Innovation Insight: How Ecosystems Transform Lending and Drive Assets Growth

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Initiatives: Financial Services Industry Business Insights

Gartner research shows strategic partnerships directly support financial institutions' growth initiatives, but aligning innovation with business outcomes remains a challenge. Financial institution leaders can use this research to learn innovative ecosystem approaches that can drive lending growth.

Overview

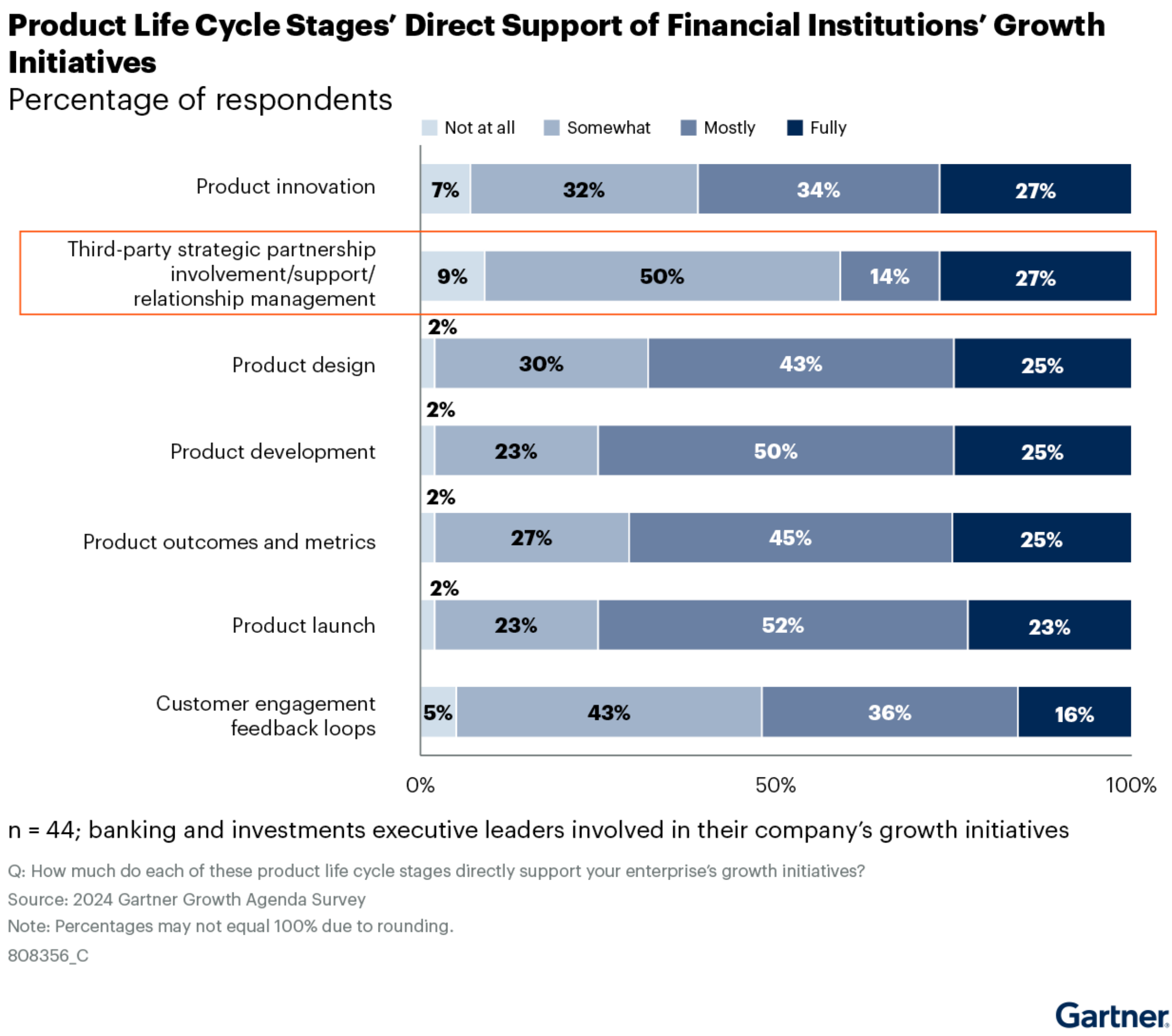
Key Findings

- Based on our interactions with banking clients, we have found technologies are not the cure to drive lending growth.
- In the next two years, more than 70% of the banking and insurance respondents from the 2023 Gartner Industrialization of Digital Business Survey expressed that they will significantly increase focus on product design and innovation capabilities.
- Eighty-seven percent of financial services respondents from the 2024 Gartner Board of Directors Survey reported that their organizations have either achieved or exceeded return on capital employed in generating new products and services and revenue streams that required business model change.

Recommendations

- Allow multiple projects to serve wider enterprise needs, as attempts to address all of the enterprise's lending needs with one solution is impractical. Deploy new models or innovative products with the right technology bundle to acquire new client segments, or to meet clients' requirements when needed.
- Develop ecosystem technology capabilities by focusing on the three fundamentals of ecosystem delivery — data analytics, partnership management, and connectivity and integration technologies.
- Enable real-time insights for business growth by monitoring key processes and using the data to drive improvements that impact revenue, cost reduction and risk mitigation.
- Set reasonable KPIs on ROI of innovation initiatives, since risks of any early-attempted innovation are hard to estimate.

Figure 1: Product Life Cycle Stages’ Direct Support of Financial Institutions’ Growth Initiatives



Lending system modernization is not a guarantee to drive assets growth. This is because a modernized lending system can serve as the foundation to support overall assets strategies. However, the deployment of a technology that can be adopted by any bank won’t make the whole lending business unique to the clients. The competitiveness can be generated through the understanding of your clients’ needs, the value of the business models, and any market or industry pain points.

This research will help financial institutions to learn the new ecosystem approaches and use cases that can drive the growth of asset portfolios.

Introduction

According to the 2024 Gartner Growth Agenda Survey, third-party strategic partnerships directly support enterprise growth initiatives for 91% of banking respondents (see Figure 1). [1] JPMorgan Chase research stated that ecosystems could create a $70 trillion network economy across at least a dozen sectors by 2030. [2] Under such circumstances, building an ecosystem through partnership will play a significant role to upgrade the model of existing financial products and experiences, and deliver value beyond traditional banking. The race of the ecosystem among banks has already started (see Top Trend in APAC for 2024: Banks' Competition in Ecosystem).

Description

*A **lending ecosystem** is a solution that embeds financial institutions' lending products and services within digital ecosystems. Such a solution can build new and customized products beyond existing offerings based on clients' needs and enable financial institutions to win in an increasingly crowded market.*

Employing a lending ecosystem as a solution requires smooth integration and aggregation of a wide range of ecosystem partners with flexible finance products and services. The aim is to provide more customized finance products, while speeding up the application process. Such a solution should be focused on:

- **New lending models,** such as marketplace, cross-border e-commerce components to embed finance everywhere when needed.
- **New products and services,** such as buy now pay later, which are dominating in the major markets in the world and changing how people lend when trade occurs.
- **Automated and simplified lending processes,** such as streamlined position management and posting updates to accounts and other financial records. Another example is automated execution of transactions based on customer orders or contract conditions.
- **Data driven analytics** based on a central customer database that unifies customer positions across all products to provide analytics like hyperpersonalization features for frictionless onboarding and insights for customer management and identification for cross-selling opportunities among different asset classes.

- **Platform architecture,** which involves a composable core engine and build-out architecture on a platform so that financial institutions can leverage both internal resources and external ecosystem partners' capabilities and data to design innovative solutions and new product bundles.

Benefits and Uses

Drive Asset Portfolio Growth Through Ecosystem Solutions

Driving asset growth is not necessarily the outcome of a modernized lending system. Banks also need to explore new models and innovative offerings to achieve lending business goals. Included below are some market practices in terms of new lending ecosystem solutions:

- **Open banking lending:** An open banking lending solution allows financial institutions to create an innovative client-centric model to embed third-party products and services on a platform. Sound Credit Union (Sound) implemented an advanced auto lending solution capable of loan issuance for subprime and near-prime borrowers within a short period of time. Sound's direct loans are processed using an outsourcing loan origination system, which is a robust platform containing third-party integrations that doesn't require too much custom configuration. [3]

- **Marketplace lending:** Marketplace lending is a growing alternative to traditional financial services to expand credit business to pair borrowers' and lenders' fundings needs in an open market. Using India as an example, the marketplace model helped Indian financial institutions improve credit flow, resulting in better customer reach and technology integration, and helped boost growth, assets and profitability. [4]

- **Trade finance ecosystem:** Trade finance ecosystems allow financial institutions to collaborate payments, financing, global trade business and information, and to enable smooth goods and services trading experiences. Trade finance and supply chain have developed a more vivid innovation ecosystem with flagship investments. For example, HSBC has developed a one-stop e-platform to manage corporate clients' transactions of guarantees, trade loans for sellers and buyers, import bills and import documentary credit, with reduced document exchange time and real-time status tracking. [5]

Ecosystems Promote Credit Risk Evolution

Improving operational efficiency and risk management are critical factors to implementing lending solutions. New ecosystem models like open banking lending and marketplace lending cannot rely on traditional credit analytics applications and old ways of risk warning techniques. Below are a few examples which illustrate a good market example of innovations from risk perspectives:

- **Innovative early warning system:** An early warning system (EWS) is a warning tool which is built through various indicators with high false positives to protect financial institutions from future risks. The traditional early warning system was built via a rule-based engine. With the fast evolution of regulatory policies and changing client needs, banks needed to improve their existing early warning systems. Doing so helped them respond to the huge variation in the quality of early warning systems and how credit assessment at micro and macro levels is core to risk management and provisioning. The benefits of having an innovative EWS are:
  - Reductions in loan loss
  - Improvements to regulatory capital
  - Enhancing the risk monitoring for credit chain from loan origination to fulfillment
- **Data-driven credit application:** Data-driven applications can assist financial institutions to change the way businesses interact and deliver customer value through AI and data and analytics technologies. Hawaii Community Federal Credit Union implemented an AI-powered credit decision making platform aimed to enhance and automate its credit underwriting. This initiative enables the credit union to automate the lending process and shorten the time to make personalized credit decisions by considering the uniqueness of each client, thereby expanding credit access to more members in the local market. [6]

Proactive Customer Engagement and Creates Competitive Differentiation

With the evolution from product-centric to customer-centric institutions, leveraging new customer engagement channels and services has become one of the most important blocks for new ecosystem model construction. However, building effective channels for the sake of new client acquisition and quality service delivery has become a pain point for the whole industry. Banking anywhere, anytime should become a reality rather than a slogan. Below are examples of a channel case from Midland States Bank and an inclusive environmental, social and governance (ESG) solution from WeBank, which can be seen as innovative market examples in this regard:

- **Banking on edge devices:** Collected and analyzed data via edge devices such as Internet of Things (IoT) sensors can create actionable insights for financial institutions to serve clients in a better way. Customers may bank anywhere, anytime with a portable and connected device. Edge device means smoother and customized services leading to customer experience, and the Midland States Bank skill for Alexa devices is a classic example. [7]

- **Inclusive ESG solutions:** The importance of ESG brings new opportunities in the lending market. This enables financial institutions to expand their assets portfolio through inclusive programs for underserved groups. We have seen some banks adopt blockchain, AI and data science technology to improve efficiency of digital for inclusive finance services. For example, WeBank launched “WeBank Blockchain” to focus on ESG. [8]

Risks

There are some risks associated with lending itself. These risks largely pertain to business model sustainability and the credit decisions that financial services leaders need to consider as they explore lending ecosystems:

- **Manage third-party risks:** When banks engage any third-party in a lending accommodation, they become exposed to many risks — strategic risk, reputation risk, operational risk, transaction risk, credit risk, compliance risk and others. And those third-party risks are difficult to manage, because such risk is nonstandard, and can vary greatly depending on each arrangement, risk assessment, due diligence thoroughness and oversight.
  - **Mitigation:** Before engaging any third-party, financial institutions should assess the organization's overall business strategy and risk appetites. They are also encouraged to establish an in-house guideline to cover the workflow and risk control methodologies for the whole life cycle.
- **Handle servicing risks:** Given the large volume of client data, handling of documents and movement of funds between institutions and counterparties, banks should anticipate risks that could arise from problems with customer service, product delivery, technology failures, outdated information handling, compliance constrictions and data security breaches.
  - **Mitigation:** Financial institutions should plan the modernization roadmap for both online and offline processes in parallel. Since lending solutions are not just operated through one system, but also various applications and systems, what financial institutions can do is to adopt AIOps to automate the IT life cycle, and ensure business resilience with observability into business analytics.
- **Anticipate benefits that don't materialize:** It's not always possible to determine if a new category of products or business models will become a distinct segment in the long run or achieve planned business outcomes. Risks of adopting emerging technologies without the proper determination of business goals and use cases might also become one of the risks of the project failing.
  - **Mitigation:** Financial services leaders should conduct preliminary market, customer, cost-benefit and exit-cost analysis to mitigate these uncertainties. Alternatively, financial services leaders could consider running a pilot program and limit long-term contracts with third-party partners or vendors. In addition, they can learn from industry peers, as well as seek professional advisory services with analysts and subject matter experts.

Recommendations

- Allow multiple projects to serve wider enterprise needs. Attempts to address all of the enterprise's lending needs with one solution would be impractical. For example, a supply chain platform can help enterprises shorten the cycle for accounts receivable and accounts payable. The commodity loan requires a separate loan structure design and deal booking. A good hybrid strategy should be able to integrate different business solutions, operational models, client services and so on.

- Develop ecosystem technology capabilities by focusing on the three fundamentals of ecosystem delivery — data analytics, partnership management, and connectivity and integration technologies. Revamping legacy systems, adopting appropriate architecture and leveraging data analytics can improve the overall capabilities of your lending solutions to fulfill both internal transformational goals, and to meet the needs of customers.

- Enable real-time insights for business growth by monitoring key processes and using the data to drive improvements that impact revenue, cost reduction and risk mitigation. For instance, enable data-driven capabilities in modules like assets and liabilities management (ALM) and FTP to deploy smarter capital allocation strategies and gain competitive edge in the market.

- Set reasonable KPIs on ROI of innovation initiatives, since risks of any early-attempted innovation are hard to estimate. Try to align with all stakeholders and set out a prioritization framework or criteria to identify the right set of use cases.

Representative Providers

Bankware Global, FIS, Infosys Finacle, Intellect Design Arena, JurisTech, Newgen, Nucleus Software

Evidence

2023 Gartner Industrialization of Digital Business Survey. This study was conducted to better understand the extent to which enterprises focus on capabilities such as improving the speed of their innovation, embedding digital into enterprise strategy and developing/leveraging visionary industry leadership to prepare for bigger changes to their markets, customer bases and methods for delivering value. The research was conducted online from June through July 2023 among 292 executive leaders from North America (70%), Europe (17%) and Asia/Pacific (13%), across all industries from organizations with at least $50 million in annual revenue. Respondents were screened for involvement in overall business strategy and digital business strategy. *Disclaimer: Results of this study do not represent global findings or the market as a whole, but reflect the sentiments of the respondents and companies surveyed.*

2024 Gartner Board of Directors Survey on Driving Business Success in an Uncertain World. This survey was conducted to understand the new approaches adopted by nonexecutive boards of directors (BoDs) to drive growth in a rapidly changing business environment. The survey also sought to understand the BoDs' focus on investments in digital acceleration; sustainability; and diversity, equity and inclusion. The survey was conducted online from June through August 2023 among 285 respondents from North America, Latin America, Europe and Asia/Pacific. Respondents came from organizations with $50 million or more in annual revenue in industries except governments, nonprofits, charities and nongovernmental organizations (NGOs). Respondents were required to be nonexecutive members of corporate boards of directors. If respondents served on multiple boards, they answered questions about the largest company, defined by its annual revenue, for which they are a board member. *Disclaimer: The results of this survey do not represent global findings or the market as a whole, but reflect the sentiments of the respondents and companies surveyed.*

[1] **2024 Gartner Growth Agenda Survey.** This study was conducted to better understand which tactics and approaches differentiate high-growth companies (those who achieved revenue growth of 10% or more) from others. The research was conducted online from 4 October through 27 November 2023 among 288 executive leaders from North America (n = 105), Latin America (n = 35), Europe (n = 104) and Asia/Pacific (n = 44), across all commercial industries, excluding information technology, and including 44 from banking. Respondents were from companies with at least $250 million or equivalent in annual revenue. Qualified respondents had personal knowledge of their company's financial performance and either led or participated in their company's growth initiatives. *Disclaimer: Results of this survey do not represent global findings or the market as a whole but reflect the sentiments of the respondents and companies surveyed. There are no respondents from China in compliance with the Personal Information Protection Law (PIPL).*

[2] Five Payment Trends for Growth Based on Current Conditions, JPMorgan Chase.

[3] Sound Credit Union Uses Open Lending to Expand Loan Availability to Underserved Near-Prime Borrowers, OpenLending.

[4] India's Digital Lending Market Likely to Grow $515 BN by 2030: Report, ETBFSI.

[5] HSBC Trade Solutions Platform, HSBC.

[6] Hawaii Community Federal Credit Union Selects Scienaptic AI to Revolutionize Credit Underwriting, The AI Journal.

[7] Alexa Banking: Voice Banking With Amazon's Alexa, Midland States Bank.

[8] WeBank Launches Its New Brand 'WeBank Blockchain' to Focus on ESG, Fintech News Hong Kong.

Recommended by the Author

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