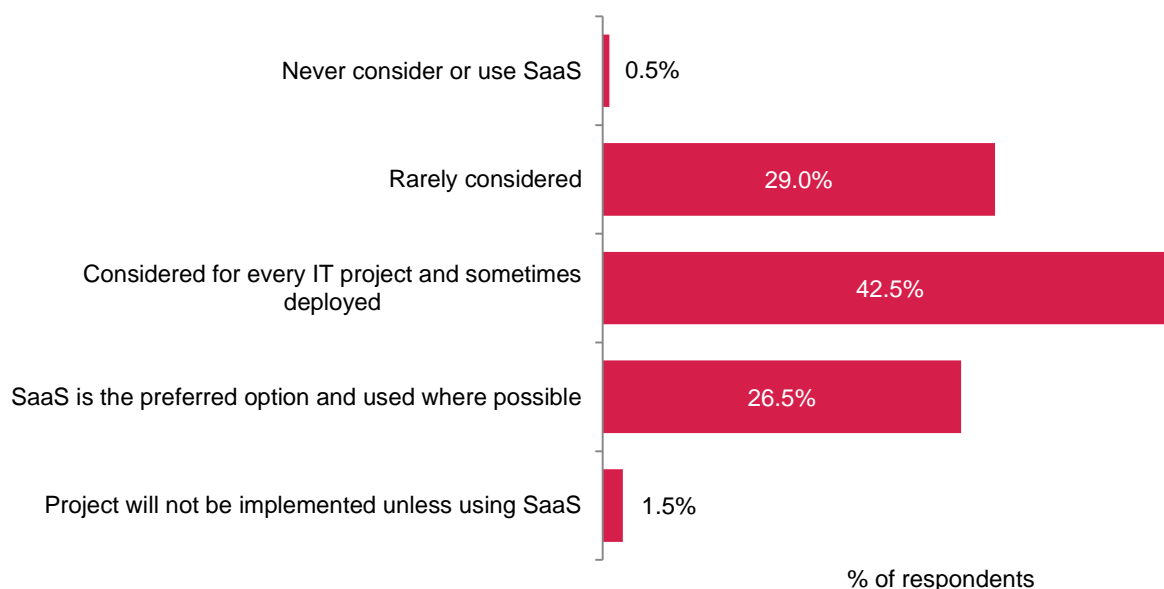
Figure 1: Current proportion of new IT spend on IaaS/PaaS and SaaS



Underpinning this is the role cloud plays in the IT provisioning process in many banks. When respondents were asked about their organization’s policy towards the use of SaaS, over 70% report that it’s a factor in every software sourcing decision. In 42.5% of banks, SaaS is deployed on a tactical basis, evaluated against the alternatives in each case and utilized where it is the most appropriate choice (see Figure 2).

While this also highlights a significant minority of retail banks that rarely or never even consider SaaS, over a quarter have a ‘cloud first’ sourcing policy in that it is the preferred deployment option and used wherever possible.

Figure 2: Respondent organization's policy towards the use of SaaS



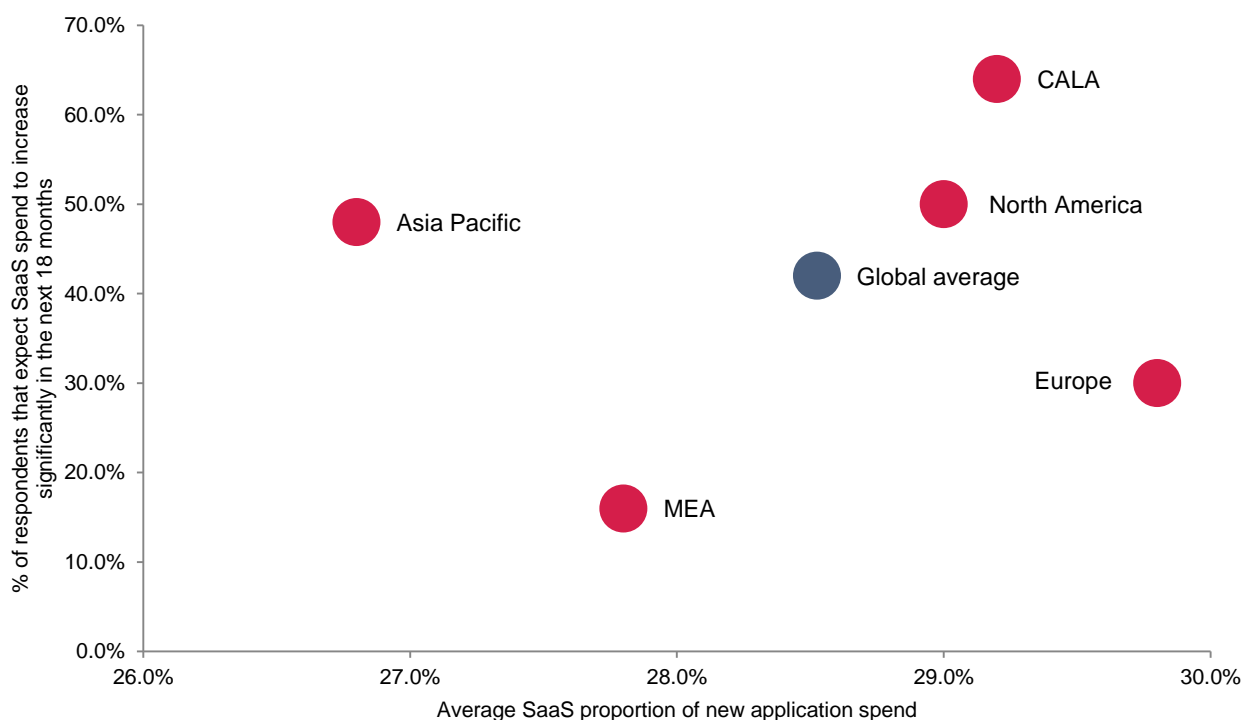
This 'cloud first' policy is particularly prevalent among banks in the highly competitive North American and CALA markets, which both see high adoption rates of both IaaS/PaaS and SaaS. Europe sees the highest penetration of SaaS as a share of new spending, with 4% of respondents from this region reporting that projects will only commence if they can be deployed using SaaS.

Banks in Asia Pacific are the least likely to consider SaaS as part of a sourcing strategy. In this region, 42% of respondents report that it is rarely considered in this context, and only 20% report that SaaS is their preferred deployment method.

These attitudes are evolving however, and the expectation across the industry is that SaaS spending will continue to increase. As Figure 3 demonstrates, there is a positive correlation between SaaS penetration and expectations of the level of future spending in this area. This points to the industry being in the 'adoption' phase with cloud, and poised to invest further as a result of having realized a range of business and cost benefits.

Banks in CALA are likely to see the highest growth in SaaS deployments over the next 18 months, with 64% of respondents expecting spending to increase significantly. As retail banks in this region already report among the highest levels of SaaS within new IT spending, the benefits are clearly being felt.

Figure 3: Current cloud spend and future growth plans



SaaS is increasingly supporting the whole business ecosystem

The use of SaaS has been relatively high in horizontal and collaborative-focused systems over the last three years with our survey respondents reporting a significant proportion of email (63%), backup/archive (53%) and business continuity (50%) solutions currently being supported by cloud technology.

But cloud is far from being restricted to horizontal activities, with SaaS increasingly used in support of what has traditionally been seen as vertical and core business activities (see Figure 4). Nor is this adoption limited to a narrow range of specific core activities; a growing proportion of retail banks use cloud services across a broad range of back, middle and front office functions. Key areas include customer-focused activities, such as product origination and customer servicing, as well as back-office functions such as payment processing.

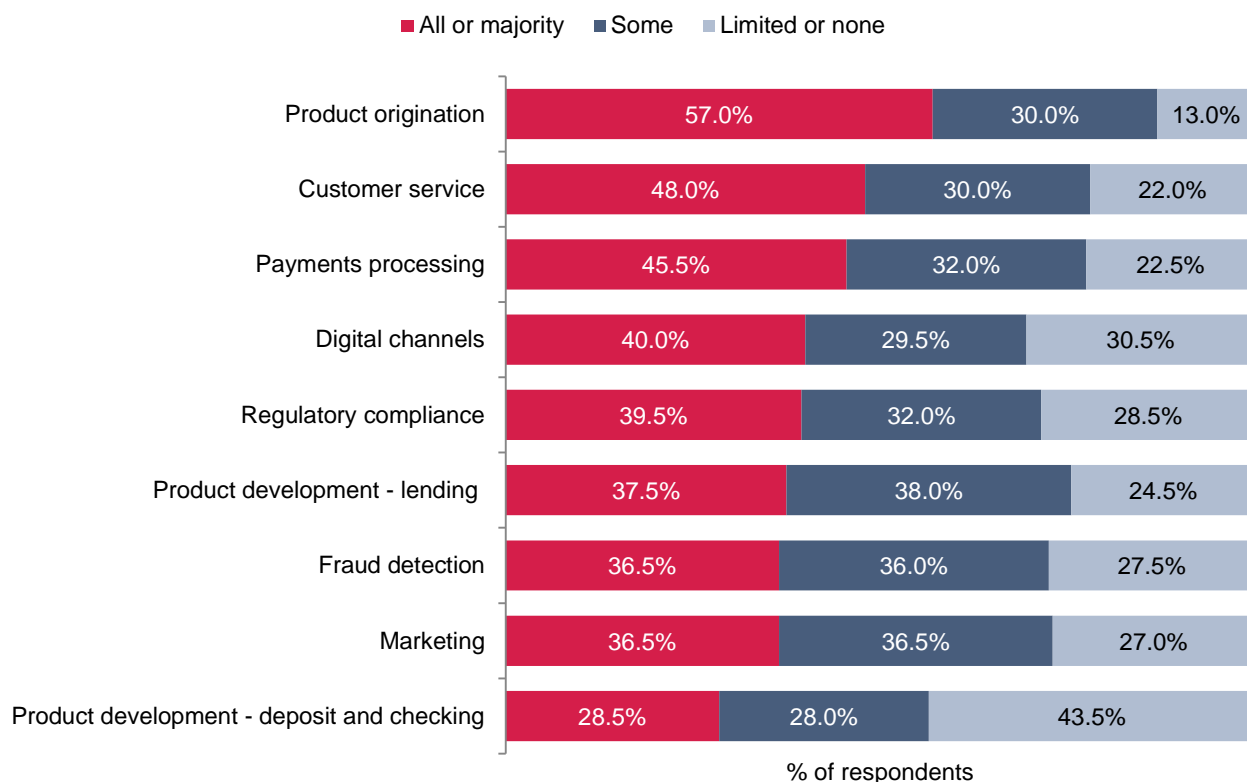
Indeed, in the case of product origination for lending, deposits and checking accounts, SaaS is used to support all or the majority of activities for 57% of banks. Considering that this covers a wide range of activities including both self-service and agent assisted applications, decisioning, processing, and compliance across the full channel estate, this is a particularly significant finding.

In addition, a high proportion of banks are also deploying SaaS in support of business growth and revenue generation activities. Over 70% of banks use SaaS in some capacity in areas including product development, marketing, and digital channels. While there remain a large minority of retail banks who do not use SaaS to support these activities, the direction of travel within the industry is clear.

Ovum believes that this broader adoption marks a watershed shift in attitudes from that of only a few years ago, when the consensus view of the industry was that cloud had only a limited role in supporting core,

business-critical processes. It should be noted that the growing maturity and viability of SaaS offerings has played a huge part in this shift in attitudes.

Figure 4: Current extent to which business functions are supported by SaaS



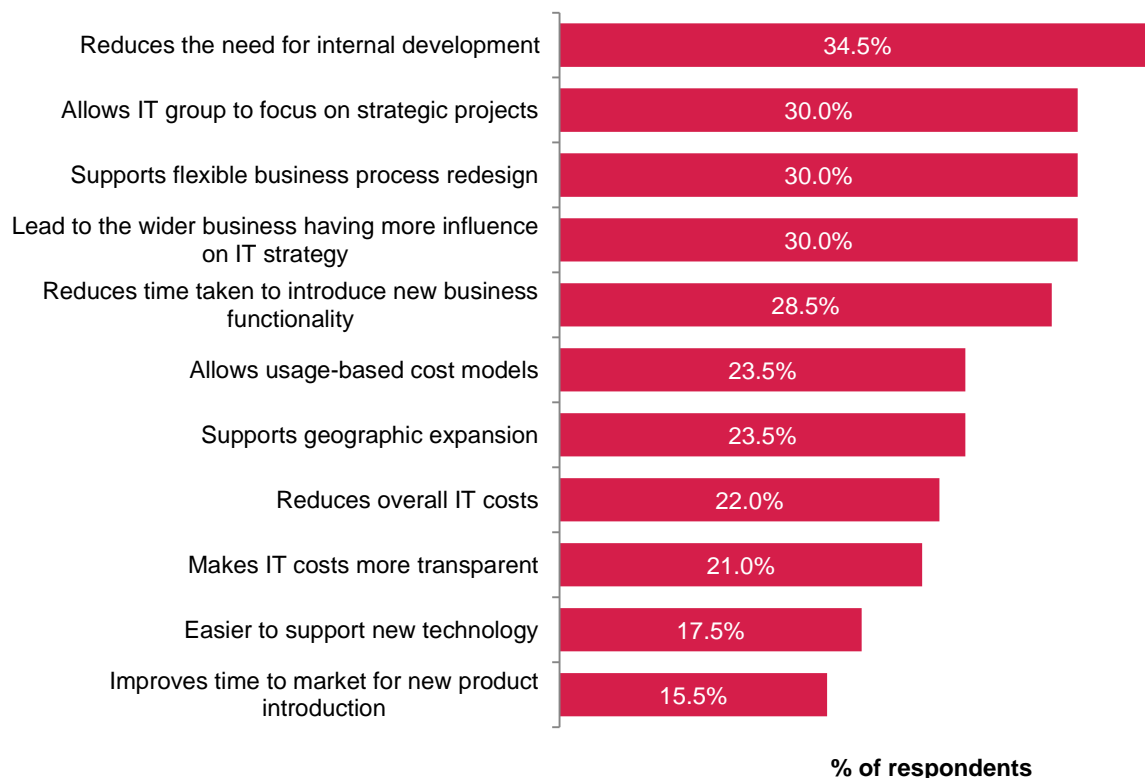
Cloud is no longer just about cost reduction, as retail banks use it to drive organizational agility

The study also revealed that the benefits sought by retail banks through the use of SaaS are far more nuanced than simply reducing overall IT costs, with business growth and organizational agility objectives emerging strongly (see Figure 5). This highlights a further shift in attitudes and priorities among banks as IT cost benefits, while still important, are increasingly expected and accepted as ‘the norm’ with SaaS deployment.

The view from within retail banking is that cloud plays a key role in removing barriers to innovation and change. The importance attached to benefits such as ‘reducing the need for internal development’ and ‘reduces the time to add new business functionality’ highlight that business lines within retail banks are increasingly looking to cloud services to overcome the organization’s inability to respond to rapidly evolving market needs.

SaaS is seen as a means of overcoming the bottleneck of extended development cycles and overworked IT groups. This reflects the fact that traditional IT delivery models are becoming increasingly unsustainable against a backdrop of rapidly developing customer expectations, growing competition and constraints on IT budgets.

Figure 5: Top benefits sought through the use of SaaS



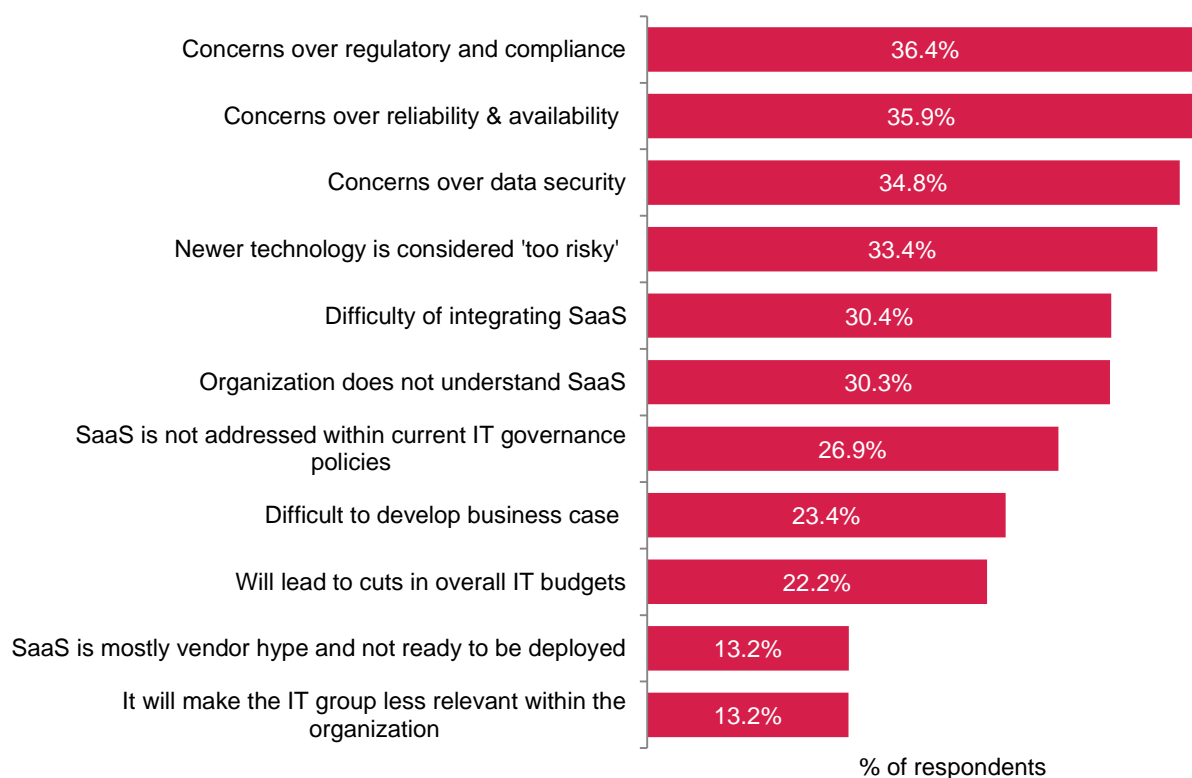
However, cloud technology is not being viewed as a silver bullet, and there remain a number of factors that inhibit the wider adoption of SaaS. These concerns are principally around the maturity and reliability of the technology and ensuring compliance in the highly regulated retail banking industry.

Concern over regulatory compliance is cited as the major factor inhibiting SaaS adoption among retail banks, which is no surprise in such a heavily regulated sector (see Figure 6). However Ovum believes this is a situation that is evolving and will be largely resolved over the next three years, particularly as governments and the public sector globally are taking the lead by adopting cloud technology themselves (the UK Government’s G-Cloud being an example).

While regulators tend to be ‘behind the curve’ when it comes to accommodating new technology within existing frameworks, their stance is generally benign, not wanting to unnecessarily restrict an already challenged banking industry. Evidence of this trend includes the recent Dutch Banking Regulator’s ruling allowing banks to use the public Microsoft Web Services (Office 360) after Microsoft and the banking industry agreed to provide access for audits. Nevertheless, concerns over data security issues remain a key inhibitor of greater SaaS use among banks.

Concerns over reliability and availability remain important as well, something highlighted by 36.4% of respondents. This points to the need for cloud vendors to further convince the industry of the maturity of their offerings by demonstrating robust SLA, proving the compelling business benefits, and emphasizing consistent, ‘best of breed’ availability metrics. At the same time, they will need to convince the 26.9% of banks which do not address SaaS within their IT governance policies to update their internal policies.

Figure 6: Factors limiting adoption of SaaS within retail banks



SaaS is poised to transform the retail banking industry

All retail banks, if they have not done so already, need to develop a clear strategy towards the role of SaaS within their organization. Despite the current concerns that some have, there is almost universal agreement that SaaS will transform the retail banking industry, with the only area of disagreement being over the timescale in which this will occur.

To understand expectations of the longer term significance of SaaS, respondents were asked what they thought its impact will be both on their organization and the wider retail banking industry over a range of time horizons (see Figure 7). The responses show almost complete agreement that SaaS will have a significant impact on the industry beyond 2018.

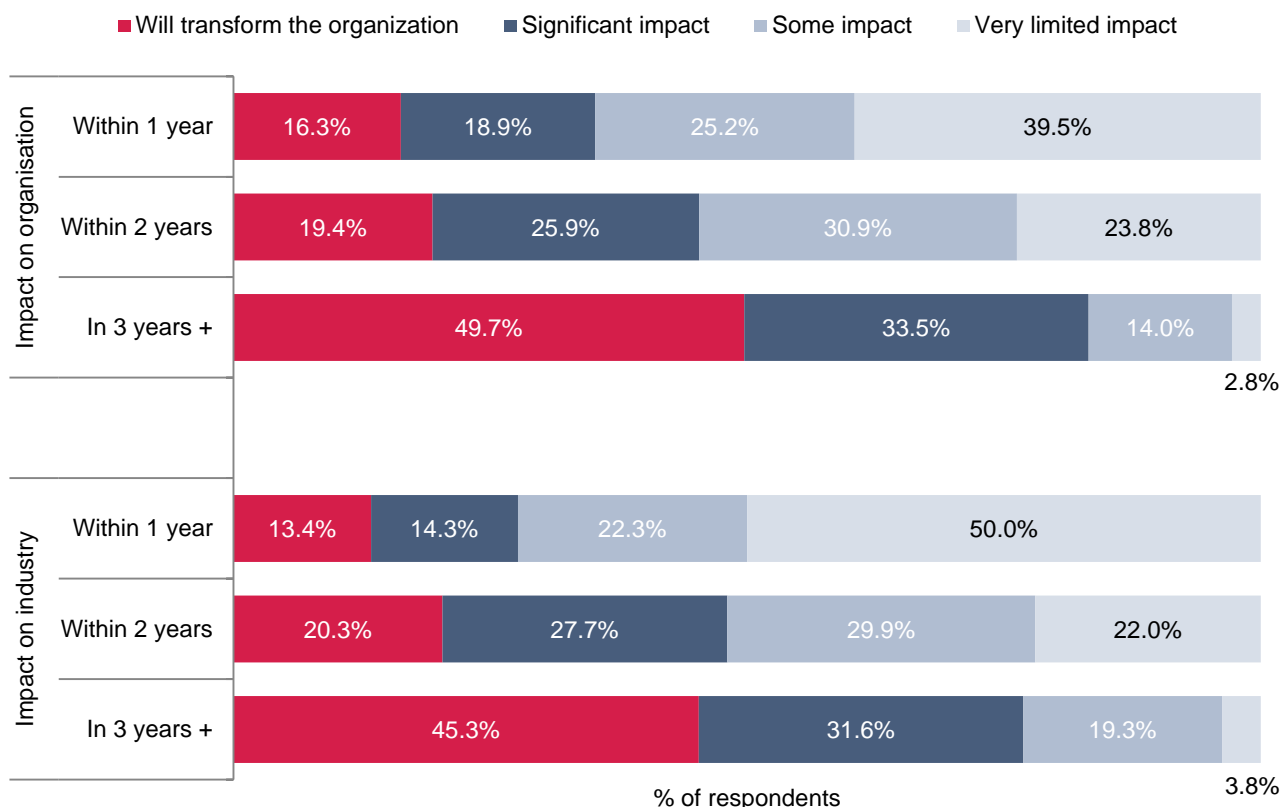
In terms of the perceived impact of SaaS, the expectation is that the early adopters will realize gains in the short term at the expense of competitors. Over 35% of respondents expect SaaS to have a significant or transformative effect on their organization within 12 months, compared to 28% at the industry level as a whole.

The impact of SaaS is expected to continue to build within the 12-24 month view, with over 45% of banks anticipating significant or transformative change. It's interesting to note that 48% expect the same magnitude of impact at the industry level in the same timeframe, reversing the short term pattern.

With regards to the longer-term three to five year view, the vast majority of respondents believe that SaaS will have a major impact on both their organization and the industry. Slightly under 50% expect SaaS to transform their business in that timeframe, with a further 34% looking forward to significant change as a result.

These findings point to the fact that even among banks that are currently not major adopters of SaaS, there is a widespread realization of its significance.

Figure 7: The expected impact of SaaS on both the retail banking industry and individual banks



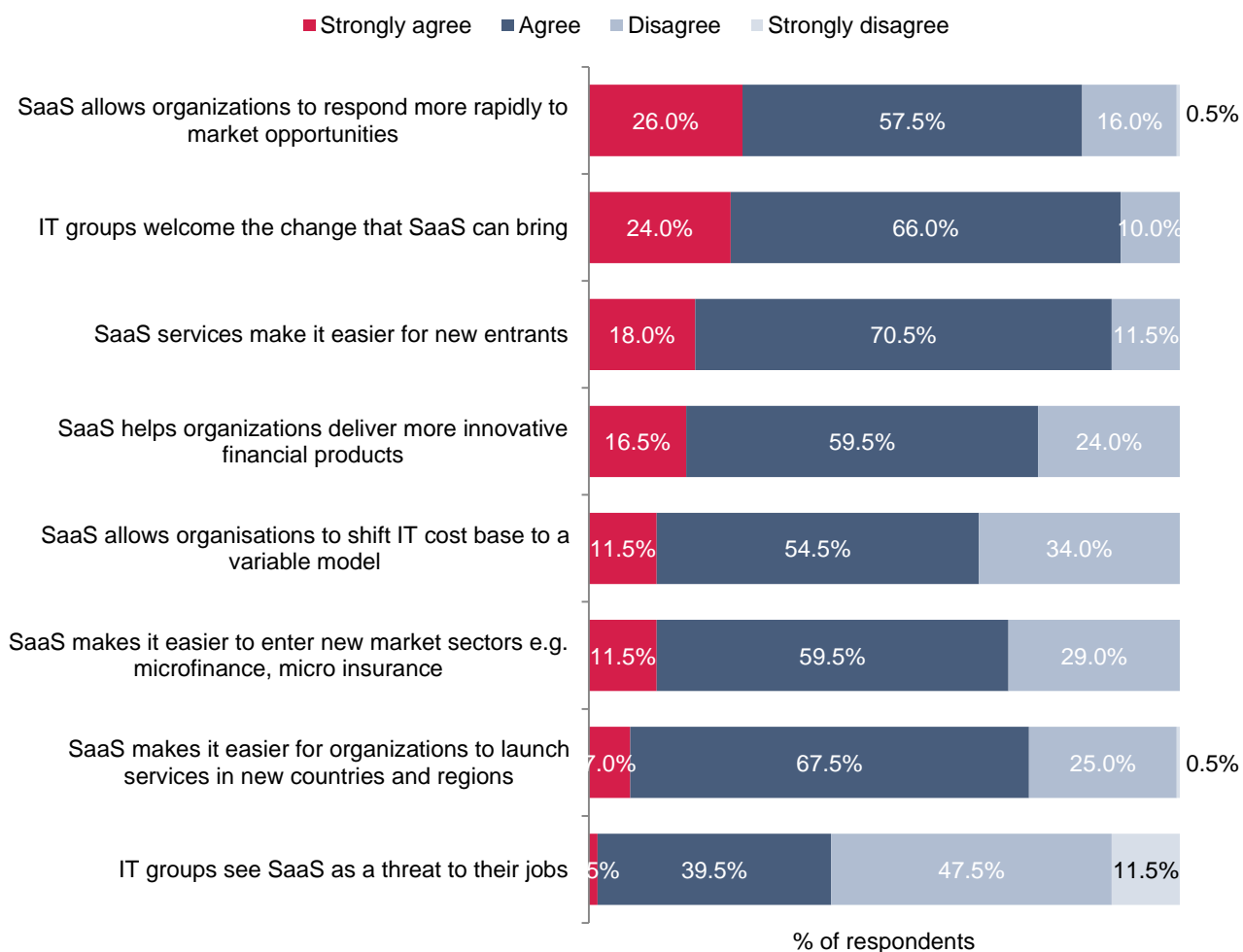
To understand the ways in which SaaS will impact the retail banking sector, respondents were asked to what extent they agreed or disagreed with a number of statements relating to the potential drivers and/or possible consequences of SaaS deployment (see Figure 8).

The ability to respond more quickly to market opportunities achieved the highest level of agreement, with 84% of respondents highlighting this as a key benefit of SaaS. Given the pace of change in this industry both due to pressure from within and also outside, such as non-banks looking to disintermediate incumbents, the facility to innovate while minimizing the impact on internal IT resources is of critical importance.

Interestingly, there was high agreement with the view that SaaS is welcomed by IT functions. Contrary to the theory that this will see a reduction in IT headcount, SaaS is viewed by these groups as freeing them to focus on delivering change in other areas within the bank. However, the responses also suggest some concerns for job security remain as IT groups look at the need to restructure as a consequence of the greater use of SaaS and the reduced need to support the organization’s existing IT landscape.

The enhanced organizational agility achieved through the use of cloud technology is likely to have the most tangible and significant impact on the industry. In particular, it allows smaller players to access capabilities and functionality that have previously remained the preserve of the larger, well-resourced players. Flexible, bank-in-a-box type offerings from vendors reduce the considerable barriers to entry facing small banks, allowing innovative, new entrants to quickly establish a foothold. Both these factors will drive yet more competition in an already highly competitive industry.

Figure 8: Agreement/disagreement with statements about the impact of SaaS on retail banks



Cloud will fundamentally change how banks source IT and drive further competition in the industry

The potential for cloud to ‘level the playing field’, by enabling smaller brands and new entrants to disrupt the market, presents a clear danger to any incumbent players taking a ‘wait and see’ approach to SaaS. While perhaps not so visible today, these banks risk putting themselves at a significant competitive disadvantage in the near future if, as expected, they have to battle with ever more agile and flexible competitors.

At the individual organizational level, cloud technology is changing the way banks source and consume IT, as well as fundamentally altering the role of the IT function within an organization. Despite IT budgets in the tens, or hundreds, of millions of dollars and substantial in-house IT teams, many continue to struggle to deliver the new capabilities needed by the business (whether in the form of new product, services, regional expansion or entry into new sectors) in a timely fashion. At the same time, significant portions of the IT budget and resources are used to maintain current IT ecosystems to support existing capabilities.

Cloud technology is beginning to fundamentally shift this model by using ‘ready to go’ infrastructure and application components. These dramatically shorten timescale and allow IT to be funded on a subscription

basis, rather than through up-front capital investment. In addition, on-going maintenance and the technology refresh of platforms and applications becomes the responsibility of the cloud vendor rather than consuming significant in-house resources.

All banks must have a cloud strategy, with the focus on long-term business transformation

So how should retail banks respond to the increasing importance of cloud technology in the industry? All banks must have a clearly defined and widely communicated strategy for cloud, and while many do, Ovum believes there is considerable scope to move beyond horizontal and cost reduction-focused activities.

Those banks that do not have some level of a cloud strategy must make it an urgent priority. They should not wait for the technology to mature further or for remaining issues to be completely resolved, as this delay will significantly impact the benefits of adoption.

In planning their IT and cloud strategies, banks must focus on creating a roadmap to transformative change, and not on incremental improvements. These roadmaps must also take account of SaaS in the context of wider industry change, as cloud technology can play a critical role in supporting a bank's overall business goals and supporting its wider ambitions. Ovum believes most cloud strategies in the retail banking industry need to be more comprehensive and more fully encompass the potential for organizational transformation.

A clear consequence of creating and implementing a broader cloud strategy is the impact on the IT function. The requirements of internal IT teams will be equally transformed, leading to the inevitable challenges of change management. Ovum believes that part of the IT function needs to evolve towards assuming a 'broker' role, bringing together the wider business functions of the banks with relevant cloud vendors. IT groups should begin to build a detailed understanding of the cloud vendor landscape and its capabilities, actively promoting opportunities enabled by cloud within the organization, in contrast to the typically more reactive role of today.

Cloud Study Demographics

For the cloud study, Ovum interviewed 200 senior IT decision makers from the global retail banking sector during September 2014. The survey respondents were typically Chief Information Officers (CIO), Head of IT Strategy or Head of IT Architecture and had to have a leading role in deciding their organizations IT strategy, control of IT budget and an understanding of the organizations current IT systems landscape.

All respondent's organizations were retail banks operating across a number of countries and regions, and of varying size in terms of assets. Investment banks and private banks were not included in the survey. The breakdown of respondent organizations by sector, region and size is shown in the table below.

Table 1: Breakdown of respondent retail banks in the cloud study

Sector	Number of respondents
Retail banking	200
Region	Number of respondents
North America	50
Europe	50
Asia-Pacific	50
Central and Latin America	25
Middle East and Africa	25
Value of assets	Number of respondents
\$1Bn to \$9Bn	52
\$10Bn to \$49Bn	60
\$50Bn to \$99Bn	29
More than \$100Bn	59

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