CAPCO

TRANSFORMING CORE BANKING

A MIDDLE EAST PERSPECTIVE

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Across the world, the digital revolution is transforming customer expectations and disrupting key markets, including financial services. Banks in the Middle East are responding by scaling up their digital innovation and trying to adopt relevant fintech behaviors, for example in terms of rapidly launching new digital products and hyper-personalizing their offerings. However, the core processes of many incumbent banks are based on technologies more than 25 years old, and the burden of legacy core technology has become a critical limitation on bank agility and the scale and rate of industry evolution.

Banks in the Middle East have launched important initiatives to modernize main bank core processes, but there is a growing realization that progress must be faster, more transformational, and deliver greater openness and flexibility. That effort will prove critical to building new personalized services for the region's youthful, mobile-oriented consumers, and to supporting Middle Eastern economies as they diversify out of carbon-dependent, commodity-driven industries into more sustainable, services-based economies.

In this white paper, we identify the drivers of core transformation within a Middle Eastern context, set out the key barriers to change, and explore how to overcome these using a three-pillar approach to successful transformation.

FOUR KEY DRIVERS OF CORE BANKING TRANSFORMATIONS IN THE MIDDLE EAST

The key drivers of core banking transformations are well understood at the global level (Figure 1), and while all are relevant in the Middle East, four have a particular resonance.

The first of these is the rapid rate of **changing customer expectations**. The Middle East is characterized by young, digitally savvy banking customers, with high rates of personal consumption. These customers now expect easy, convenient hassle-free digital customer journeys in their daily lives and banking services. They do not want, for example, to have to shift to another app to spend the rewards they have accumulated on their credit card, or to fill in multiple applications when purchasing cross-sold products. However, answering these needs requires a modern core that can integrate easily with, and supply real-time information to, the hyper-personalized, real-time embedded banking services of the near future.

> "*Core transformations are not something that banks willingly do twice, so learning from experience is not an option.*"
>
> Naim Alame, Capco

Increasing competition in Middle Eastern banking markets – including challenges from fintechs, greenfield digital-first banks, and potentially 'Big Techs' – means that banks need to rapidly build and launch new services through improved **agility and time to market**. This second driver explains the new trend towards 'composable banking', which applies microservices and API-first architectures to improve the granularity and connectivity of banking core systems, their functions and key associated applications. With the right architecture, each discrete bank function can be reused to speedily build new products, while other functions can be supplied or augmented through easy-to-integrate ecosystems of external vendors. The new core architecture can then support a wider culture of innovation across the bank and unlock profitability through scalable operations.

The third regional driver is the role of **technology innovation** across Middle Eastern economies. The market research company IDC forecasts that digital transformation investment across all industries in the Middle East, Turkey and Africa region will more than double in the 2021-2026 period, as CIOs double-down on a digital-first future after the pandemic. The trend is related to a host of national campaigns such as the UAE's various strategies to become a global center of the digital world and its Financial Infrastructure Transformation Programme (FIT), or Saudi Arabia's Vision 2030 and Financial Sector Development Program. In this broader economic and political environment, Middle Eastern banks are aware that their core infrastructure needs to be ready to:

- Deliver an innovative financial services sector that helps Middle Eastern economies to diversify away from carbon dependency and towards trading and services-based industries.
- Provide support for innovation in key areas of digital-first national strategy such as artificial intelligence, the metaverse, and the development of central bank digital currencies such as the 'digital dirham'.

Neither objective may be attainable while massive technical debt forces bank technology teams to maintain and adapt obsolete technology, rather than working on innovation and strategic improvements. The scale of technical debt in Middle Eastern banking is also creating significant **resource dependencies**, our fourth key regional driver. As the legacy coding skills required to maintain legacy systems become scarcer over time, the reliance of Middle Eastern banks on a large ex-pat workforce is making them particularly vulnerable. The region's banks need to move to core technologies that require far less maintenance and that, through composable banking and low- and no-code approaches, shift day-to-day workloads towards business lines and wider ecosystems rather than central technology teams.

Figure 1: Key drivers of core transformations

Changing Customer Expectations

Customers expect superior experience, hyper personalization, speed, ease and intelligent support in their day-to-day interactions with their financial institutions and these need to be enabled by core banking systems

Agility and Time-to-Market

Legacy and proprietary technologies with monolithic and loosely coupled architectures make every change very complex and heavy leading to a slow adaption to customer, environment and regulator imperatives

Technology Innovation

Technology innovations such as artificial intelligence and other fintech advances now need to be part of the integrated platform to bring immediate benefits to institutions and their customers.

Resource Dependencies

Legacy and proprietary technologies require staff with specific skills that can become scarce over time, while staff retention is made all the more imperative by poor system documentation

Technical Debt and Costs

- Legacy systems are driving high Total Cost of Ownership (TCO)
- The higher portion of IT spend is dedicated to operations maintenance and only a small portion to innovation

Openness and Ecosystems Collaboration

Openness is now a 'must' for core systems both as an obligation to align with open banking requirements and to open up opportunities from ecosystem collaboration

Regulation

Legacy core banking systems can no longer cope with the breadth and the speed of changing regulations and standards

Market and Revenue Growth

Legacy system constraints hinder the ability to unlock value in new markets and streams of revenue

Source: Capco

THREE PILLARS OF SUCCESSFUL TRANSFORMATION

The drivers of core transformation in the Middle East are compelling and the region's banking industry seems prepared to invest in its long-term goal: lean, agile, cloud- and microservices-oriented architectures around the books of record.

For many banks, however, the barriers to transformation remain daunting, including fear of failure given the banking industry's patchy record of core transformations; a desire to avoid 'Big Bang' risks during core data migration to a new system; concern that regulators will not yet accept moving data to new cloud-based solutions; uncertainties about how to select the right technology strategy; and a lack of experience in how to set up and govern such large, bank-critical multi-year programs.

Some of these barriers are weakening. For example, as global cloud-providers move to establish data centers in the Middle East, regulators are cautiously opening discussions about a more cloud-based future for banking. However, the most important challenges are 'internal', in terms of setting the right goals and road map and deploying resources in the right way.

Capco has gained significant experience in the UK and around the world in planning and implementing bank core modernization and transformation strategies, as well as in setting up digital-first neo banks. Our tried and trusted approaches suggest that banks in the Middle East can significantly increase their chances of success by strengthening three pillars of core transformation: the **case for change**, **strategy selection**, and **execution planning**.

> “*Change management is an even bigger factor than technology selection in determining success. Failures in core banking transformation can often be attributed to underestimating the significant effort and cost, the need for leadership support, and the importance of robust planning and governance.*”
>
> Kushal Dhammi, Capco

1: The case for change – Clarity around bank-specific goals

Core transformation affects the whole bank, can take three or more years, and involves a considerable investment in terms of the dollar figure and allocation of talent. Banks easily lose their way during this multi-stage, multi-year exercise and begin to question why they have embarked on it – which can lead to the sacrifice of long-term benefits for short-term expediency.

It is therefore essential to clarify the business case for change in terms of overall objectives and guiding principles at the outset, so that these can act as the bank's North Star during the initial discovery process and throughout the transformation. Some fundamental observations:

- **Business driven** Core transformation is about customer and business transformation, enabled by digital and technology transformation. The case for change should be driven by a vision of future business objectives, for example in terms of the need to speed up 'time to market' for new products; process data in real time wherever possible; automate by design and reduce costs; adopt a cloud native approach that offers a new ability to hyper-personalize offerings to customers; and follow modern security and resilience paradigms. These objectives can then be related to a complementary set of guiding principles including technology principles.

- **Bank-specific** All banks are different in term of their business priorities and how they approach change. The key challenge is to build a case for change that is bank specific, that gains buy-in from all the key leadership team and business and technology stakeholders, and that is executable. This is itself a significant discovery exercise that may take 8-12 weeks at a large bank, and may require the help of an experienced partner if it is to generate a credible result. For example, to make sure the case for change is executable, the bank needs to build an up-to-date understanding of the pros and cons of different transformation strategies, and it also needs to set out an integrated package of objectives and relate these to tangible key results indicators.

- **Led from the top** Core transformations are complex and require a rigorous investment case, senior executive leadership and board support, with sign off from the initial discovery and goal-setting phases and then throughout the implementation. This ensures the execution teams have the correct mandate.

2: Strategy selection – Getting to your target state from where you are now

To avoid setting off in the wrong direction, the bank needs to understand where it is now as well as where it is going. The discovery phase must therefore include a current state definition (including key business pain points) that can be compared to a detailed target state (defined by the bank's case for change).

> *"It is essential to clarify the case for change so that it can act as the bank's North Star during the shaping phase and throughout the transformation execution, while balancing this with the flexibility to accommodate changes and the agility to unlock more value"*
>
> Aymen Belhedi, Capco

Based on this gap analysis, the bank must select a strategy and useful transitional stages that comprise the optimal route towards the target state. Strategy selection should include exploring a set of modernization options, set out in Figure 2 at a high level, and the key technologies that support these. Some observations:

- **Strategies are diverse and continue to evolve** At the industry level, there is no universally applicable optimal strategy for core transformation and a range of strategies are now in play. Some banks attempt 'Big Bang' transitions from their legacy system to an updated offering from long-established vendors, while others 'hollow out the core' by progressively abstracting bank functions away from legacy mainframes. Other banks are buying cloud-native platforms as cores for all or part of their businesses, or using them to set up greenfield side-car digital-first banks or business divisions. Some banks are choosing to run new cores in parallel with legacy cores for extended periods, while smaller banks in various geographies have begun banding together with peers to pursue a shared service model.

- **Strategy selection is key** While there is no standard approach, we believe there is always a right (and wrong) strategy for each individual bank, depending on the bank-specific case for change, the bank's starting point today, and the bank's proper understanding of the pros and cons of core transformation technologies and strategies.

- **Don't learn from experience** Core transformations are not something that banks willingly do twice, so learning from experience which strategy works best is not an option. Partners who have helped others to select the right modernization option and have previously implemented a variety of these can offer useful, disinterested advice during the initial discovery and planning phase, as well as being essential to creating the right vendor relationships.

- **Unlock value and defuse risk** Banks are sometimes wise to avoid core transformation approaches that depend on a single moment of transition to a complete front-to-back end new core. The alternative is to select a strategy that defuses risk and unlocks value early, for example through progressive modernization of core bank modules, or that simplifies any eventual transition by first decoupling key functionalities and hollowing out the core. Setting well-defined transitional states as interim targets can be a useful way to rapidly satisfy key business priorities and develop and scale the transformation team's capabilities. A transitional state, however, must form a logical and significant stepping-stone in the direction of the bank's target state, rather than an end in itself.

Figure 2: Strategy selection: Core banking modernization options

Scope	**Only Back End** Scope of the modernization is limited to the back-end core banking services		**Front to Back End** Scope of the modernization goes from front end to back end including the channels for bank staff and customers	
Approach	**Full Replacement** Replace all the core banking capabilities of the whole legacy banking system with a new core	**Progressive Modernization** Modular or phased approach, that stages the modernization by core banking domain (Deposits, Lending, etc.) leveraging decoupling and componentization	**Hollowing the Core** Decoupling and offloading the legacy core from different functionalities (e.g. MDM, product catalogue, pricing capabilities, etc.) to reach a lean core	
Scenarios	**Buy** Buy a new solution to replace the legacy system	**Upgrade / Back to Core** Keep the same solution, move to a higher version and do a back to core exercise	**Reuse** Reuse a solution that is already used by another business line in the bank	**Build** Build a custom solution: • On a platform • Full customization

Source: Capco

3: Execution planning – Route maps and governance frameworks

Like travelers setting off on a long journey, banks must plot out a route map that has a clear destination while remaining flexible enough to accommodate changes in customer requirements and advances in available technologies. The route map should be supported by an execution and mobilization plan that sets out the resources the bank will need, such as a right-sized core transformation team and a governance framework to ensure that the project remains on course. Some observations:

- **Grow your core team with care**. The most experienced and capable members of the IT team and business teams are always in high demand. However, given the complexity and criticality of a core transformation, the bank must make sure the project is staffed by the bank's A-team, in terms of both technology talent and business line talent. The latter will need to have strong networks and the credibility to gain buy in and make sure business-level decisions are taken in a timely manner.

- **Adopt rather than adapt**. One of the key strategic decisions is whether to buy a well-established platform that possesses a large portfolio of functionality adapted to many different product lines; or whether to build this functionality in house or working with a digital-first platform. However, many banks that buy into established platforms often then embark on a lot of customization around their existing business practices. These extensive adaptions cost money and time upfront, while creating a maintenance cost in future years because most vendors provide updates only for their standard functionality. It is therefore usually better to think carefully about the target state and, wherever possible, adopt the tried and tested approach offered by the vendor. This allows time, effort and funding to be focused on supporting carefully identified areas of market differentiation.

- **Freedom requires self-discipline**. Conversely, other strategies leave the bank with more work to do in terms of building out functionality across product portfolios. This means more work upfront but has the advantage that modern no-code/low-code approaches can give business lines significant continuing control over configuring systems and building new, innovative products – liberating them from the vendor. The potential downside is that businesses often interpret this freedom as a license to do what they like. Banks need to set up principles and governance around how things should be done – and how they should not.

- **Tracking progress**. The bank needs to set up how it will track progress towards its target state using a set of measurable KPIs ('now' versus 'target state') tied to business objectives, so that it understands where in the transformation journey it is and maintains momentum. For example, if a key business objective is to halve the time it takes to open a new account, the bank needs to set out the time it takes now and measure that against its emerging target state.

- **Robust governance framework** Major bank transformations require the setting up and staffing of a series of governance committees from the Steering Committee downwards through the working groups to various work streams such as data migration, testing and so on. Each must be staffed by the right people and the right number of people, depending on the character of the transformation, e.g. whether it is focused on a specific banking line such as retail banking or the whole bank. Each committee needs to be supplied in a timely fashion with the right level of detail. We have found that organizing the flow and gating of information is critical to ensuring the right decisions are taken.

CONCLUSION – PLANNING FOR SUCCESS

Banks in the Middle East are at the center of the region's shift towards digital, services-based economies. However, many still depend upon legacy core technologies that will restrict their agility in terms of launching innovative, hyper-personalized, data-driven products and services.

Banks have been reticent about launching core transformation projects because of the complexity and the risk. A series of strategies and technologies that can reduce the risks of core transformation are being tested in the global marketplace, but they all have pros and cons. Banks must identify which will best address their present situation, internal capabilities, risk appetite and key ambitions.

Accelerating digital disruption means banks need to take decisions on core transformation. However, pushing forward without properly defining where they are now and where they want to go could set banks on the wrong path. In this paper, we've argued that the answer is to fully develop the bank's case for change, use this to consider the range of strategies and technologies that are becoming available, and then build an execution and governance roadmap that delivers value early on. For banks in the Middle East, this offers a route to core transformations that can foster step changes in innovation, the ongoing disruption of local markets, and the capture of global opportunities.

Figure 3: Next steps: What tools do you need to minimize risk and maximize benefits?

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ABOUT CAPCO

Capco, a Wipro company, is a global technology and management consultancy focused in the financial services industry. Capco operates at the intersection of business and technology by combining innovative thinking with unrivalled industry knowledge to fast-track digital initiatives for banking and payments, capital markets, wealth and asset management, insurance, and the energy sector. Capco's cutting-edge ingenuity is brought to life through its award-winning Be Yourself At Work culture and diverse talent.

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