Julia: **Hello and welcome to a DerivSource podcast. I'm Julia Schieffer, Founder and Editor of DerivSource.com.**

GreySpark Partners recently published a report on digital transformation within investment banking which explores the emerging industrial revolution taking place within the wholesale investment banking business models. With me today I have Saoirse Kennedy, senior consultant at GreySpark who's going to be discussing the findings of this new report.

Welcome to the podcast, Saoirse.

Saoirse: Thank you Julia, it's lovely to be here.

Julia: The first question is really about digital transformation in itself, and what it actually means, especially in the context of financial services?

Saoirse: Yes. So what we are seeing in the financial services space, and among investment banks in particular, is the need for total overhaul of banks' operations, their business models, the processes that are happening internally within the bank, and this overhaul is kind of the essence, or core, of digital transformation.

As a client, you won't necessarily experience these internal changes that are needed to take place, but for you it is more the end product, or the way you engage with the end product, will become more streamlined, more integrated with your own workflows and processes. You will experience a more holistic engagement with your bank, and you will find this engagement easier to manage across different channels as you choose to engage with your bank and go about your business.

How we would like to break it down: we look at this from the perspective of the business model, the drivers of the business model, the drivers of the investment bank, the focus and the delivery method, and we see this moving from what has been a 'push' method to a 'pull' method, and this push was always driven by sales and will now be driven more by technology. The focus will move from the product (push-driven, sales-driven product), towards a pull, technology-driven service, and the delivery will change from something that was always proprietary, in-house, maybe a little bit heavy and sluggish to deal with, to something that is more innovative in terms of technology and in terms of supply chains and suppliers.

Julia: **So, FinTech is something that a lot of people are talking about, and there's so many different buzzwords that are out there; big data, block chain (well, block chain is an actual technology, but it's got quite a buzz around it). Digital transformation, you just explained very well what it is, but was there a particular motivation behind you researching and producing this paper for investment banks?**

Saoirse: We have always at GreySpark had a focus on producing ecommerce supports and producing views on the trends that are happening across ecommerce platforms in the industry. What we have seen more recently is that ecommerce is not anymore necessarily about an ecommerce touchpoint for a client, it's not about the client being able to login to a portal online anymore to be able to do things electronically. It's about a more holistic ecommerce experience, and this ecommerce experience incorporates business elements of the bank into the customer experience, and how these business elements will affect the customers' or the end clients' user experience. It is this all-encompassing view of ecommerce, not just being electronic but also including the voice elements, being able to pick up the phone and later during the day login to your portal, or log on to your mobile app, and have a reflection of your phone conversation in this app and be able to interact in an electronic way then. This is digital; it's not just about the e-touchpoints, it's more holistic engagement.

Julia: **Looking at the report itself, what are the main external or internal influencers or influences that you really identify that are driving this change towards digital transformation of the business operating models for investment banks?**

Saoirse: What we have explored in the report, we strongly looked at the external influencers and we would see that these influencers, including regulations, buy-side demand, competition, and technology innovation that is evident in the marketplace, we would see that these external influences lead to the internal influences, not separate. What's happening externally is leading to these internal changes and these internal adjustments, and a refocus on what's happening internally to the organisation. So, I wouldn't consider them separate influences; they're definitely very connected and interrelated.

Looking a little bit more at the external influences, when we see regulations (and it's a topic that is widely discussed and covered), and the move recently in recent years is towards transparency and regulations that are adopting methods and tools that will incur transparency in markets, and not just in Europe and the US, but globally. When you look at MiFID II, Basel III, the Dodd Frank Act, all these regulations push for transparency. They cover this, approach this, generally looking at risk within financial markets, financial systems. Within this report, we have identified counterpart risk, market risk, and then charges, fees and quality of service regulations as being key to transparency and key drivers of this digital transformation that we're seeing.

The impact of these changes or these regulations, which lead to the internal influences, are the need for data capture that the transparency requires, to be transparent and clear, need better data on your clients, better data on your interactions, better data on how you engage with them on what you're doing. The need for this data will then drive investment in technology, investment in innovative technologies. Banks will begin to look outside to find these technology solutions, and then this in turn will lead to better informed clients and your own ability to provide better services and products to these clients.

So it's very much a holistic kind of cycle that is being caused by these regulations, and then when you probably move on to look at buy-side demand, what is happening there. Buy-sides are now choosing to engage with sell-sides very differently to how they previously have done, and we would see this as being strongly driven by the power, the assets under management that they now hold, and the wealth and cash spending ability that they now have. Buy-sides are now investing in their own technology solutions rather than relying on outsiders to provide them with TCA risk management, collateral management, FX traders, they're bringing the expertise in-house, they're sourcing employees and people with the know-how, who have a background outside of the buy-side and can bring in their knowledge to allow them to operate somewhat more independently than they have in the past, but also operate on their own agenda. They're not in a position anymore where they have to accept what's being presented to them and say "Yeah, we'll take the whole thing". They'll say, "No, you're good at this, we'll take that. They're better at this, we'll take that from them and do the rest ourselves".

Banks are having to be far more agile, on their toes, they're having to really reconsider how they present their products, their services, what exactly they're presenting rather than going and trying to be all things to all potential clients. And that is key as well, that is changing the internal business approach that is being taken by banks.

And then, moving on to competition among the different investment banks and among the different players in the area, what we have been seeing and what is evident since the 2008 financial crisis that we're still talking about, we now see that European…there is a big divergence between European and US investment banks. European banks have fragmented quite significantly; they're pulling out of Asian markets, non-core markets; they're streamlining their product offerings and focusing on those products where they have a competitive advantage or where they have better experience and better know-how, whereas we still have these five large US global investment banks who are not going anywhere. Their presence is still as evident as it has ever been, they will continue to provide a full product suite coverage, and they will continue to dominate the markets.

Then, when you consider what is happening in Asian markets with Asian players, there is a threat to European banks mostly, but also slightly to the US banks who remain in those markets, from local participants who have a better knowledge of local markets, of local interactions, and this is a threat also in the competitive space.

This then fits in as well with the regulatory moves that require better data, better technology, the buy-side demands which are causing further rationalisation, and then when you put it into the competitive landscape you have another level of rationalisation. You could say a higher level of rationalisation is the really pulling end of markets, cutting their head count.

In terms of thinking of an individual bank, these would be the outside influences which are causing them to consider how to streamline their products, their services, how to better present them and how to better kind of attach their clients onto their product, how to get them engaged more strongly.

This fits in to the internal influences which at the moment, and always has been, cost. If you look at what digital is really trying to achieve in terms of operational business process models and then you consider the problems that the banks have with cost and the need to cut costs, there is definitely potential for these two things to work in tandem. For digital transformation to happen and to become a digital bank you do need to invest, it will cost money to bring in these external technologies rather than building everything in-house, but at the end point in 5, maybe even 10 years' time, you will see that you're not trying to maintain legacy systems which are slow and cumbersome and not necessarily fit for purpose all the time. There will be a cost saving there.

In terms of head count, it's unclear if digital will bring about a reduced head count. What we are seeing from talking to some of our clients' clients (so the clients of banks), that they still want this personal touch, or these personal relationship managers; they want to be able to pick up the phone and speak to somebody who can directly address their problem.

Digital is not necessarily going to remove that, and nor will it remove the need for you to have techie people within the organisation if you're having these difference channels like an SEP, a mobile app, your phone calls integrated across one solution, you need people to maintain this system and it needs to be quite high-spec, and that kind of comes from people's experiences of the consumer goods industries and the way they go home and sit on their iPad and they engage with all of these other companies. Then they come back into work in the morning and suddenly they're dealing with this tool that just doesn't fit with how they normally engage with another company, or as a client with another company. People's expectations are changing massively in that respect, too.

Julia: Picking up on what you've just said a little bit, Saoirse. So, expectations have changed but also, like with any kind of investment in technology it sounds like expectations need to be managed, both in, and there is still a need and desire for that kind of personal touch, as you pointed out. So even though there's cost savings, efficiency gains to be had by investing in digital transformation, there are still some of these elements that still have to be maintained by a bank, as you mentioned, for their clients, for instance. It sounds very similar to other trends that we've kind of seen, in terms of technology investment over time.

My next question is really looking at why and how should the approach to digital transformation and these new operating model for banks really differ from other types of companies such as maybe start ups or big technology firms? You've already explained how it works within banks, but is there a difference, given we're kind of in this FinTech space at the moment, that the banks should be aware of; maybe they should compare themselves so closely with these other tech firms?

Saoirse: Throughout the report we continue to make reference to the automotive industry and the airline industry and how these industries have also undergone a similar transformation whereby they developed these outsourced supply chains. If you look at a Boeing or any large aircraft these days, every element of that aircraft is sourced from a different company: the wheels are made by a different company than the windows, than the wings, the internal controls, the propellors, and that is what we mean for a bank in terms of digital transformation. It's really about the internal things that the end client isn't necessarily going to know has changed, for the end client they should have the same quality of service, maybe the quality of service will improve, they should have the same quality of product, maybe an improved product that is better suited to their needs as data becomes better used within the organisation. The difference is in how internal systems are managed, and how these systems are sourced and where they come from should make really no difference to the client. And that is true of the automotive and airline industry; a car is still a car to you, it doesn't matter where the wheels come from, it doesn't matter where the seats on the aeroplane come from, as long as it's comfortable it doesn't matter. You will still look to Delta or to EasyJet or whoever and blame them for the problem. You're not going to blame their outsourced supplier for the problem.

We don't see this in a tech firm such as Google and Amazon; what these big tech firms have tried to do is to either create a new marketplace or completely revolutionise the marketplace, and digital transformation among banks and financial services isn't going to do that. The marketplace will remain the same marketplace; you have your buy-sides, your sell-sides, your exchanges, your central banks - they're not going to change the way they interacts with each other. At the end of the day, the very base interactions, that's still going to be the same. In terms of the touch points of interaction, that will change, and that is really what will change for the end user. It's not a new marketplace, not redefining financial services, it's making it more streamlined and easier to engage with.

Julia: Going into the paper itself a little bit, you mentioned these 3 pillars in terms of what you recommend, the approach that banks take when they transform their operations digitally. Can you talk to us and explain a little bit about these 3 pillars that you recommended?

Saoirse: The 3 pillars that the report identifies and that we always present to our clients when we try to explain the idea of digital to our clients, we always use the idea of a fully automated manufacturing plant and the idea of a multi-channel distribution franchise, and the idea of data as an asset. When you fit all these things together and when you really look at the changes that each of these is demanding, and when all of these changes come together at the end conclusion, and that is digital.

So, kind of covering each of these points in more detail… The fully automated manufacturing plant: This comes back to the previous example I gave of the outsourced supply chain, looking at innovative technology providers who can provide perhaps a better technology solution, maybe at a lower cost but an innovative technology player who focuses solely on this one technology element, be it something to do with payments, be it something similar to SWIFT or the FIX protocol, but something that is very focused and doesn't require you to hire 8 people, bring them in-house, have them develop some tool or system and then maintain that tool over time. This outsourced supply chain should bring you with a better internal operating model. The systems should speak to each other in a better way, they should be better systems that do exactly what you want them to do, rather than half doing what you want them to do and then building on another bit when some other business head comes along, decides "No, no, we need it to do this", and these tools will be integrated across asset classes, across business lines, and across technology heads across these business lines. In that sense, there's a lot more talking needed for this fully automated manufacturing plant (bank) to come about.

What this should result in at the end of the day is a straight-through processing from order management, through execution to clearing and settlement. A real clean, neat, streamlined approach to trading from pre-trade, execution, to post-trade, rather than this kind of disaggregated idea that the front office and the back office are completely separate functions, nothing to do with each other and the middle office kind of deals with everything in between that nobody wants to pick up. Front office and the back office will become completely integrated in some sense. They will still have their distinct functions, but these functions will streamline a little bit better with each other. There will be better data inputs and outputs from both sides and they'll communicate better with each other.

Looking at this multi-channel distribution franchise: This comes back to the client touch points and client engagements with their investment bank. This can be applied to a buy side as well, a large buy side who feels that they need to kind of adopt this approach, that you can pick up the phone, as I said, you can login to your single dealer platform, login to your multi-dealer platform, you can have your mobile app on your phone if a mobile app happens to come about, you can have a direct API, but all of these things you have one portal to login. You can see everything that you need to see on every trade across every asset class. There is evidence of every interaction that you've had, and ideally that evidence would also be historical; you can look back to what you've done 2 or 3 years ago and see that, and see how your interactions trend. There should be graphing, there should be reporting functionality, everything should be within this. You should never need to look into another website to find anything, you should not need to click on another URL, you should not need to look anywhere else, it should all be here. And I think this is the biggest challenge, and this leads on to the point about data and the need for investment banks and these large institutions to really harness the data that they have on their client interactions on the way their clients choose to interact with them, and how they interact with them.

Once you have this information and once you pilot it effectively across the organisation and allow it to move across asset class silos and move between the business and technology functions, and then move between the front office and back office desks, and once all this data is enriched and you have a clear picture of what each individual client wants, and how they want it, you are better able to provide them with a solution that suits their needs and a price that is fitting to how they engage with you and what they do with you.

Data is really key to all of this, and the data element starts at the first point which was on regulations, and regulations requiring transparency, and transparency has been brought about by data.

Julia: I always ask this when we discuss research reports such as the one that you've just completed: was there a surprising finding that you came across in your work on this paper?

Saoirse: What is surprising, and we have run a survey to kind of back up what we have said in the report (the survey was run after the report was published and will be used in a different project), but the surprising finding was that regardless of how a client is able to engage with their bank, regardless of good a portal may be, or a mobile app may be, or any sort of electronic communication method may be, at the end of the day every single client who we spoke to wanted to be able to pick up the phone and speak to somebody at the end of that line. In an age where everything seems so digital and everything is on your phone and everything is on the TV, and you call up a phone and you press numbers and buttons to speak to somebody, or else your problems are resolved by simply pressing buttons on your dialpad, it was surprising to find that people cared so much about that personal relationship. It was nice to find that, but also a little surprising.

Julia: I have to agree with that. I like the human element there, and I don't think that will ever go away, whether it's dealing with your internet provider or a problem with your own computers, I completely understand that as well. Although given the whole conversation about digital transformation, I agree that might be a little surprising and how important that is, but nevertheless it is.

Final question for you Saoirse is about kind of looking ahead: going forward how do you see this trend towards digital transformation really evolving? Will it become a differentiator for banks?

Saoirse: I would not consider digital to be a differentiator for banks. It will become a hygiene factor, it will become expected by clients that all banks operate in this way, in this streamlined, easy-to-engage manner. Digital will come about slowly and with difficulties, I think, for some of the larger banks particularly there will be quite significant difficulties. Even if you think now just about what is really involved in getting all these different siloed asset classes and all the business and technology heads within those asset classes to sit down and have a conversation and agree on something and then implement that wide project across the entire organisation, it is a massive undertaking and that will be slow and difficult.

The key thing is data. If they can come to some agreement and some methodology that allows them to have data piled into one place and sorted and dealt with, and then really kind of streamed throughout the organisation, that will automatically eliminate a lot of the need for these sit-downs and agreements and these long technical processes. Once this hurdle is overcome it should be a little bit easier, but it is a massive project. It's not an 18-month project, it is a 5-year project, and the real outcome, the real positive outcomes may not be felt for some time after that.

Julia: **Great. Thank you for sharing your insight with us, I appreciate you explaining a lot about this report as this is something of a new area I believe for most of our users.**

Thank you for joining us.