TEMENOS

Value Benchmark

Temenos Value Benchmark

Insight Paper


Digital Distribution & Sales
Analysis
▲+89%
AR Consumption growth
Average user base

Contents

Executive summary

Amidst a backdrop of persistent tough macro-economic conditions and geopolitical uncertainty, the rise of new competition and evolving customer demands, as well as crippling legacy architectures, incumbent banks have an immense opportunity to harness the power of digitization to transform their business. Recognising our role as a true strategic partner to our clients, we introduced the Temenos Value Benchmark program in 2018 to provide our clients with tangible data-driven insights on the business value enabled by their investment in IT. Nearly 50 retail, corporate and universal banks across the globe have participated so far. An analysis of the data collected to date, highlights that our top-performing clients already achieve industry-leading cost-income ratios of 26.8%, half the industry average and returns on equity of 29%, three times the industry average.

These clients also invest over 51% of their IT budget on growth and innovation rather than on maintenance, which is double the industry average. In this paper we share our analysis of the key factors that differentiate high performing banks (i.e. those with better cost-income ratios and/or returns on equity), from the average performers, focusing on the tangible drivers of business performance in the industry.

Industry performance and challenges

Post-2008, the industry has struggled with historically low interest rates, margins and growth rates caused by prolonged recessionary conditions, the debt crisis, geopolitical uncertainty and increased market volatility across the globe. McKinsey predicts that margins will continue to fall through 2020, and the rate of decline may even accelerate. This view is reflected in the drastic drop in average returns on equity from above 20% until 2008 and then hovering between 8 and 10% since 2012, a level that most consider the industry's cost of equity[1].

The situation is not helped by price pressures exerted by the new entrants. Across the globe, traditional banks have average cost-income ratios of 55-60%[2], whereas the new digital-only challenger banks are aspiring to below 30%. Furthermore, the cost models of potential entrants into financial services from the technology world such as Google, Apple and PayPal, are orders of magnitude lower than those of traditional banks, eroding their margins and market shares.

Regulators all over the world are driving innovation and competition through new standards in open banking, issuance of new banking licences to non-traditional entrants, and creation of technology sandboxes for banks to collaborate with new players on innovative propositions.

Customers meanwhile continue to demand more convenience and personalization across the entire banking experience, not only in the products and services provided; hence the onus is on banks to ensure digital customer journeys are seamless, channel-agnostic and proactive.

1 McKinsey Global Banking Review 2018: New rules for an old game: Banks in the changing world of financial intermediation and McKinsey Roaring to life: Growth and innovation in African retail banking, Feb 2018 | reporting based on 2017 data

2 Calculated based on global average weighted by sector (Retail and Corporate / Mass Affluent / Wealth) in the Temenos Value Benchmark 2018 – Sources: McKinsey Global Banking Insights (02/18), Oliver Wyman Global Wealth Managers (02/18)

Limitations of legacy systems

The vast majority of established banks still have complex and fragmented legacy-based systems pre-dating the digital era. For some, a history of mergers and acquisitions has resulted in multiple, overlapping systems across their business lines and countries of operation. Banks have responded to industry pressures by adding new niche applications and interfaces around the legacy, to provide a near real-time experience for customers, resulting in an IT architecture that is expensive to run and maintain but also inflexible and unresponsive to change.

Banks spend on average 11%[3] of their revenues on IT, a percentage much higher than industries like manufacturing or oil & gas (3-4% of revenues on IT), which have already industrialized their processes with the help of packaged, upgradeable software. Moreover, only 27%[4] of banks' IT spend is on growth and innovation; the rest is on non-discretionary regulation or on business-as-usual, coping with the legacy spaghetti that leads to manual processes and greater integration and maintenance efforts.

Regarding responsiveness to change, time to market to introduce new products can be months (9-12) because of the need for coding, rather than weeks (4-5) with off-the-shelf software. Of 65 senior banking executives surveyed by Ovum in Europe[5], 80% said outdated core banking systems were causing them to struggle to bring new products to market quickly, while 75% felt that existing systems do not support regulatory change.

Legacy landscapes are also typically characterized by high duplication of data, seriously hindering the use of advanced analytics required to proactively understand customer needs, supply regulators with necessary information and to make informed business decisions to improve performance. A global Tier 1 bank, for example, embarked on a big data implementation project in 2012 to extract data from 46 mainframe-based data warehouses that over a span of 30 years, had built up 90% data duplication[6]. In contrast, even the average performing banks with packaged software have duplication in the range of 30%.

3 BCG IT benchmark in banking 2004-2011
4 Celent report "IT Spending in Banking" 2019
5 The Business Case for Core System Transformation - Ovum Research 2012
6 Press research 2016

Translating the opportunity into reality - The Temenos mission

Incumbent banks still possess an enormous competitive advantage over non-traditional entrants. Their scale, connectivity, assets and special role as custodians of consumers' financial information put banks in a prime position to capture the market of the future. Being regulated means implicit state support in the shape of insured deposits and access to central bank funding, resulting in lower costs of liquidity and raised barriers to entry. Historically, this has led to increased trust between the bank and the customer. The very public challenges to banks' reputations recently, such as large-scale fraud and the banking bailouts, have done little to reduce this trust.

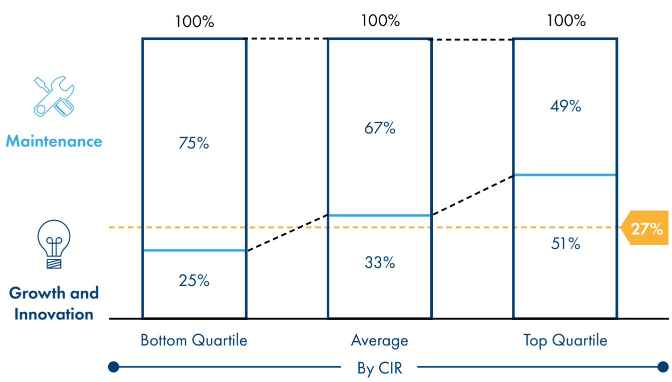
McKinsey estimates a substantial impact on the ROE of the banking sector through digitization-driven productivity improvements (2-5% uplift) and by building on the digital foundation to orchestrate an open banking eco-system strategy (3-6% uplift), from improving margins, acquiring new customers at lower cost, and then capturing a share of some non-banking markets through the platform model. There is tangible value to be gained if banks are able to digitally transform their businesses and move from legacy systems to modern, off-the-shelf packaged software running on the latest cloud-native, cloud-agnostic API-based platforms.

As the world's leading provider of packaged banking software focused exclusively on banking for 25 years and with 3000 banks already running our software, it is our vision and mission at Temenos to help our banking clients out of the vicious circle of low profitability and into achieving tangible business value directly driving banking performance.

To this end, we launched the Temenos Value Benchmark (TVB) Program[7] in late 2018 to provide our clients with tangible, data-driven insights into their business performance, in the spirit of a true strategic partner rather than as merely a software provider.

The average return on equity for participating banks in the Temenos Value Benchmark at 16.4% is significantly higher than the current industry-average return on equity of 9.5%. This differential translates into up to a massive additional one trillion USD profit potential for the global banking industry, were it to digitally transform and thereafter follow successful ecoystem strategies. This is calculated assuming a $140 billion increment in operating profit for each 1% increase in return on equity.[8]

IT spend on growth and innovation vs. Cost-Income Ratio (CIR)



Global average spend on growth and innovation - IT Spending in Banking 2019 report, Celent

In this paper, we share the tangible drivers of business performance in the banking industry, based on data collected from the 2018 Temenos Value Benchmark comprising nearly 35 retail, corporate and universal banks from across the globe. We are committed to grow this sample by ~30 banks per year to make it the most comprehensive and credible programme in the industry, as this is a true data-driven analysis of how software capability directly impacts a bank's operational metrics and ultimately, profitability.

7 The objective is to measure and compare a bank's business performance with other Temenos clients, around specific business and IT metrics and best practices along the banking value chain. The exercise is conducted by Temenos strategy consulting professionals deployed on site to collect and validate the bank's data. Each bank receives executive-level insights and recommendations to help them unlock future improvement opportunities in their business, by further exploiting Temenos software capabilities to derive even more value from their Temenos investment.

8 By closing the 6.9 pp gap between Temenos and Global average. Every 1pp increase in ROE equates to incremental $140B in pre-tax profit. Source: McKinsey Global Banking Reviews 2017/2019, Temenos analysis.

A great example of the value I got from the Temenos Value Benchmark and why I would encourage my banking counterparts to participate in this program, is the metric I received on Page 1 of the report: IT cost as a % revenue. This benchmark metric paid off immediately as it revealed to me the true cost of my IT and how I must continue to optimize and automate as I grow my customer base as Canada's first digital challenger."

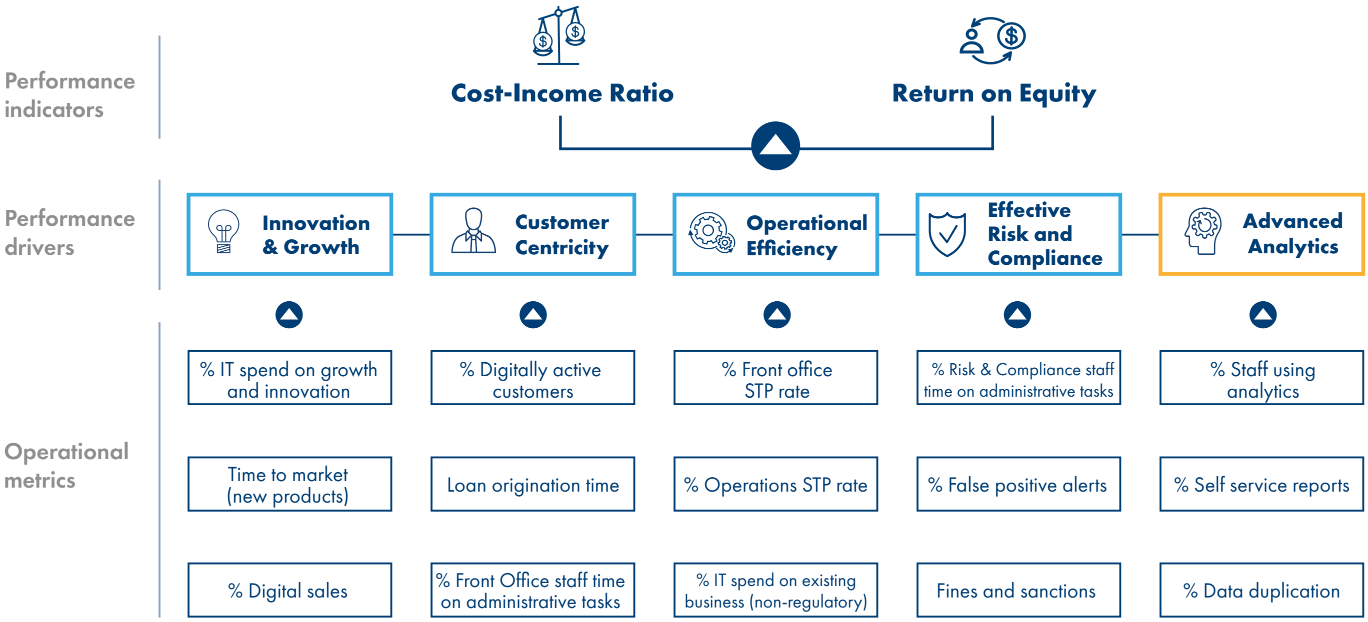
– Dan Dickinson, CIO, Equitable (EQ) Bank Canada

This is a unique program compared to the other surveys I have been involved in – it brings in a business flavour to show management the value of IT investments. The benchmark gives me the right indicators and KPIs to justify my IT spend to the board so we can invest in new technologies."

– Khurram Qadir, CIO, CIB Egypt

Drivers of high-performing banks

The Temenos Value Benchmark has revealed what factors make high performing banks different i.e. those with better cost-income rations and returns on equity, and what characteristics[9] they share:



Note: All listed operational metrics correlate with one or more performance indicators.

Innovation and growth

Higher performing banks focus more of their IT spend on growth and innovation rather than on maintenance, are more agile in their ability to launch new products more quickly and sell (onboard more customers and originate more products and services digitally).

Temenos packaged software optimizes the IT landscape. The use of well curated digital marketplaces and active collaboration with fintechs through Temenos's robust API-driven cloud-native, cloud-agnostic architecture helps banks to focus their IT on growth and innovation, thus reducing spend on keeping the lights on and on non-discretionary regulation. Temenos provides advanced code-free product development with rules-based exception handling capabilities and a standardized regulation-ready model bank to adapt to regulations in new markets / business lines which lower times to market. Strong omni-channel capabilities for digital marketing and highly configurable digital engagement platforms with seamless onboarding and origination capability drive digital sales.

Customer-centricity

Higher performing banks engage digitally with more of their customers, have shorter origination times for loans, and their front office staff spend more of their time adding value to customers rather than on administrative tasks. All of these contribute to greater customer satisfaction.

Temenos enables this through its configurable and modular digital engagement platform, with a single rules-based decision engine and the capability to launch targeted digital marketing campaigns. Strong omni-channel capabilities with digital security and self-service features like robo-advisors, embedded into seamless customer journeys from onboarding and origination all the way through to servicing underpinned by the use of customer-centric journey analytics like journey mapping, propensity to buy or next best product, help banks become more customer-centric.

9 Direct correlation found between performance indicator (Cost-Income ratio/ ROE) and the operational metrics

Operational efficiency

Higher performing banks have higher levels of automation driven by straight through processing (STP) both, in the front office and the back office. They also spend less of their IT on keeping-the-lights-on (non-regulatory) maintenance.

Temenos enables operational efficiency by providing a robust digital engagement platform to improve front office staff productivity and drive self-service, thereby improving STP rates in the front office as well as in the back office through product and process automation, use of embedded workflows and digital document and signatures, and simplification and standardization in the back office. Optimized IT landscapes with packaged configurable software lowers spend on IT maintenance and operations.

Effective risk and compliance

Higher performing banks have more efficient and effective risk and compliance functions with higher staff productivity i.e. staff with lower time spent on administrative tasks and more efficient operations i.e. lower false positive alerts. They also successfully avoid fines and sanctions.

Temenos with its advanced Model Bank capability is able to help banks dramatically lower their operational and IT costs on regulation through the ability to adapt to new regulation, and enter new regulatory jurisdictions and new business lines quickly and easily without major customization. Advanced Financial Crime capability allows banks to reduce false positives through the use of commercially consolidated exhaustive watch-lists, ability to assess and continually optimize risk management through use of third party / external benchmarks and granular risk profiling and segmentation.

Advanced analytics

Higher performing banks use analytics more widely and more effectively across the entire organization with better user enablement in terms of higher proportion of self-service reports and a greater proportion of business users using analytics. They also have a stronger data foundation in terms of lower data duplication across their systems[10].

Temenos provides a comprehensive user-friendly self-service portal for all business users. Advanced descriptive, diagnostic as well as predictive, prescriptive analytics are based on a solid centralized data foundation with embedded automated data traceability, lineage and provenance, and enterprise metadata management and cataloguing, to help banks get the most out of their analytics capability.

10 Direct correlation found between performance indicator (Cost-Income ratio/ ROE) and % self service reports, % of users using analytics and % data duplication.

Author

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Kanika Hope is Global Strategic Advisory Director at Temenos, leading the Temenos Value Benchmark program and strategic advisory practice. Kanika has 25 years of experience in banking technology and operations. Prior to Temenos, she worked as Business Development Director at SAP for 10 years, where she engaged with European retail and corporate banks on core transformation, digital banking and more. Before that, she was a consultant at McKinsey & Company in their Business Technology Office, London focused on Banking, and at General Electric in a variety of global Information Technology roles.

About Temenos

Temenos AG (SIX: TEMN) is the world's leader in banking software. Over 3,000 banks across the globe, including 41 of the top 50 banks, rely on Temenos to process both the daily transactions and client interactions of more than 500 million banking customers. Temenos offers cloud-native, cloud-agnostic and AI-driven front office, core banking, payments and fund administration software enabling banks to deliver frictionless, omnichannel customer experiences and gain operational excellence.

Temenos software is proven to enable its top-performing clients to achieve cost-income ratios of 26.8% half the industry average and returns on equity of 29%, three times the industry average. These clients also invest 51% of their IT budget on growth and innovation versus maintenance, which is double the industry average, proving the banks' IT investment is adding tangible value to their business.

For more information please visit **www.temenos.com.**

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