HFS

Commercial banks need a digital reboot— their customer expansion aspirations depend on it

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Executive summary

Commercial banks are at a critical turning point. They must modernize to drive growth or risk diminishing returns with the same large corporate customers that have sustained them for decades. Their best potential for growth is via serving their large business customers better and expanding by targeting the growing small and medium-sized enterprise (SMEs) segment. The path is not through new offerings but through better versions of existing offerings. Commercial banks are committed to improving digital interactions and are investing in intelligent automation for transactions and operational management; however, roadblocks like data, antiquated business practices, and ineffective partners impede progress. Commercial banking needs a digital reboot!

HFS Research, in partnership with Infosys, surveyed 150 commercial banking leaders across North America and Europe to better understand where commercial banks go from here. Commercial banks are exploring how to optimize innovation and technology to serve and interact with their existing customers better and target new customer segments.

Key findings

Land on the right side of the divergence between macroeconomic challenges and innovation aspirations

Commercial banks face conflicting challenges and opportunities. While current macroeconomic forces are unfavorable to banks, the availability of innovation and technological advancements is the best it has ever been. Digital identity and trust (29%) and platformification (29%) of banking are the most impactful trends, while revenue growth (27%) and creating partnership ecosystems to generate new forms of value (26%) lead the ranks of traditional business objectives critical to enterprise success.

Unlock growth and value as commercial banks progress through each Horizon

Commercial banks ready to create new value are targeting ecosystem creation. They are investing across three Horizons of innovation: Horizon 1, functional digital transformation; Horizon 2, enterprise transformation; and Horizon 3, ecosystem transformation. Forty-seven percent (47%) of respondents are currently at Horizon 1, focused on digital optimization. The innovation outlook for two years from now shows aggressive progress plans. Respondents plan to flip their focus and investments from Horizon 1 to Horizon 3 as they court ecosystem development and associated new value.

Commercial banks are creating models fit for purpose for their target customer base of SMEs and start-ups

Sexy new offerings are not the growth mantra for commercial banks. The focus is on executing core offerings well. The top six offerings continue to be deposit accounts, lending and lines of credit, commercial cards, merchant services, treasury services, and trade finance now and in the next two years. While large corporations continue to make up the lion's share (73%) of commercial customers served, we see promising growth potential in targeting customers in the overlooked and underserved segments targeting SMEs, start-ups, and scale-ups.

Win clients by improving customer onboarding time through digital—one of the worst pain points for clients is a complex onboarding process

The average onboarding time from our selective survey is 32 days. This overly long onboarding time is mainly attributable to implementation and integration challenges.

Out with the old and in with the new: APIs and virtual meetings will become the de facto way to engage with commercial banks in the future

Host-to-host technology is still widely used in commercial banks, with 65% of respondents still interacting with their customers through this method. It will soon be replaced by faster and more secure real-time technology provided by bank APIs.

A "Hurray!" moment, where planned investments align with offering enhancements to serve existing and targeted customer segments better

Commercial bank leaders currently prioritize intelligent automation in transactions and operations management. We expect the focus to shift to trade finance modernization and embedded finance in the next two years.

Antiquated business practices and legacy tech keep commercial banks from realizing value from their investments. Too many ineffective partners are part of the problem

Respondents indicate a lack of centralized data governance (39%), legacy technology and tech debt (35%), too many or ineffective tech and service provider partners (34%), and overly manual processes (28%) as the top challenges. Partners are a part of the problem because commercial banks have an imprecise and overly generous approach to strategic partnerships.

With the right approach, partnerships are the catalyst to unlock value across innovation horizons

Over the next two years, 67% of commercial banks favor full services firms with a growing need for fintech (65%) and IT outsourcing (55%) to help them grapple with roadblocks and drive progress

Commercial banks' use of strategic partners is growing, but they need to be more selective

Commercial banks work with 12 strategic partners on average, and 63% expect this baseline number to grow. Commercial banks have prioritized almost all attributes as strategic for partners, including cost savings, offering capabilities at scale, the ability to co-innovate and collaborate, and the duration and scale of the relationship.

The Bottom Line

Commercial banks need a digital reboot to better serve their existing customers and target new customers. Useless partners must get the boot, or banks risk staying stranded in Horizon 1.

This report is part three of a four-part series examining the growing importance of ecosystems in the BFS market through the lens of making practical progress across the innovation Horizons and the savvy use of partners to help drive modernization and create new forms of value. The series includes a broad view of banking and financial services trends complemented by drill-down spotlights on innovation and ecosystems in payments, commercial banking, and wealth and asset management.

Land on the right side of the divergence between macroeconomic challenges and innovation aspirations

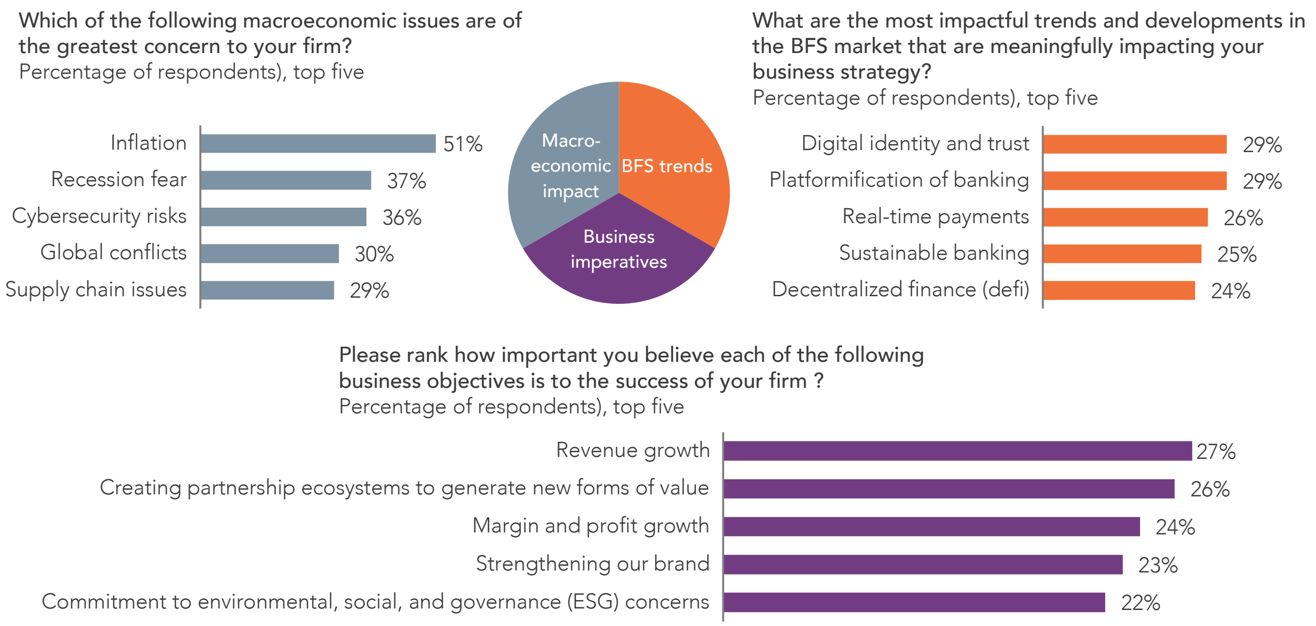
Spiraling inflation and recession, the proliferation of cybersecurity risks, a global conflict, and a fractured supply chain create a difficult market environment for commercial banks (see Exhibit 1). Macroeconomic forces feel weightier for commercial banks looking to drive growth, but the silver lining is that innovation and technology advancements are at their best.

Commercial banks view digital identity and trust and platformification of banking as the most impactful innovation trends that could help leapfrog aging processes like onboarding. Sustainable banking presents a massive opportunity to mobilize finance to aid commercial clients to transition net-zero carbon emissions.

Creating partnership ecosystems to generate new forms of value has joined the ranks of the traditional business objective of revenue growth as critical to enterprise success. The ecosystem partner approach will help commercial banks enhance service capabilities to existing clients while enabling them to excel at delivering new client service models for their digitally native customer base. Margin and profit expansion has slipped to the third spot in the ranking, with banks prioritizing new forms of value rather than creating shareholder value.

There are no crystal-ball-like predictions on the eventual severity and duration of the crises. Still, independent of baseline views of the economic outlook and concerns, commercial banks need to balance macroeconomic uncertainty and innovation potential to gain a competitive advantage and win a greater share of their current and future commercial clients' wallets.

Exhibit 1: Commercial banks are weathering macroeconomic challenges, capitalizing on the excitement of innovation, and tapping partner ecosystems' adjacencies



Sample: 150 commercial banking leaders
Source: HFS Research in partnership with Infosys, 2023

Critical takeaway: At a time of growing divergence, commercial banks everywhere need to work harder to "future-proof" themselves, improving their short-term resilience and embracing longer-term opportunities to grow and become more profitable.

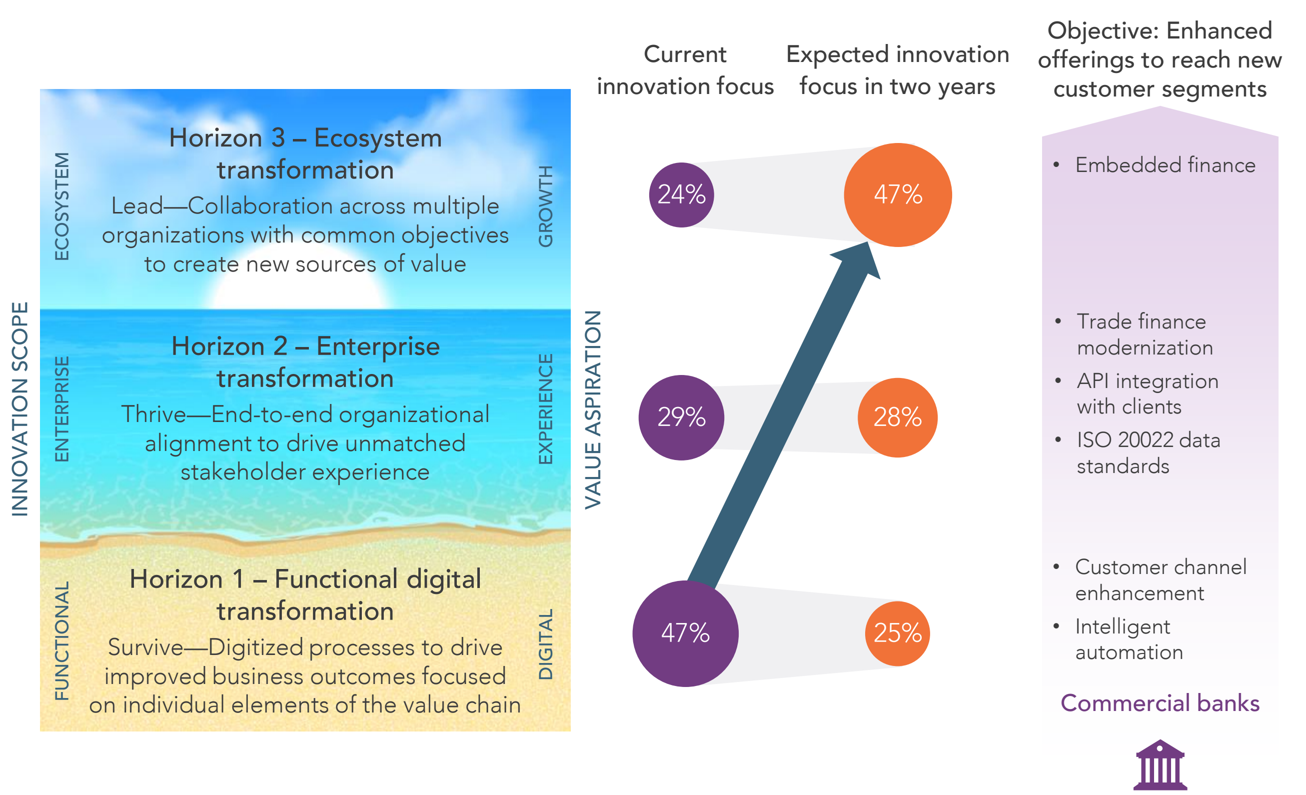
Unlock growth and value as commercial banks progress through each Horizon

Ecosystems have emerged as the new hope for driving growth in commercial banks. HFS defines ecosystems as collaboration across multiple organizations with common objectives to create new sources of value. Effective ecosystem creation is tied to enterprise maturity and innovation adoption. HFS views innovation across three Horizons:

- **Horizon 1**: Functional digital optimization, the current state, required to survive
- **Horizon 2**: End-to-end enterprise modernization, the required state, necessary to thrive
- **Horizon 3**: New value creation through ecosystems, the future state, the opportunity to lead

We asked our survey respondents to comment on their current focus on enterprise innovation and their planned focus in two years, mapped to the three Horizons (see Exhibit 2). The current reality is firmly Horizon 1, with 47% of respondents indicating they focus on digital optimization, often at the functional or line of business level. The remainder is split between Horizon 2 and Horizon 3. The innovation outlook for two years from now shows aggressive progress plans. Respondents plan to flip their focus and investments from Horizon 1 to Horizon 3 as they court ecosystem development and associated new value

Exhibit 2: Each innovation Horizon unlocks growth and value; the Horizons model is a blueprint for commercial banks aspiring to unlock the highest value through innovation for clients



Sample: 150 commercial banking leaders
Source: HFS Research in partnership with Infosys, 2023

We've mapped commercial banks' investment plans to the Horizons model. In Horizon 1, commercial banks harness intelligent automation to drive operating efficiencies and standardization and diversify customer channels for better client engagement. After optimizing Horizon 1, the innovation focus moves to Horizon 2, and the outcomes change. Horizon 2 focuses on modernization and experience, with efforts to drive data standards and integrate application programming interfaces (API) with clients. Modernizing infrastructure to support enhanced international trade finance and building an open banking environment helps round out modernization initiatives—vital to large corporates and a growing number of SMEs. As a bank progresses to Horizon 3, all the work on enterprise-wide modernization pays off, and commercial banks can realize the aspiration to effectively collaborate with ecosystem partners to claim a share in the fast-growing market of embedded finance, an opportunity premised on effective ecosystem collaboration.

When we boil down all the data from commercial banks in this study, the resulting value objective is that commercial banks are keen to leverage innovation to expand their customer base. The Horizons model offers a roadmap for execution, manifesting different forms of value with progress through the Horizons.

The ecosystem opportunity in Horizon 3 is wildly exciting but also wildly unrealistic unless commercial banks take measured steps to address enterprise modernization and decades of legacy technology. There is no skipping Horizon 2. Those trying to do so will be sucked into the Horizons innovation chasm of limited progress. Neeraj K. Jindal, Vice President and Head-FinTech, Infosys, summarized the ecosystem imperative that helps manifest Horizon 3 values.

> With the adoption of open finance, banks are rapidly evolving from standalone firms to ecosystems. Embedded finance, as an example, is a rapidly growing market currently valued at $20 billion, and it presents a new avenue for banks to acquire and retain clients. The ability to interface with the ecosystem is a prerequisite, and banks must have technological maturity, including API-based architecture and data expertise, to enable collaboration with fintech firms, technology providers, and e-commerce platforms.
>
> – **Neeraj K. Jindal**,
> Vice President and Head-FinTech, Infosys

Critical takeaway: The Horizons model is the blueprint that can help commercial banks improve their innovation and unlock value for clients along a stepped continuum. Commercial banks must advance through the Horizons; otherwise, they will struggle to reach Horizon 3 because they will not be able to effectively collaborate with ecosystem partners.

Commercial banks are creating models fit for purpose for their target customer base of SMEs and start-ups

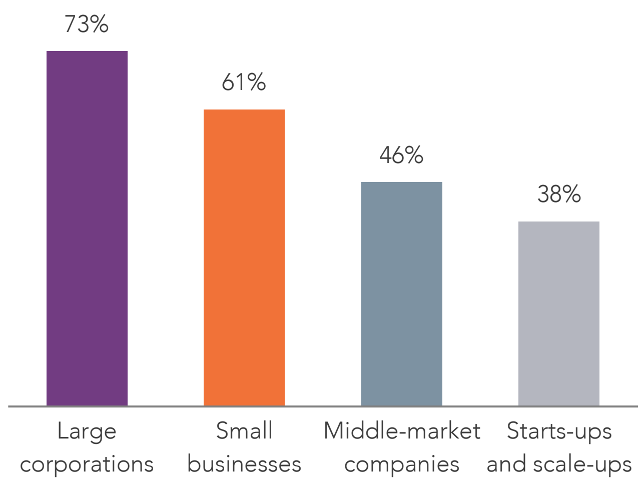
Unlike payment providers clamoring to launch new offerings, commercial banks focus on continuing investments into existing offerings. Respondents indicated that their top five commercial banking products and services today are deposit accounts (66%), lending and lines of credit (55%), commercial cards (51%), merchant services (49%), and trade finance (45%). The areas offering the most expansion over the next two years are…drum roll, please…more of the same. Lending and lines of credit, deposit accounts, and commercial cards will be the top three expansion areas. Sexy new offerings are not the growth mantra for commercial banks; the focus is on executing core offerings better.

We do see some interesting growth potential in expanding customer segments. Large corporations have long been the bread and butter of commercial banks, as shown in Exhibit 3, where the category leads the roster of current customers served (73%). Less than half of our respondents work with middle-market, start-up, or scale-up firms. Respondents expected this distribution to change. When asked about the fastest-growing customer segments over the next two years, 89% of respondents picked either start-ups and scale-ups (35%), small businesses (28%), or middle market companies (25%).

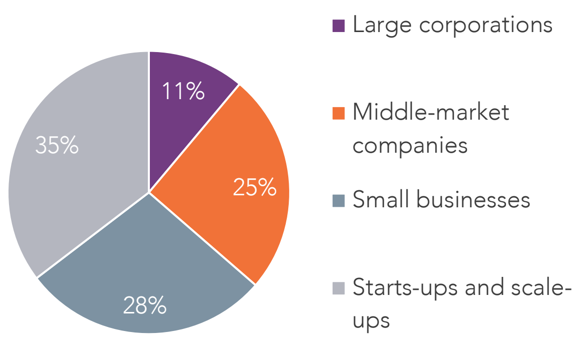
In the aftermath of Silicon Valley Bank's (SVB) failure and the ensuing liquidity crisis, the finance partner gap in the start-up ecosystem presents a revenue opportunity for commercial banks. It's easier said than done for many commercial banks, which, despite claims of pursuing this sector, typically don't have the risk appetite for early-stage companies. As our study underscores, the interest is there, but will established banks dive in?

Exhibit 3: Failing to leverage digital's full potential to serve SMEs and start-ups would be leaving piles of money on the table

What customer segments do you currently serve?
Percentage of respondents



Which of these is expected to be the fastest growing over the next two years?
Percentage of respondents



Sample: 150 commercial banking leaders
Source: HFS Research in partnership with Infosys, 2023

Despite the demand for banking from SMEs and start-ups, the opportunity to successfully service the segment is elusive, largely attributable to the complex and rapidly evolving banking needs and unstable risk profile. Since no one-size-fits-all approach can work for the segment given its varied needs, business types, and decision makers, banks can only profitably serve the segment via enterprise modernization in support of new customer segments' varied and growing demands. Commercial banks need to lean into innovation to help improve their risk management practices and satisfy the tech-centric and consumer-banking-centric expectations of start-ups and SMEs. Chinmay Patel, Chief Technology Officer at Citizens Bank, reinforces the intensity of banks' need to act now to balance the converging forces.

> With the rapidly evolving market trends, macroeconomic environment, and competitive landscape, it is important to raise the bar with superior customer engagement, tailored solutions, and embedded capabilities. Commercial banking is the next frontier. At Citizens Bank, we are committed to redefining banking with innovative technology solutions.
>
> – **Chinmay Patel**, CIO, Commercial Banking Technology, Citizens Bank

Critical takeaway: Commercial banks want to drive growth by expanding the customer segments they serve. In order to serve SMEs and start-ups well, banks need to innovate to make purposeful strides in their segment-specific capabilities, service models, and value propositions. Their existing clients will also benefit.

Win clients by improving customer onboarding time through digital— one of the worst pain points for clients is a complex onboarding process

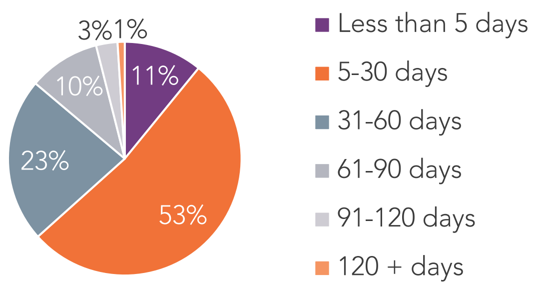
Commercial client onboarding remains a daunting process for customers, fundamentally taking longer than needed primarily due to outdated processes. Exhibit 4 shows that fifty-three percent of our survey participants indicate it takes 5 to 30 days to onboard commercial clients, while 23% have a 31-to-60-day window. The average onboarding time for the sample is 32 days. In retail banking domains—and almost every facet of their life as a consumer—clients are exposed to personalized and speedy banking access. This overly long onboarding time risks creating dissatisfied clients and has more serious financial implications, such as decreasing time-to-revenue.

When we queried our survey participants about the bottlenecks slowing the onboarding process, the top inhibitors were implementation or integration requirements (33%), legal and contractual issues (29%), and regulatory issues (17%). Delays due to implementation and integration requirements are often down to challenges or complexity around propping up the twenty-plus-year standard of host-to-host connectivity.

Legal and contractual issues like know-your-customer (KYC) due diligence are still overly manual and lacking internal connectivity in most banks. Breakthroughs in automation and AI can aggregate public data, eliminate duplicative elements in forms, support self-servicing platforms for KYC, and set a rigorous evaluation process that satisfies local and global regulatory bodies. Here, third-party providers and fintechs offer onboarding digital functionality as a value proposition that can complement the bank's in-house technology.

Exhibit 4: Commercial customer onboarding takes on an average of 32 days; integrations slow the long onboarding.

What is the average amount of time it takes to onboard a commercial customer?
Percentage of respondents



The average onboarding time is 32 days

What is the top factor slowing customer onboarding?
Percentage of respondents

- 33% Implementation or integration requirement
- 29% Legal and contractual issues
- 17% Regulatory issues
- 15% Customer delays
- 7% Data mapping needs

Sample: 150 commercial banking leaders
Source: HFS Research in partnership with Infosys, 2023

Critical takeaway: Prioritizing the onboarding of commercial clients is quickly becoming a top agenda item for many banks. Investing in this overlooked aspect of customer experience represents not only an opportunity for competitive differentiation and greater process efficiency but also future revenue growth with existing and targeted customer segments with high expectations.

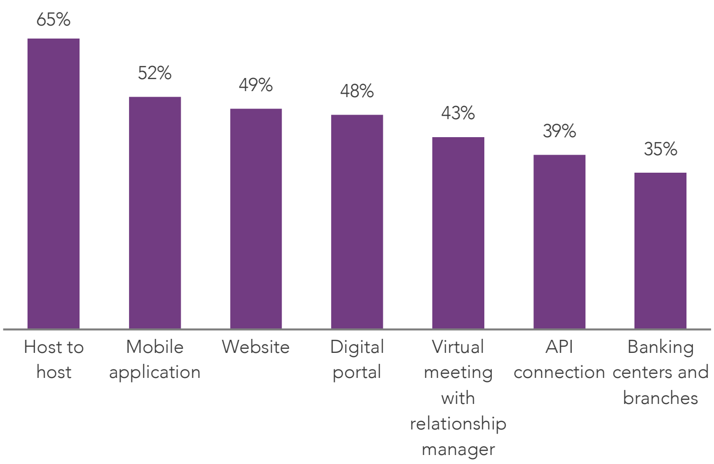
Out with the old and in with the new—APIs and virtual meetings to become the de facto way to engage with commercial banks in the future

For most of two decades, commercial banks have relied on host-to-host technology based on legacy web services to integrate with their client systems. That seems to be the state of play today, with 65% of commercial banking respondents indicating that the top way they interact with their clients is through file-based integration. This works well for a single-step transaction, but this technology cannot support complex needs like global transactions with multiple routes or real-time liquidity management.

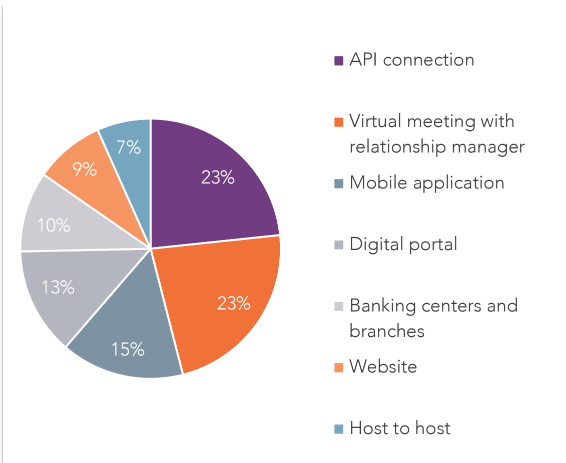
But the tides are turning. Twenty-six percent (26%) of respondents expect APIs and virtual meetings with relationship managers to grow the fastest, while only 7% have the same expectation of host-to-access. Given all the potential upsides with API connections like real-time data, instant transactions, seamless flow of data in a secured closed network, and self-servicing onboarding, it's no surprise that APIs represent a significant disruption to how commercial banking services will be consumed. Corporate treasury functions will be powered by APIs with real-time access to instantly assess cash positions and payment execution within their enterprise resource planning (ERP) systems.

Exhibit 5: Enough with host-to-host connectivity; commercial banks are prioritizing APIs and virtual meetings, a requirement for courting emerging companies

How do your customers typically access your products and services?
Percentage of respondents



Which access method is expected to grow the fastest over the next two years?
Percentage of respondents



Sample: 150 commercial banking leaders
Source: HFS Research in partnership with Infosys, 2023

In his role as Head of Analytics and Process Optimisation at Citi Enterprise Operations and Technology, Ben Rayner gives us a glimpse into current technology's ineffectiveness for accessing commercial bank services.

> The problem is that commercial banking is so manual, with loads of legacy and subject to phone conversations and less tech investment. While banks love whizzing things through the pipes on the market side, it takes loads of human interaction and automating queues in commercial banking. It needs more self-service and API integration.
>
> – **Ben Rayner**, Head of Analytics and Process Optimisation, Citi Enterprise Operations and Technology

Critical takeaway: Host-to-host technology is still widely used in commercial banks due to its highly customizable capabilities. But many commercial banks are considering using APIs more to take advantage of real-time, faster, and more secure technology. Commercial banks that have not yet taken steps must act urgently to enhance their own API propositions and ensure they optimize client engagement and remain relevant in the fast-evolving landscape.

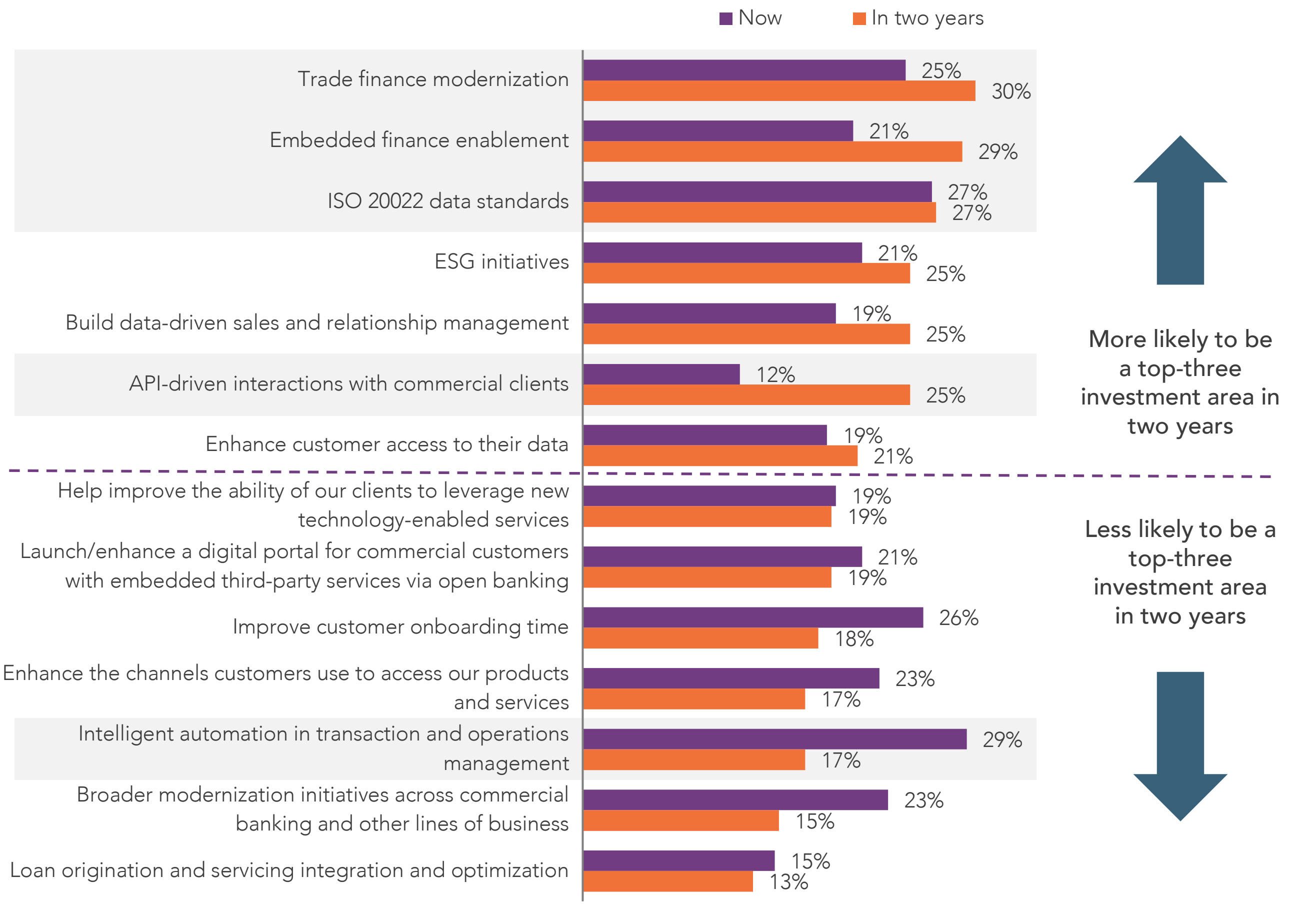
A "Hurray!" moment: Planned investments align with offering enhancements to serve existing and targeted customer segments better

The path to value for commercial banks is clear: Enhance offerings to serve large business customers better and attract new SMEs and start-up customers. We asked commercial banking leaders about their investment plans to see if this aligns with their plans for customer expansion. Timing is critical for commercial banks hoping to retain their existing clients by serving them more effectively and achieving their desired expansion strategy with SMEs, start-ups, and scale-ups. Modernization is key to making this a reality.

Exhibit 6 shows that commercial banking leaders currently prioritize investments in intelligent automation in transaction and operations management (29%) and ISO data standards (27%). Intelligent automation initiatives will likely be in sprints rather than multi-year projects and can achieve near-term cost savings through reduced processing time, greater straight-through processing, and reduced manual work.

Exhibit 6: A moment of truth: Commercial banks are investing along their customer expansion plans and meeting the demand for modernized trade finance and embedded finance

What are the top three areas of investment in your commercial banking capabilities now? In two years?
Percentage of respondents



Sample: 150 commercial banking leaders
Source: HFS Research in partnership with Infosys, 2023

In two years, priorities will shift from optimization toward modernization, focusing on trade finance modernization (30%) and embedded finance enablement (29%). We see connective tissue in timelines for investing in trade finance modernization, with the demand among large enterprises and SMEs wanting to accelerate and initiate their engagement in international activities, participate in the global value chain, and foster inclusivity in trade. These enterprises will look to their banking partners to lower the barriers of complexity, high costs, and resource-intensive due diligence. The focus on embedded finance aligns with API investment and the opportunity to enable commercial customers to enhance their offering capabilities.

Commercial banks serving large corporates and targeting SMEs and start-ups compete with the fully evolved digital experiences retail banks and payment providers offer. With their open and responsive architecture and technology, retail banks and payment providers are ahead of the curve to comply with ISO 20022 data standards and facilitate embedded finance. These customer segments are already exposed to sophisticated real-time and hyper-personalized banking experiences. Mohit Mehta, CTO of Wholesale Banking and Payment at Truist, shows us the increasing importance of digital services and the value placed on investing in them.

> Our focus at Truist is always just on that: How can the investments we seek to make today create a more unique and efficient offering through our products and services? It could be the use of smarter analytics, better risk control, or even efficient customer servicing tools—all of which help create a positive payment experience for our customers. We want to focus on these critical areas more; we believe these are the key differentiators. This is what, in our opinion, future client relationships are going to evolve around.
>
> **– Mohit Mehta**,
> CTO of Wholesale Banking and Payment, Truist

Critical takeaway: Commercial banks' investments and digital efforts should build a compelling value proposition to serve their large business customers better and expand by targeting the growing SME and start-up segments.

Antiquated business practices and legacy tech keeps commercial banks from realizing value from their investments; too many ineffective partners are part of the problem

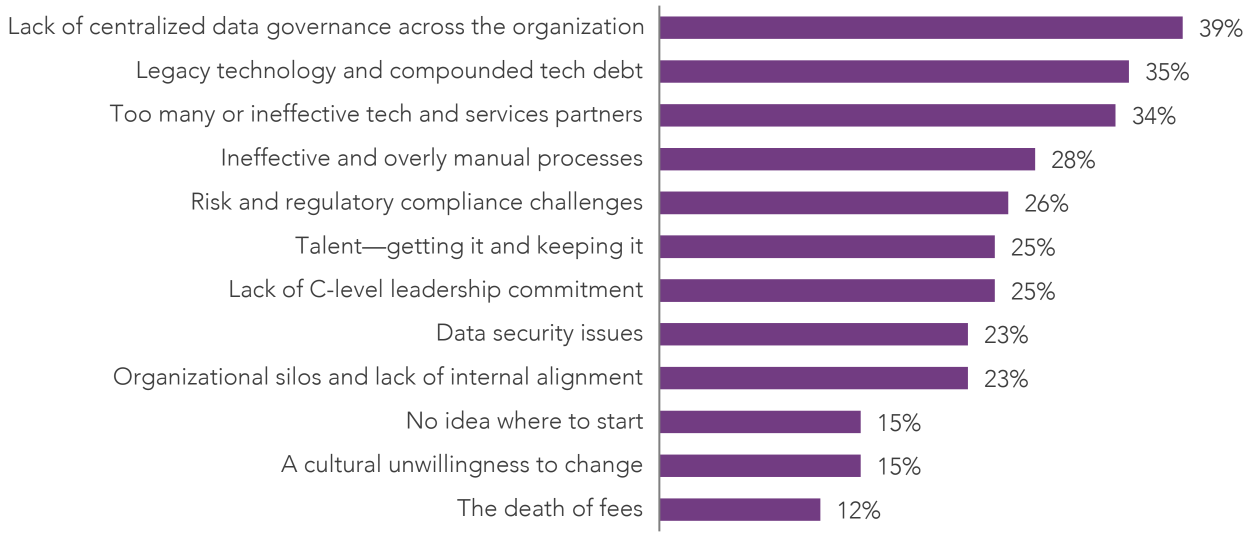
Commercial banks have a well-defined innovation roadmap, good potential for customer expansion, and investment plans that align with growth objectives. So why are most commercial banks stuck at Horizon 1 in Exhibit 2?

We asked commercial banks what's inhibiting progress (see Exhibit 7); it wasn't a surprise that they identified a lack of centralized data governance (39%) as the top inhibitor preventing commercial banking leaders from achieving their Horizon 2 and 3 goals. Banks generate the most data, and they need to manage and use it effectively. Centralized data governance can meet heightened regulatory compliance and reporting needs, and interpreted data can be an adjunct to customer-centricity. Banks cannot address the enormity and complexity of the data challenge with a quick fix or half-measure solution. The solution requires a strong data foundation, effective controls aligned with compliance mandates, and data harnessed to create a sustainable business advantage.

The challenge of legacy and technology debt (35%) looms nearly as large as data challenges, reminding us why commercial banks need modernization in the first place. The third biggest inhibitor, which should have been an integral part of the solution mix, is having too many ineffective tech and service partners (34%). If service providers merely support business-as-usual operations, it's time to refresh.

Exhibit 7: A lack of centralized data governance and dealing with legacy tech keep commercial banks from realizing value from their investments; ineffective partners are part of the problem

What are the three biggest challenges to realizing value from these investments?
Percentage of respondents



Sample: 150 commercial banking leaders
Source: HFS Research in partnership with Infosys, 2023

Ineffective and overly manual processes (28%) compound the top three challenges. Current investments in intelligent automation in transaction and operations management (see Exhibit 6) should take some edge off the overly manual processes in back-end operations. Intelligent automation permeates the value chain for commercial banks in transforming overly manual processes, including optimizing customer journeys and reducing process complexities. Optimizing and digitizing banks' heavy manual processes, rigorously prioritized by potential cost impact, can achieve significant near-term cost savings.

Critical takeaway: Commercial banks risk being stranded at Horizon 1 unless they are willing to grapple with persistent transformation roadblocks such as data, legacy tech, ineffective service partners, and overly manual processes. As commercial banks progress on their innovation journeys, they need to learn from the experiences of companies native to the digital business environment and firms in other financial sectors, such as retail banking, that are further down the digital path.

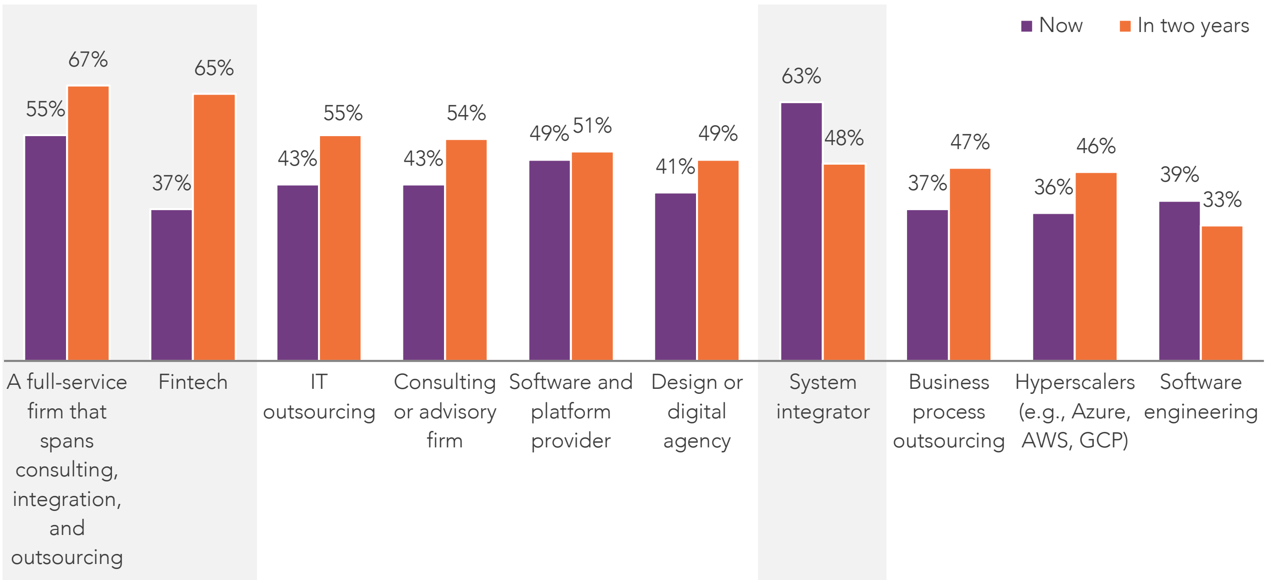
With the right approach, partnerships are the catalyst to unlocking value across innovation horizons

Commercial banks view antiquated service provider partnerships as inhibitors to realizing value, as shown in Exhibit 7. It can take a year or more to vet and onboard partners due to various risk and regulatory standards, so approved vendors tend to stay for the long haul, seeking ways to stay perpetually useful amid changing macroeconomic circumstances and digital shifts. The difference is participation versus innovation. Great partners need to do more than show up every day. They need to earn their right to continually support their clients. Commercial banks can learn from their colleagues in retail banking and payments, who drive strong innovation agendas forward with strategic service partners.

We asked our respondents to indicate which kinds of partners they work with now and their plans for the next two years (see Exhibit 8). Our respondents currently use two types of partners most: 63% leverage system integrators (SI), and 55% use full-services firms (spanning consulting, integration, and outsourcing). Two years from now, we will see a shift in expected partnering behavior. Full-services firms make a strong gain to 67%, and SIs significantly decline to 48%; the most marked increase is with fintechs, to 65%.

Exhibit 8: Commercial banks favor SIs and full services firms, with a growing need for fintechs in the future

Please indicate which of the following types of partners you currently work with? What about in two years?
Percentage of respondents



Sample: 150 commercial banking leaders
Source: HFS Research in partnership with Infosys, 2023

A global payments services provider indicated that full-service firms could solve many problems and take holistic ownership, often pulling through partners such as fintechs. The IT Director of a global payments services provider shared:

> We selected our services partner for our payments settlement transformation based on their existing knowledge of our systems, skills, and understanding of needs, and they presented a full solution inclusive of hardware and software. It was a complete solution in every sense of the word.
>
> – IT director
> at a global payments provider

Fintechs, once feared by banks, are becoming partners of choice for their ability to bring the latest and greatest technology-led innovation to complement established banks' offerings. Commercial banks that have not adequately invested in Horizon 2 modernization, as outlined in Exhibit 2, may be hard-pressed to realize value from fintech partners as they cannot adequately integrate, often lack the requisite skills, or risk disintermediation by surrendering customer relationships and revenue to their more nimble fintech partners.

Critical takeaway: As banks' interest in fintech partnerships grows, so does the corollary role of full-service partners as ecosystem orchestrators.

Commercial banks’ use of strategic partners is growing, but they need to be more selective

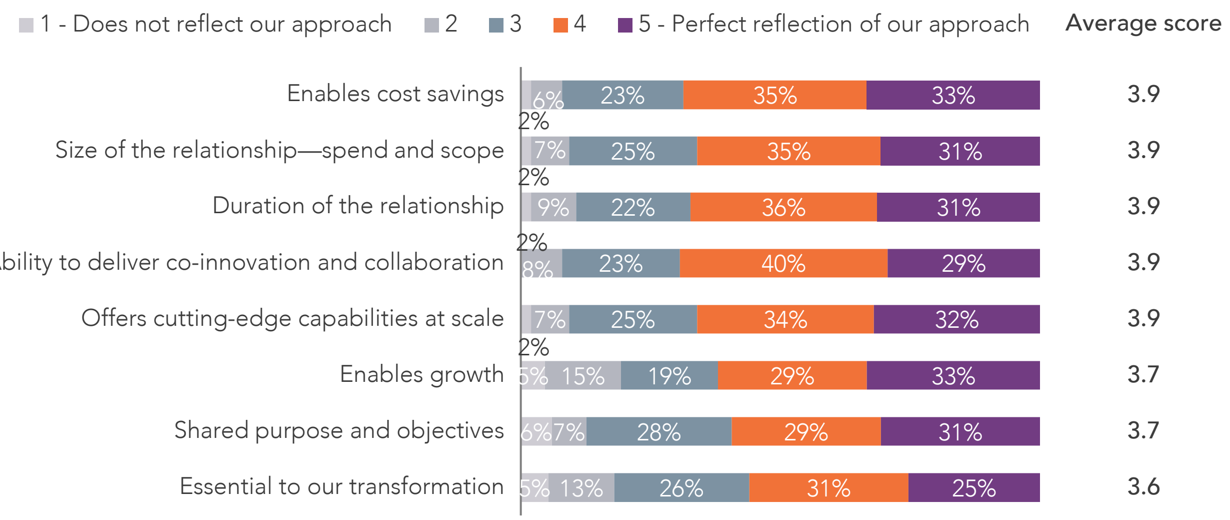
We questioned commercial bank leaders to understand how many partners are deemed strategic, the trend trajectory, and how they define “strategic.” Commercial banks identified multiple attributes as characteristics of strategic partners, including cost savings, offering capabilities at scale, the ability to co-innovate and collaborate, and the duration and scale of the relationship, as seen in Exhibit 9. Commercial banks prioritize almost all attributes as strategic. This is part of the problem. The lack of clear articulation of strategic partners has inhibited banks’ progress to Horizon 2 and Horizon 3 because they must interact with too many ineffective partners in their solution mix (see Exhibit 7). Commercial banks need to be more selective about what qualifies a partner as “strategic.”

The plot thickens. Commercial banks indicated that, on average, they work with 12 strategic partners. Over the next two years, 63% of respondents anticipate an increase in this baseline figure (see Exhibit 10). Given the imprecise and overly generous approach to defining a strategic partner (see Exhibit 9) and their assertion that too many ineffective partners are holding them back (see Exhibit 7), commercial banks would be wise to thin and define their partner roster before swelling the ranks.

Partnerships are integral to banks’ response to progress through the Horizons; their value is not contested. However, to reap the full benefits of partnerships, banks need a focused approach to identifying which partnerships are strategic. Additionally, to leverage partner competencies effectively, banks need to evaluate what’s core to their differentiation and determine if they can develop it themselves or whether they are better placed (and exposed to less risk) to partner with a service provider. Without this self-assessment, partnering will always perpetuate mediocrity.

Exhibit 9: Commercial banks have too many criteria for defining partners as strategic; they need to be more focused and selective!

What makes a partner strategic?
Percentage of respondents



Sample: 150 commercial banking leaders
Source: HFS Research in partnership with Infosys, 2023

As commercial banks chase growth by serving their large business customers better and targeting their growing customer segments of SMEs and start-ups, strategic partners will be imperative to this equation. Rohan Ranadive, Head of Third-Party Risk Management at a large US financial institution, adds a real-life perspective to the meaning of "strategic partners."

> Partner numbers are going up. Everyone wants to be a strategic partner. However, there is often no focus or identifiable purpose for their roles. And many of these so-called strategic criteria are odd bedfellows—like co-innovation and cost savings are oxymorons. And great talent does not come cheap. There is often a lack of clarity between co-innovation and collaboration. I would question whether tech leaders really want to co-innovate or would they rather have providers do what they are told.
>
> **– Rohan Ranadive,**
> Head of Third-Party Risk Management, large US financial institution

Exhibit 10: Commercial banks will embed partner competencies to grow their traditional offerings and serve their targeted customer segments

How many strategic partners does your firm have today?

12

Average number of current strategic partners used by commercial banks

How will this change in the next two years?
Percentage of respondents

63%

Percentage of commercial banks that expect to increase their strategic partners in the next two years

Sample: 150 commercial banking leaders
Source: HFS Research in partnership with Infosys, 2023

Critical takeaway: Simply adding more "strategic" partners will not drive modernization and growth. Commercial banks need to be partner-ready with clear objectives and outcomes. Select partners that help make real progress, increasingly through more than just cost savings.

The Bottom Line: Commercial banks need a digital reboot to serve their existing customers better and target new customers. Banks must boot useless partners, or they risk staying stranded in Horizon 1.

Commercial banks' best strategy for growth is to serve existing customers better and attract new customers. The path to achieving this strategy is clear: They must focus on executing core offerings better, not just launching or flooding their customers with sexy new offerings. Commercial banks are committed to and investing in digital optimization capabilities in areas like intelligent automation in operations. They need to continue this modernization to broader business initiatives like trade finance modernization in support of international capabilities and embedded finance enablement to help enhance clients' capabilities. It is not a headlong dash toward a digital reboot and developing "all" these capabilities, but a broader innovation strategy mapped against the three Horizons. The worst thing a commercial bank can do is stay stranded in Horizon 1. Digital optimization of functions may help processes flow better, but it will likely not satisfy the growing needs of large bread-and-butter corporate clients, and it certainly will not attract digital-hungry SMEs. Commercial banks should leverage the Horizons framework to define their best path forward.

However, various challenges inhibit commercial banks from realizing value from innovation—lack of centralized data, legacy technology, ineffective partners, and overly manual processes. Partners have become a part of the problem because commercial banks need to update their definitions of what they need from strategic partners, moving away from tenure and business-as-usual operations to focus more on innovation-led modernization. It's a quality—not quantity—play. Commercial banks must redefine their needs and requirements for strategic partners as part of modernization initiatives. Partners must continue to prove their worth by providing value and outcomes. Partners that have outgrown their usefulness must get the boot.

Let's be clear. The partner imperative is not contested. The problem is that a lack of a clear definition of what makes a partner "strategic" has impeded innovation progress. As innovation becomes complex in a maelstrom of macroeconomic events and digital shifts, commercial banks have identified end-to-end services partners as the ones who will have a major role in supporting their digital reboot, supplying some fraction of the skills and technology innovation needed to make progress. Increasingly, the concept of end-to-end partners also includes curating technology inclusive of fintech, hardware, and software.

This report is part three of a four-part series examining the growing importance of ecosystems in the BFS market through the lens of making practical progress across the innovation Horizons and savvy use of partners to help drive modernization and create new forms of value. The series includes a broad view of banking and financial services trends complemented by drill-down spotlights on innovation and ecosystems in payments, commercial banking, and wealth and asset management.

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