

# **Digital transformation and trends in financial services**

## Overview

The financial services industry has traditionally lagged when it comes to digital transformation, but that is changing. Particularly as the expansion of fintech and bigtech firms into the financial space has put pressure on incumbents to respond to a shifting landscape of competitive threats.

In a recent survey commissioned by Pure Storage, executives from financial institutions and fintechs, including banks, lenders, payments processors, asset managers and more, gave their views on the current state of digital transformation and the technologies, trends and challenges that will shape the future of the financial industry.

In particular, the differing views of financial services incumbents and their fintech challengers provides insight into both the current state of play as well as the likely future course of development.

## About the survey

Our survey sought to understand the current state of play among financial institutions and fintech firms in terms of their own digital transformation and in response to challenges and future plans.

The survey was carried out by *FinTech Futures* in October and November 2021 and was sponsored by Pure Storage.

We looked at the level of transformation achieved to date in different areas of business, where the emphasis would be going forward, and which technology strategies would be deployed.



## Successes and challenges on the road to transformation

While the pandemic acted as a catalyst for digital transformation, and firms and customers alike were forced to go digital almost overnight, the pace of change has not been even across the industry.

The critical nature of that transformation, though, is not in doubt.

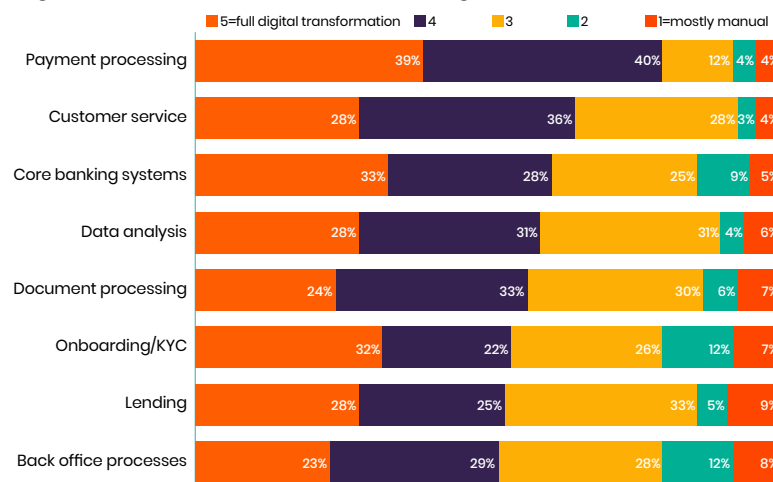
In an increasingly competitive environment, for financial institutions to stay relevant and competitive, they must leverage technology to provide compelling products and services and a more personalised experience.

### The good news

While digitisation has been especially transformative in revenue-generating functions such as payments, trading and sales, this has not been replicated across traditional support centres. In middle and back-office areas, operating with a cost-centre mindset, it can be difficult to make the case for transformation. Reflecting the competitive challenges they face, digital transformation in most firms has focused on customer-facing areas.

According to our survey, payment processing has witnessed the greatest degree of transformation, with 79% of respondents reporting that they have achieved full or considerable digital transformation. This will be critical as payments is a profitable area of attack for new digital competitors, including platforms, processors, card networks and buy now, pay later (BNPL) firms, who have made some of the greatest gains in market share over the last two years.

**How would you rate your firm’s progress when it comes to digital transformation in the following areas?**



Customer service and core banking have also seen significant success, with nearly two-thirds of respondents – 64% and 61% respectively – reporting complete or nearly complete transformation.

“ *Businesses must transform to leverage data as a valuable strategic resource and adopt a digital-first approach across the enterprise.* ”

**The bad news**

In contrast to the customer-facing areas above, cost centres and complex challenges have garnered the least attention to date. These middle and back-office functions are often considered cost areas, not revenue generating parts of the business, and as such may find it difficult to compete for limited investment spend.

Rather than focusing on innovative technologies and automation in these areas, firms may be relying on low-cost legacy technology and even migration of processes to less expensive geographies.

Our survey found that, within financial institutions, back-office processes as a whole lagged significantly with only 23% at full transformation and document processing at only 24%.

One complex area that has seen mixed results is customer onboarding and know your customer (KYC). While this is a critical and highly customer sensitive function and has been a focus for digital transformation for over 50% of respondents, 19% are still mostly or wholly manual.

Especially for financial institutions and fintechs that operate globally, onboarding compliance is complicated, and the best solutions require real-time analysis of both traditional and non-traditional data such as business verification services and media reports.

The reality is that all these areas must be addressed to achieve holistic digital transformation and avoid the technical debt and increased risk that could hamper success in other areas of the business.

It is not enough to plug gaps in legacy investments with new technology. Businesses must transform to leverage data as a valuable strategic resource and adopt a digital-first approach across the enterprise.

## Future trends in digital transformation

### Leading areas of interest

So how are respondents looking to head off threats, address pain points and leverage innovative digital technologies in the coming years?

#### 1. Open access in the form of APIs for open banking and embedded finance dominate at 75%.

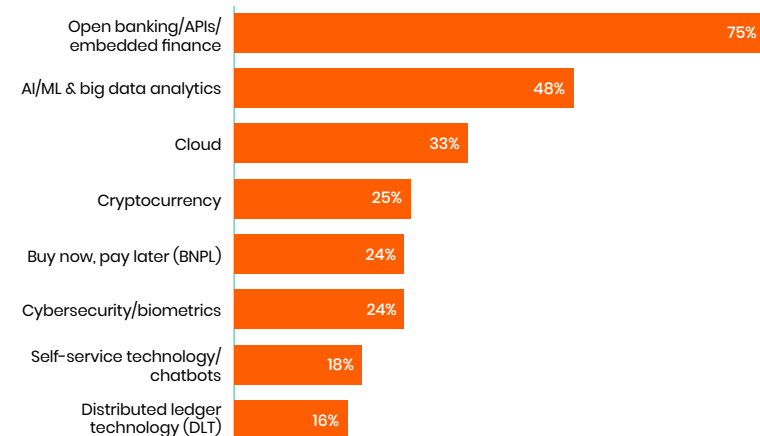
Originally driven by the EU’s revised Payment Services Directive (PSD2) and the UK’s Competition and Markets Authority (CMA) ruling, and now expanding to other parts of the world, open banking regulations are intended to encourage competition and the development and adoption of innovative online and mobile offerings.

These are enablers for bringing ever more “contextualised” financial services. This is the ability – with consumer consent – to gather data from multiple sources and build a more complete, up-to-date and detailed picture that opens up the opportunity to offer much more nuanced services that reflect a customer’s actual needs.

As non-bank companies increasingly offer financial products, such as checking accounts or wallets, payments and lending, or insurance at point of sale, the services are seamlessly embedded into non-financial processes providing customers with financial products, advice and services that are likely to be the most relevant at that moment.

While fintechs and other firms are embracing embedded finance to create new revenue streams and increase lifetime customer value, financial institutions are responding with Banking-as-a-Service (BaaS) offerings that allow them to maintain some traditional revenue streams, potentially with the loss of customer relationships. With the growth of APIs, embedded finance and BaaS, the lines between financial institutions, fintechs and other firms are increasingly blurring.

#### Which technologies do you consider the biggest game changers in your sector for the next five years? (Select up to 3)



“ *AI/ML can be the key to generating more revenue, reducing costs and enhancing customer experience while ensuring data protection and compliance.* ”

**2. AI/ML and big data analytics are next at 48%.**

Artificial intelligence (AI) and machine learning (ML) will continue to be game changers in the next few years, according to almost half of respondents.

The combination of advanced computing resources, abundant data and new software development and business practices are transforming how insight, analysis and new products and services are brought to market.

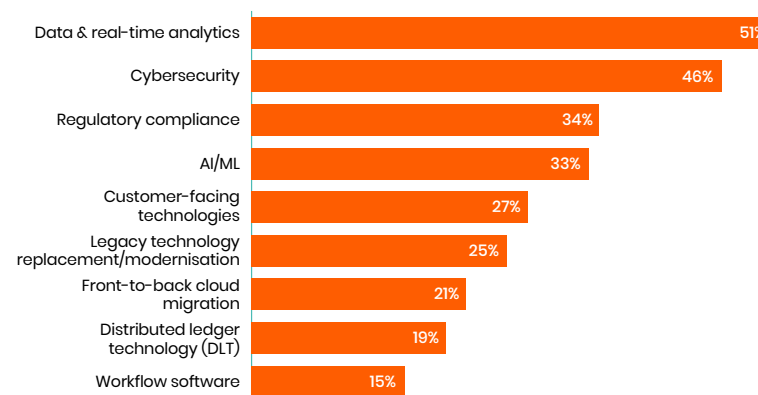
In this context, AI/ML can be the key to generating more revenue, reducing costs and enhancing customer experience while ensuring data protection and compliance. Financial institutions and fintechs alike are looking to leverage these technologies to drive decision making across diverse use cases including customer service, credit approvals, algo trading, fraud prevention, risk and compliance.

**3. Interestingly, despite the headlines, distributed ledger technology (DLT) is last at only 16%.**

This may be one to watch for in next year’s survey as the financial industry is increasingly looking at new applications for DLT and blockchain technology, including such applications as smart contracts, peer-to-peer transactions and regulatory compliance.

The importance of AI is again reflected in respondents’ views on the most critical areas for future investment, where real-time analytics came in number one at 51%. Not surprisingly, cybersecurity was a close second at 46%.

**Which three areas do you see as most critical for future investment in 2022 and beyond? (Select up to 3)**



**Key challenges**

Respondents’ two highest priority challenges, competition and legacy technology, may be viewed as at least partly two sides of the same coin.

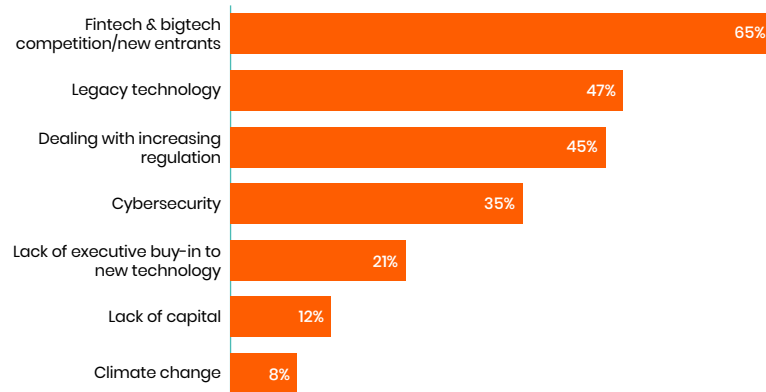
Competition from new entrants was cited by almost two-thirds (65%) of respondents as the biggest threat, with digital-native fintech and bigtech (think Amazon, Google, Alibaba, and so on) companies bridging the value chains of various industries to create ecosystems that reduce customers’ costs and increase convenience. These firms are able to exploit their vast quantities of data to become central in the customer journey.

“ Legacy technology will make compliance less efficient and more costly and risky while preventing scarce resources from focusing on more profitable activities. ”

At the same time, legacy technology, cited as a top challenge by 47% of respondents, slows access to data and impedes the adoption of crucial new technologies and the ability to offer the “anytime, anywhere” services demanded by today’s digital-savvy consumer.

Dealing with increasing regulation came in third place at 45%. Again, legacy technology will make compliance less efficient and more costly and risky while preventing scarce resources from focusing on more profitable activities.

**What do you see as the most significant challenges to your business’ success over the next five years? (Select up to 3)**



**Obstacles to growth**

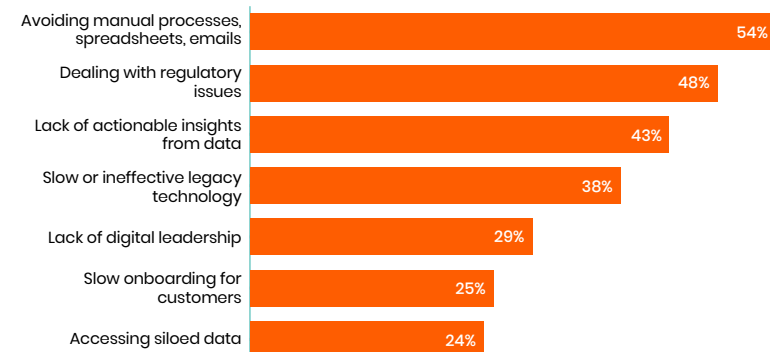
For all the focus on automating processes in recent years, it is clear that many firms remain beset by inefficiencies.

The biggest pain points when it comes to day-to-day work remain manual processes, spreadsheets and emails, cited by 54% of respondents.

Not surprisingly, addressing regulation was cited next at 45%. With the unrelenting increase in both the quantity and complexity of global regulatory obligations over the past several years, the inability to automate compliance processes results not only in massive expense for headcount but increased risk of errors, fines and reputational damage.

As with the challenges discussed above, in many ways, the pain points reported by respondents can be seen as interlinked. For instance, slow or inefficient legacy systems (cited by 38%) will result in increased dependence on manual processes.

**Which of the following are the biggest pain point(s) for you today in your day-to-day work? (Select up to 3)**



Similarly, issues accessing siloed data (24%) are almost certain to contribute to the challenges of meeting regulatory requirements as well as the inability to derive actionable insights from data (43%).

As reflected in the survey findings, digital transformation is dependent on the ability to efficiently collect, store, access and analyse massive quantities of data. At the same time, the use of new technologies such as ML and Internet of Things (IoT) is itself generating more data, all of which is extremely valuable, especially when it can be fed back into the system to identify hidden correlations and opportunities.

## Technology adoption strategies

Traditional storage infrastructure that is both highly siloed and built on architectures optimised for specific workloads will simply not be sufficient to support robust digital transformation.

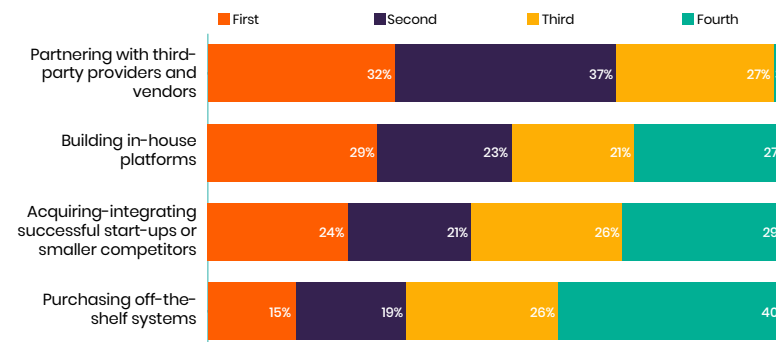
In the face of new opportunities and new challenges, organisations looking to accelerate their transformation face the fundamental question – build or buy? In fact, the options are much broader than that and most firms will end up taking a hybrid approach of home-grown, third-party solutions and fintech partnerships.

So as firms adopt new technologies, we wanted to understand their decision criteria for adopting and deploying new technologies.

Respondents' primary strategy when investing in new technologies is to look outside the organisation, with over two-thirds listing partnering with third-party providers as their first or second choice, and one-third listing it as their top choice.

Building in-house platforms was next, the first choice for 29% of respondents, albeit with a fairly notable quarter looking at an acquisition strategy, buying and integrating successful start-ups or smaller competitors. Financial institutions at 30% were keener on this latter route than fintechs at 18%.

### Please rank the following strategies in terms of their importance to your organisation when adopting a new technology



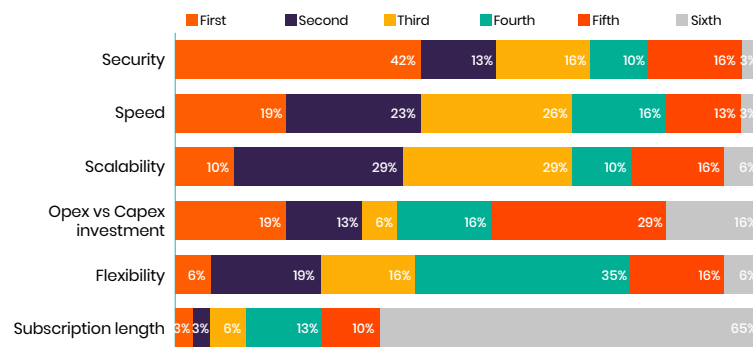
For preferred deployment methods, the world has clearly swung towards cloud. Both financial institutions and fintechs expressed a preference for hybrid or full cloud, particularly for AI/ML workloads, payment processing and front-office/digital banking systems. Perhaps not surprisingly, given the varying requirements of different application areas, there was quite a spread when respondents were asked about the drivers for those deployment decisions.

“ Fintech firms reported a greater focus on emerging services such as compliance/regulatory technology (regtech) and customer facing technologies. ”

Nevertheless, security was the clear favourite with nearly two-thirds putting it in first or second place and 42% identifying it as their first consideration. Scalability was a close second followed by speed.

Security was a more important driver for financial institutions, with 55% putting it first or second, than with fintechs at 42%. This may reflect the belief of fintech firms that they are relatively more secure, through having newer, less complex technology stacks. The banks are also more heavily regulated and arguably may pay a higher price in terms of fines, corporate and personal liability, loss of market access and reputational damage in the case of a security breach.

**Please rank the following considerations in terms of their importance when making deployment method decisions (on-premises, hybrid cloud, full cloud)**



## Differences between financial institution and fintech approaches to digital transformation

The survey reveals a wide gulf in both expectations and execution between financial institutions and fintech firms when it comes to digital transformation. These differences shed light on both the current state as well as how the future course of transformation might unfold.

**1. Digital divide:** Financial institutions rate their progress higher than fintech firms in areas that have seen the greatest transformation (e.g. payments and customer service) while fintechs have put a greater focus on areas such as core banking, onboarding/KYC and, in particular, back-office processes. This may reflect the relative starting points of the two types of firms, with digital native fintechs only recently adding more traditional banking functions.

It's probably also worth noting that the "payments" category crosses both traditional bank activities such as card issuance and acquisition and fintech functions such as payment processing and gateways.

**2. Future investment:** Fintech firms reported a greater focus on emerging services such as compliance/regulatory technology (regtech) and customer facing technologies. There is a seeming contradiction in fintech's greater focus on modernisation and less interest in cloud.

Again, the starting point is important as fintechs are often cloud native and are more likely than legacy financial firms to recognise the opportunities in platform modernisation.



**3. Pain points:** No surprises here – financial institutions recognise challenges arising from a lack of digital leadership and siloed data while slow onboarding is a bigger issue for fintech.

**4. The curious case of DLT:** Counterintuitively, DLT is among the lowest scoring areas of future interest and traditional financial services display a greater interest than fintech. This may reflect a sense among respondents that DLT is not quite ready for prime time and so less likely to have a significant impact near term.

**5. Technology Adoption Strategies:** Overall, respondents’ primary strategy when adopting a new technology is to partner with third-party vendors and providers, followed by building in-house platforms. And when making deployment method decisions, financial institution respondents’ primary consideration is security, while technology firm respondents’ primary consideration is scalability.

## Conclusion

Most respondents in our survey believe they have made good progress with regard to digital transformation, primarily within the customer-facing and revenue generating parts of their businesses, such as payments, trading and sales.

Going forward, the focus is likely to shift to the back office and complex challenges such as fraud prevention, KYC and regulatory compliance.

Without a transformation of the building blocks of the operation – including critically the data infrastructure – full digital transformation is not possible. Manual and siloed operations will always mean there are compromises and inefficiencies which impact the competitiveness and customer-facing sides of the organisation.

The world is becoming ever more digital, with the pandemic only hastening the trend. Customers expect the same convenience, ease of use and relevance with their financial services as they experience in online shopping and entertainment.

The bigtech companies, the e-commerce giants and the nimble, digital native fintechs are well positioned but successful banks and financial institutions are embracing change and leveraging their large customer bases, strong balance sheets, deep resources and invaluable but often underutilised data.

The next few years will be critical in terms of who builds, buys and partners and who comes out on top in the digital transformation stakes.

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## About Pure Storage

Pure Storage (NYSE: PSTG) gives technologists their time back. Pure provides a modern data experience that empowers organisations to run their operations as a true, automated, Storage-as-a-Service model seamlessly across multiple clouds.

Pure helps customers put data to use while reducing the complexity and expense of managing the infrastructure behind it. And with a certified customer satisfaction score in the top one percent of B2B companies, Pure’s ever-expanding list of customers are among the happiest in the world.

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Learn how Pure delivers enterprise-class data storage solutions to accelerate financial services [here](#).

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Our solid reputation, combined with in-depth coverage across global fintech, makes us the leading resource for technology buyers, sellers, developers, integrators, and other specialists across the sector.

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