INSIGHTS FROM THE BDO FINANCIAL INSTITUTIONS & SPECIALTY FINANCE PRACTICE

3 Reasons Why Banks Should Lean into Digital Transformation in 2023

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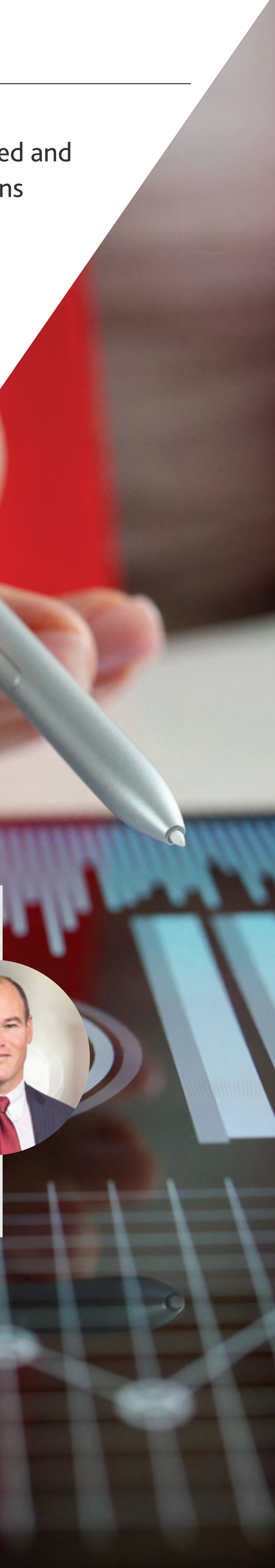
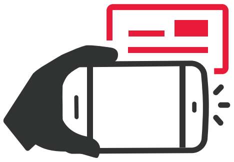
During economic slowdowns, IT spend is one of the first areas to be reassessed and dialed back. It is likely that banks, credit unions and other financial institutions will begin to cut back investments in their digital transformation initiatives. As of November 2022, 58% of banks and other businesses said their digital transformation strategies "have slowed from a year ago or will slow in the year ahead," according to **The Financial Brand**.

To remain competitive once the market rebounds, banking executives would be wise to make cuts judiciously rather than completely abandoning their digital transformation plans in 2023. Falling behind competitors' digital capabilities will put banking professionals at a significant disadvantage in serving clients, regardless of economic conditions. Instead, look carefully at which digital tools and capabilities will provide the most value to the organization and customers, then tweak the digital transformation journey from there.



Maintaining momentum will be important for financial institutions to build customer loyalty, capitalize on fintech partnership opportunities, and build a buffer for the bottom line.

Mark Houston, Financial Institutions & Specialty Finance National Practice Leader



Reason 1:

Customers Expect Their Banks to Provide Advanced Digital Experiences

Customer expectations for banking services continue to heighten. Customers don't expect less because there is a recession – if anything, they will likely want to monitor their finances more closely and look to use new banking tools in 2023. Chief among these demands is the ability to **easily access and visualize their account activities** and payment history, as well as integrate their bills and/or see investment options their institution provides.

To capitalize on what consumers want, however, banks first need a deep understanding of their customers' habits and priorities. Financial institution executives and teams should be doing their research and analyzing available customer data, such as transactions and credit card spend, to determine who may benefit from enhanced product offerings.

While many banking executives understand this on the surface and have even implemented the necessary technology, they have been slow to leverage the analytics and insights derived from these tools to optimize the customer experience. Traditionally, financial institutions have struggled with their data collection and analysis capabilities due to the incumbent systems in place. Financial institutions have invested ample time and money into their legacy technology and want to leverage that tech the best they can instead of starting over with brand new software.

For those who have adopted new tools or are using a hybrid approach of old and new tech, doing migrations away from legacy tech can slow down the digital transformation process. This can impact a bank's ability to capture actionable insights about their customers, as well as their ability to roll out new, robust digital tools or capabilities that can be personalized to meet customers' needs.

Avoiding this scenario will be paramount. Financial institutions must continue their digital transformation journeys in 2023 to meet customer expectations and build brand loyalty. To do this, many banking executives plan to lean further into AI over the next two years – **25% of them** believe it will be "the most effective technology" to help them improve the customer experience.

Banking executives should work to **develop an understanding** of their organization's posture and readiness for adopting AI and analytics. Upon adoption, AI has the potential to uncover powerful insights from data that help fuel growth.

Reason 2:

Increasing Risk of Falling Behind Fintechs

Fintech companies continue to provide traditional banking services, and new fintechs often provide the advanced digital experiences customers are looking for. Both scenarios pose a risk to traditional financial institutions, which must take action to remain competitive.

While this is not new, it should be a consideration this year as banks reassess their digital transformation investments and strategies. Pulling back too much could mean losing ground to fintechs. Instead, we encourage banking executives to look toward ways they can work with fintechs to move the needle on their own digital transformation initiatives. There are various opportunities:

- Partnering with fintechs to "plug and play" APIs
- Providing Banking-as-a-Service (Baas) to fintechs
- Acquiring fintech companies

In particular, BaaS is an area where we expect growth in 2023 as the market continues to show interest for embedded finance offerings. We will most likely see banks providing BaaS infrastructure or core technology to fintechs, dependent upon how that fintech is growing and its needs. Consider Apple Pay as an example, which is now offering a line of credit to customers. This is powered through embedded finance.

BaaS is popular among both banks and consumers – it allows banks to generate an ongoing revenue stream while allowing customers to move their money around in one comprehensive, simplistic platform.

On the fintech acquisition front, it is likely we will see a few deals in 2023. Banks are still keen to acquire fintech companies to leverage the latest technology and capture market share, but we won't see as much of this at the big bank level. Large banks are unable to make further acquisitions due to their scale and market dominance. Instead, big banks are looking toward international fintech purchases, which they can execute to leverage the technology and build infrastructure in the U.S.

Each of these strategies can enable banks to better activate their digital transformation plans and potentially prevent them from falling behind, despite economic headwinds. And for those interested in acquiring a fintech company, it will be paramount – especially in 2023, amid a quiet M&A market – that banking executives have a **holistic understanding** of the company their purchasing. Target identification exercises and thorough due diligence will be critical.

Reason #3:

Putting the Bottom-Line Impact into Focus

When done right, digital transformation can have a material impact on a financial institution's bottom line by propelling business, according to **Forbes**. As those metrics are met and/or improve, banks can see a positive impact on their financials and net income.

Typically, dollar-for-dollar investment in digital transformation can have higher ROI than investment per person. To see that impact, however, digital transformation journeys can't be halted completely. No matter the current stage of their digital transformation plan, we believe banks must continue to make headway, even if that headway is slowed during turbulent times.

Half of financial services executives, including respondents from retail banks, insurers and others, noted that their company was either a "beginner" or "implementer" when it came to digital transformation, according to **The Financial Brand**. This means half of executives are either at the precipice of digital innovation or have recently started adopting and using new technologies. Only 21% categorized their firms as "leaders" in this area.

This illustrates that the banking industry and, more broadly, the financial services industry, still have a long way to go. To make strides in the year ahead, BDO recommends the following:

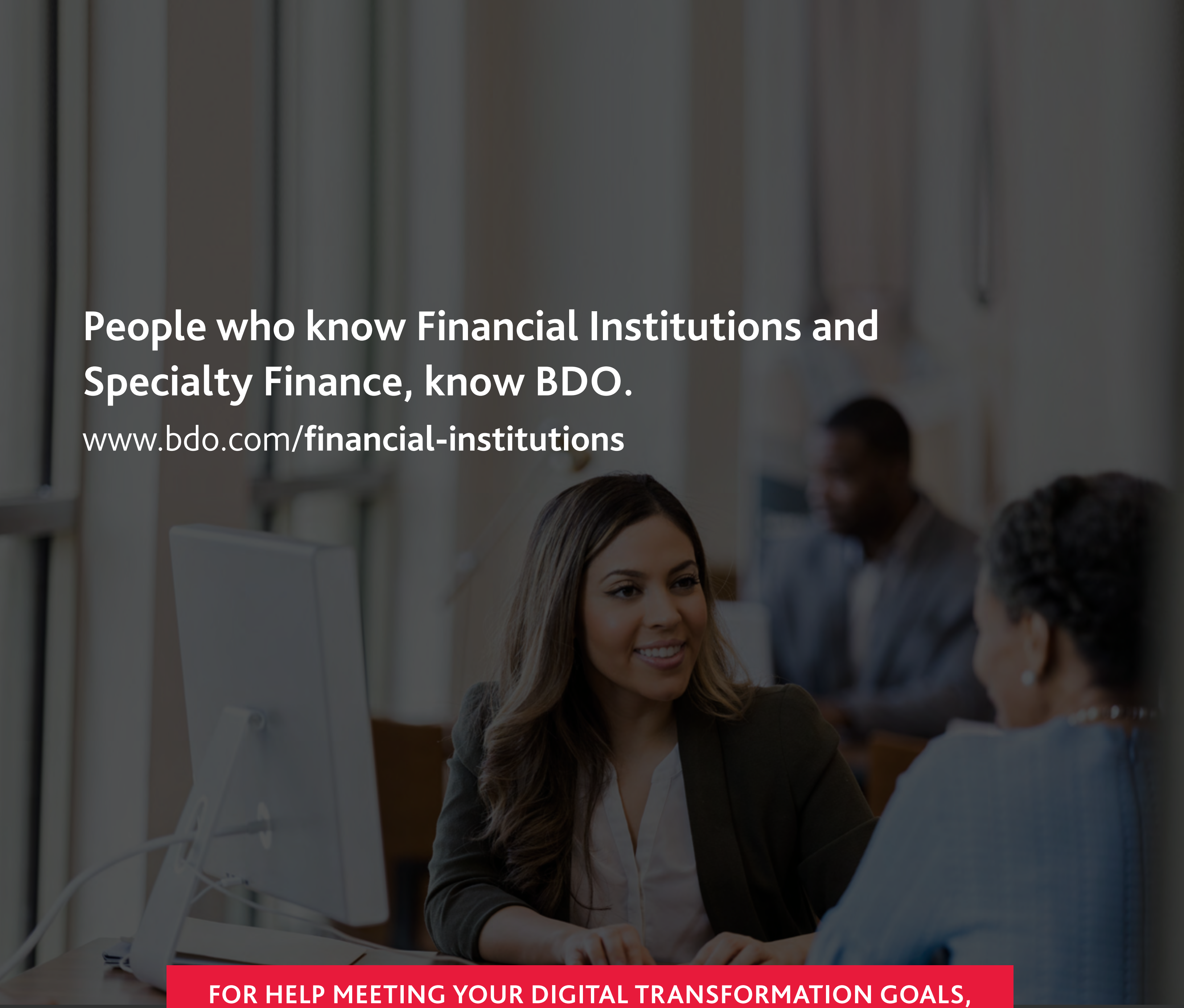
- Consider ways you can move away from legacy technology and/or migrate the data from legacy systems as efficiently as possible
- Codify ways to leverage data analytics and the insights generated by these tools to learn about shifting customer behavior; then apply that information to decision-making
- Prioritize cybersecurity and data protection – particularly for institutions that have already made substantial investments into digital transformation, focusing on infrastructure protection may be the appropriate next step
- Assess the fintech landscape to see where you may be missing opportunities, and look for alignment that may help drive your digital transformation priorities forward

Developing a **digital transformation roadmap** upfront leads to better execution, which can then lead to better customer experiences, streamlined business processes and more secure data.

Make Your Digital Dollars Count

In 2023, U.S. banks are expected to spend nearly **$93 billon** on IT and tech expenses, up from $85.5 billion in 2022, according to Insider Intelligence. While this seems like a big increase, most of these dollars will be for maintenance of IT systems, cybersecurity and other programs such as enterprise resource planning and HR systems. In fact, financial institutions only spend about **10% of their IT budgets** on true digital transformation projects.

Banking executives should consider their spend ratio as they chart their paths forward, especially in a recessionary environment. While elements of digital transformation can be postponed – and many senior leaders will likely choose to do so – financial institutions of all types should continue to allocate a portion of their budget and their teams' time to digital innovation. This is an essential tactic to future proof your organization in 2023 and beyond.



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