# 5 BE MODULAR

## A lesson for financial services

Chris Allchin and Matt Austen

Twenty years ago, new low-cost carriers attacked the newly deregulated airline industry, using techniques that ranged from quick plane turnaround to dynamic seat pricing. The established airlines that survived were those that adopted a “modular” approach and outsourced processes such as maintenance, ground handling, and catering.

Other industries are going the same way at different speeds, as digital technology makes it easier to split off different stages of the value chain into modules. Hotels are already highly modular in their handling of demand, letting traffic arrive through a variety of customer interfaces. By contrast, many oil and gas operations are still fully integrated.

Financial services are now on this path. The industry traditionally functioned as a collection of vertically integrated one-stop shops. Monoline investment banks and securities firms have long taken a more modular tack in the United States. Now their approach is spreading globally amid declining customer loyalty, new products, processes, and customer platforms that compete in performing many of the industry’s traditional tasks.

In total, $1 trillion of revenues and costs are up for grabs in an industry with revenues of $5.7 trillion. Some of that will simply be passed along as savings to customers through lower prices. Much of the rest could go to fintech startups unless established firms aggressively develop new products and customer interfaces. That means first understanding what modular financial services will look like.

The most visible changes will come where customers seek out a service. In the United Kingdom, aggregators appeared in property and casualty insurance in the early 2000s, letting customers compare prices easily. Aggregators’ penetration in auto insurance has risen to 65 percent, from just 5 percent a decade ago, and a quarter of all policyholders now switch providers every year, driving down prices. Throughout the financial services industry, price compression could benefit customers from between $150 billion and $300 billion.

A race is now on to build digital platforms that go beyond simple price comparison, and reduce hassle, increase choice, or boost speed. These could focus on major life events, such as buying a house. Through an online platform, a potential buyer could instantly access their asset portfolio;

**A BREAKDOWN OF MODULAR FINANCIAL SERVICES**
ONCE THE FINANCIAL SERVICES INDUSTRY BECOMES MORE MODULAR, AS MUCH AS $1 TRILLION OF COSTS AND REVENUES WILL BE UP FOR GRABS

**BANKING AND INSURANCE REVENUE**

| VALUE SHIFT | ESTIMATED IMPACT |
|---|---|
| PRICE COMPARISON | **$150-$300** billion<br>*Reduction in cost for customers due to transparency and competition* |
| NEW BUSINESS MODELS | **$50-$250** billion<br>*Revenue opportunity for innovative product offerings* |
| CUSTOMER PLATFORMS | **$50-$150** billion<br>*Revenue opportunity for incumbents or third-party platforms* |

**BANKING COSTS**

| VALUE SHIFT | ESTIMATED IMPACT |
|---|---|
| BANK RE-PLATFORMING | up to **$340** billion<br>*Potential cost savings from re-platforming largest 230 banks* |
| SOURCING PROVIDERS | up to **$50** billion<br>*Operation profit opportunity for sourcing providers* |

Maximum Total **$1.09** trillion

**Source:** Oliver Wyman analysis

then check out their eligibility for a loan – and search for the best deal. Electronic contracts could make the whole process extremely quick. New customer platforms could capture between $50 billion to $150 billion of revenues from today's banking and insurance markets.

Platforms will provide access to a wider range of products, which will therefore need to be designed for very specific customers and needs. Data and analytics will be big enablers: In auto insurance, telematics systems are already tracking driver behavior, promising lower prices for safer drivers (and possibly reducing road fatalities). Robo-advisory – the use of algorithms to find the right investment product for a customer – has triggered an analytics arms race. Innovative products could capture between $150 billion and $250 billion of existing revenues.

The biggest bottom-line impact could come from retooling financial institutions' back offices, which are often too big, too old, and too clunky. Many firms will outsource large chunks of these operations, such as loan-payment processing or property and casualty insurance claims management.

Bigger groups might be better off completely overhauling their internal systems and creating a "data fortress." This could cost a bank $4 billion or more and comes with the risk of the new model being obsolete by the time it is ready. However, legacy systems will not be sustainable in the new, modular world, which will need speedy launches for new products and a slick customer experience.

Financial services have so far been spared a large-scale startup invasion. The industry has proven a high hurdle for newcomers because of its capital intensity, high level of regulation, and greater need for trust and privacy.

But startups may now be able to skim off some of the more lucrative lines – depending on how quickly traditional banks respond. Specialist customer platforms attract a price-to-earnings ratio of 35 and back-office providers trade at ratios of 25, compared to ratios ranging from 14 to 17 for a representative sample of integrated financial institutions.

To survive in a modular world, firms need to ask themselves: What are my areas of strength? And what can others do better?

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