

Challenger banks are fast emerging, raising the stakes for incumbent players and bringing unique propositions made possible by cloud. Banking in the post-COVID-19 era calls for a reimagination of digital.

# Challenger Banks Most Likely to Succeed, and How

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This IDC Event Proceedings summarizes the insights of an exclusive by-invitation-only digital roundtable organized by IDC, Red Hat, Thought Machine, and Intel.

The event saw a lively exchange among the attendees representing a cross-section of the industry: digital-only banks, digital brands of traditional banks, fintechs aspiring for digital bank licenses, and three technology providers enabling the journeys of today's emergent challengers.

## Key takeaways

1. A digital subsidiary is a quick way to address customers' digital expectations; mobile banking and social applications are the emerging battleground across the Asia/Pacific, with the new digital banks set to bring fast gains through financial innovation.
2. Cloud is a key part of their strategy for reimagining and delivering financial services at scale and speed.
3. Common standards are needed to drive epayments, while regulatory issues around data residency and customer information confidentiality remain hot-button issues.
4. Avoid unwanted scenarios like technology silos by having early conversations with cloud partners.

## Marks of the Best Challengers

IDC predicts that by 2022, more than 100 challenger banks will emerge across the Asia/Pacific region, introducing new and exciting ways of banking.

In trying to understand what makes today's market disruptors tick, IDC identified eight characteristics that define the Asia/Pacific region's best challengers to banking's status quo (see Figure 1).

## AT A GLANCE

### DIGITAL ROUNDTABLE

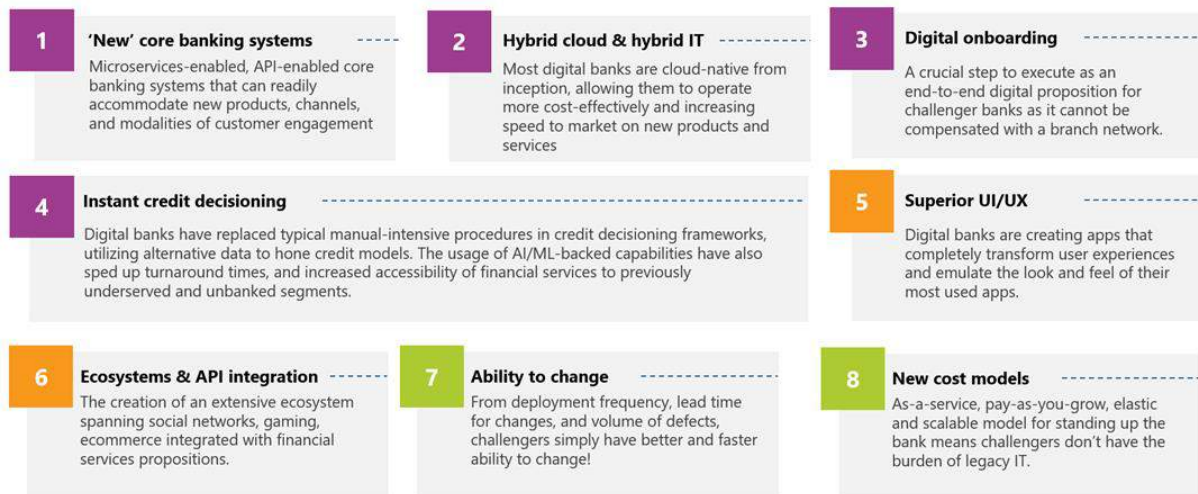
Friday, November 27, 2020

Roundtable theme: *Challenges Most Likely to Succeed, and how*

### MODERATOR & PANELISTS

- » Michael Araneta, Associate Vice President, IDC Financial Insights Asia/Pacific, as moderator
- » Arvind Swami, Director of Financial Services, Red Hat Asia/Pacific
- » Nick Wilde, Managing Director, Asia/Pacific, Thought Machine
- » Christopher Tan, Regional Alliance Manager, APJ, Intel Corporation

Figure 1: Defining Characteristics of the Best Challengers



Source: IDC Financial Insights, 2020

Leveraging technologies such as cloud to gain scale and agility, traditional banks have no choice but to leave their comfort zone.

"For the first time in a long time in core banking, the risk of doing nothing is greater than the risk of transformation," said Nick Wilde, Managing Director, Asia/Pacific, Thought Machine.

In this context of disruptive change, four key takeaways emerged from the roundtable.

### Banking on digital and ecosystems for greater financial inclusion

For traditional banks, building a parallel digital brand is a quicker way to address the digital expectations of customers, including those outside the financial sphere.

Attendees highlighted the appeal of building ecosystems, underpinned by security, agility, cost-efficiency, and a scalable infrastructure. This is necessary if they are to win a larger share of customers' transactions.

Ecosystems that span across multiple industries are among the "new" that banks are leveraging to stay relevant and competitive in the fast-evolving banking landscape. Having access to a larger pool of customers and gaining customer mind share through their everyday transactions bring significant opportunities in terms of customer reach and scale.

Indeed, mobile banking and social applications are the battleground where competition is expected to intensify.

According to the CEO of one of Thailand's latest digital banking joint ventures, leveraging non-financial data is an opportunity to gain behavioral insights into a bank's customers.

Another attendee agreed that instead of relying on a bank's customer branches, digital and mobile strategies are more cost-effective in widening access to financial services.

Competition among lenders is also heating up, as digital proves its efficiency as a distribution model with paperless and speedier processing. Unburdened by legacy systems, smaller fintechs have the advantage of being agile and are

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**Nick Wilde,**  
 Managing Director, Asia/Pacific,  
 Thought Machine

in a position to take higher risks and reach underserved segments, said one attendee from a leading peer-to-peer lender that is part of a consortium eyeing a digital wholesale bank license in Singapore.

Indeed, digital is where every bank is jostling for pole position. And the race is on in Southeast Asia's emerging markets.

Sharing the perspective of a Philippine digital bank, one attendee noted, "It is no longer the issue of fitting in an additional way of doing things, but to level up to where the proposition is more hybrid to become a neobank or a challenger bank."

The digital bank, which launched its finance app during the height of the pandemic, saw 3 million downloads within three months of the launch. He attributed the surge in downloads to the relatability of the app to Filipinos. "It is the only app using Taglish (a mixture of Tagalog and English) to hit the core of the barrier to entry of these segments to digital banking," he said.

All eyes are also on Vietnam, which has an unbanked population of more than 40 million and 4 million micro-merchants.

Amid the current pandemic and fast-changing consumer habits, digital banking is set to pick up the pace with the launch of Vietnam's first digital-only bank. Its goal is to plug the financial inclusion gap and build an ecosystem between customers and merchants. Small merchants will not only gain access to financial services but be able to also digitalize their operations.

### *Reimagine financial services with cloud for agility and scalability*

According to IDC's research, cloud adoption has reached critical mass, with 65% of Asia/Pacific financial institutions' workloads in private and/or public cloud environments. IDC further predicts that by 2023, 3 in 4 top Asia/Pacific banks will make substantial organizational changes with the goal of becoming digital-ready.

Cloud as a strategy has become more critical than ever for traditional banks, with challenger banks and fintechs being cloud native from inception. Being truly cloud native offers advantages for greenfield banks to buy best-of-breed technologies.

Most legacy cores are a highly integrated set of data structures, functions, processes, and products in a monolithic black box. Banks have thus collectively spent billions of dollars to wrap digital infrastructure around these to support developments such as online banking, and are facing increasing demands with platformization, Open Banking, and the like. The alternative to this is a best-of-breed approach which traditionally has required much higher integration effort and posed a challenge of ongoing maintenance, and the problem arises when a major component is no longer at the leading edge.

"Whichever path they took, [banks] spent a lot of money and encountered a lot of challenges, but cloud and APIs have started to change the picture in best of breed," said Wilde.

Describing Thought Machine as a "headless core", Wilde explained, "If a modern digital stack is built and architected properly, even the core can be unplugged and replaced, thus giving banks the freedom and flexibility to incrementally migrate and upgrade."

Large established banks, he added, will take 3-5 years to set up the technology and change internal cultures to manage cloud-based operations and DevOps. In contrast, digital neobanks which control their own technology will be able to start their journey, focusing on customer centricity and building ecosystems as part of their value proposition.

In agreement, Arvind Swami, Director of Financial Services, Red Hat Asia/Pacific, noted open source's growing adoption as banks strive for new levels of innovation. The trust that customers expect of financial institutions, he said, will drive the need for stability, security, and resilience from their technology providers.

### ***ePayments in need of common standards, data residency among hot-button issues***

There was strong consensus on the importance of a regional approach to regulatory issues that will help address fragmentation across the industry, particularly in epayments.

The industry, one attendee said, would benefit from an Asia/Pacific regionwide roll out of an interoperable QR code. Unified QR code epayments will be a huge welcome in Vietnam, a market that has over 39 ewallets using various QR standards, some of which may not be secure enough, he noted.

Another hurdle for Thailand is around creating an end-to-end digital experience, particularly for setting up electronic Know Your Customer (eKYC) processes. A shift to paperless processes for KYC is still on the agenda, even for digital bank aspirants and challengers like Grab due to the country's regulatory complexities.

The region's appetite for technology adoption in banking has also been defined by the latency in legacy overhauls.

"As much as we would like to service greenfield banks, which is cheaper and easier, it takes a lot of domain knowledge to understand the complexities a traditional bank has and how to overcome them," one attendee aptly noted. She also emphasized the necessity for technology providers to introduce bridging and migration technologies required for banks to digitalize and transform over time.

Regulatory restraints on cloud adoption, in terms of data residency, customer information confidentiality, and risk management, especially when it involves shifting infrastructure and data externally, remain hot-button issues. "A lot of bank data are not allowed to be ported out of the country, but there should be exceptions, especially for the training of AI algorithms," one attendee noted.

On this point, Wilde highlighted that regulators in Australia, Singapore, and Thailand have been more receptive by regularly engaging the market.

On data residency, he pointed out that Thought Machine's core does not need any personally identifiable information (PII) data in the system. "Everything is tokenized," he said. This allows for the adoption of cloud while adhering to local regulatory guidelines. Technology providers should work alongside banks to customize cloud strategies according to the markets in which they operate.

### ***Success starts with early conversations with cloud partners***

A bank's digital transformation goes beyond upgrades of existing systems and also involves reengineering the way a bank operates in order to fully leverage platforms such as cloud services and APIs.

"One of the biggest challenges of new technology is that organizations need to understand how best to use it to suit their needs — many jump head-on into it without a clear strategy, and this creates its own set of problems in the longer run."

**Arvind Swami,**  
*Director of Financial Services,*  
*Red Hat Asia/Pacific*

Offering a word of caution, Swami said, "One of the biggest challenges of using new technology is that organizations need to understand how best to use it to suit their needs — many jump head-on into it without a clear strategy, and this creates its own set of problems in the longer run."

He sees the approach for Asia/Pacific banks as being more suited towards hybrid cloud to support the regulatory requirements.

On the role of a technology infrastructure player in helping banks digitally transform, Christopher Tan, Regional Alliance Manager for APJ, Intel, noted the importance of starting the conversation as early as possible.

Banks will benefit from having a clear understanding of their existing and planned infrastructure before embarking on their journeys. This, he explained, will help avoid the unwanted scenario of building an infrastructure that becomes a siloed customized solution that does not scale.

"Architecture matters," he said. "Have the discussion upfront to understand what underlying infrastructure is required, regardless if it is a private or public cloud approach."

## Conclusion

Challengers are fast becoming formidable forces in the banking landscape and are putting forth unique value propositions born from the digital gap left behind by traditional banks. Recognizing that digital strategies are no longer an option, rather a necessity, traditional banks have accelerated their transformative technology adoption, and are coming up with creative ways to reach their customers digitally.

The hallmarks of successful challengers rest upon embracing modern technologies and new digital cores that are first and foremost, cloud-based, or cloud native.

Cloud, though a foregone conclusion, is not simply a lift and shift. With the right strategy and partners, banks can overcome integration headaches and find their footing amid intensifying competition which will force out the digitally inept.

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*Christopher Tan,  
Regional Alliance Manager, APJ,  
Intel*

## About the Analyst



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Darshiniy leads the regional research of Asia Pacific's digital and challenger banks. She also serves the Fintech space both in Malaysia and the greater Asia/Pacific region in research, custom consulting projects, and related events. Prior to IDC she has served as an Assistant Manager at KPMG, specializing in the financial services sector and is a qualified CPA.





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