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# Success or shutdown: Is your **digital ecosystem** effort on the right path?

Key insights for financial services organizations

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## “Better to be clever and slow than fast and foolish.”

Are you a big bank, insurer or a payment provider with a large team focused on building a digital ecosystem? If yes, then you're not alone. Many of your fellow financial services institutions (FSIs), caught up in the digital hype, are busy spending money visiting fintech conferences, building API portals and signing monetization agreements with external partners.

But just because everyone's doing it doesn't mean they're doing it right. Considered “breakthrough” in 2015 — or “building digital muscle” in 2016 — digital ecosystem initiatives are starting to face a reckoning in 2017. And if you are one of the few FSIs that have mastered the art of “agile,” you might be launching ecosystem initiatives at a faster rate, but it's only good news if those initiatives add value.

### Time for a check-in

You may want to look closely at your ecosystem effort and make sure it isn't like a fintech startup with no differentiation — built on an interesting idea and some initial funding, and ultimately headed for shutdown in a year or two. Are you crystal clear on what value your effort creates and what underlying assumptions you're testing?

Start your check-in by answering these three questions:

- How do I measure the success of my ecosystem initiatives?
- What is the ratio of client-facing vs. IT employees on the pilot team?
- How much revenue are these efforts generating as a percentage of my core business?

If your answers are “API calls,” “< 20%” and “< 0.1%,” we suggest you keep reading.

There are some inspiring success stories: Amazon is now deriving ~10%\* of revenue from its AWS platform. One fintech bank is exceeding 5% in white-labeling its APIs. What are successful companies like these doing differently?

### Are you all about the “business” or the “digital”?

Buzzwords can be intoxicating and distracting, and can easily eclipse the basics — your business goals. With “digital,” the hype is particularly strong:

- “Embracing a new technology, adopting a new process or hiring better people could help us leapfrog over a governance challenge.”
- “Spending \$100 million on a digital platform or building an agile innovation center with 50 hires from Silicon Valley will be easier than persuading our business leadership to assign full-time team members.”

What's wrong with this type of thinking? It's focused on the path of least resistance, often avoiding a real root cause of slow progress.

While it is tempting and gratifying to build “something,” many financial firms lose sight of the business value they wanted to create.

\* Source: <http://www.businessinsider.com/amazon-q1-earnings-2017-4>

# Five common mistakes of digital ecosystem innovation (and how to avoid them)

One leading bank had no business representatives on its minimal viable product (MVP) teams but continually sent IT members to fintech conferences. Another hired almost 100 “digital natives,” built several innovation centers, trained thousands of employees on agile ... and six months later still didn’t have a single cross-functional MVP team. Why do smart executives in leading companies make such ineffective decisions?

Based on our engagements and interviews, here are the five most common missteps in financial services. Test your organization, even if you have avoided at least some of them, and find out how to get back on track:



## Insufficient value orientation

Move away from “If we build it, they will come.” Focus instead on getting business engagement and *building the business case upfront* for innovation efforts. Digital transformation must be a No. 1 strategic priority for the business, with a significant investment and strict enforcement of process and architecture rules. Include full-time client-facing roles on each team to ensure continuous focus on customer needs.



## Lack of discipline

Are you running innovation as an IT program, building multiple MVPs and continuing failing projects? IT-centric performance management is unnecessary in the early days. *Pursue one idea at a time* that addresses customers’ pain points and aligns to business goals, and enforce minimal governance/process before proceeding with execution. Use metrics that track *business results*.



## Doing everything in-house

Develop core expertise in partnership and vendor management, and become comfortable using third parties, even for core processes and customer-facing capabilities. Partner with those who are *more advanced in innovation*, and only work with startups that have reached a scaling phase.



## Disconnecting the ecosystem initiative from the core organization

Use an API-first and cloud-first mandate for *all software development*, including internally for IT, and integrate “digital native” talent with front-office competencies right from the start. Shared experience, behavior and culture are success drivers, so invest in environmental transformation (hackathons, staff rotation, co-creation with clients, cross-function collaboration, etc.).



## Ignoring the importance of superb UX for third-party developers

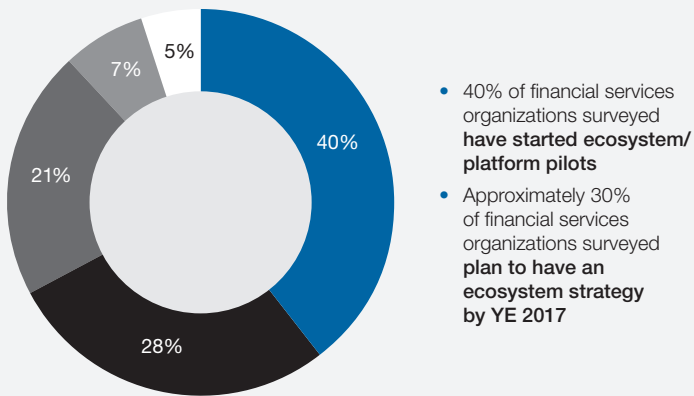
Start with a superb seamless experience for your customers and third party, which develops by building on open-source PaaS platforms with mini-services and DevOps environments — and think design first.

## Get smart before you start

Our research has yet to identify an incumbent FSI that has made a major breakthrough in building an ecosystem, even in payments. Most are in the early phases of planning and testing (see Fig. 1).

FIGURE 1

### State of financial services ecosystems in 2017



- 40% of financial services organizations surveyed **have started ecosystem/platform pilots**
- Approximately 30% of financial services organizations surveyed **plan to have an ecosystem strategy by YE 2017**

#### Who makes money

- Risk information companies
- API mono-lines among FSIs: Stripe, Braintree
- API service providers

#### Good news

- Enough customers are likely to agree to less privacy (more tracking) in return for discounts
- Everything else being equal, customers prefer to receive financial services from fewer providers

#### Why not more traction

- Even best fintech startups take 2 to 3 years to find product-market fit
- Most FSIs have anti-ecosystem bias (closed systems, risk aversion, hands-off relationship with customers)

Gartner survey, February 2017; n = 36



## Are you familiar with only two of the eight building blocks?

The ecosystem building blocks seem straightforward at first, like this example for a commercial insurer:

FIGURE 2

### Example of ecosystem building blocks for a commercial insurer

<b>1</b> Type of Business <ul style="list-style-type: none"> <li>Participant: Distribution</li> <li>Participant or owner: Data monetization</li> <li>Owner:             <ul style="list-style-type: none"> <li>Offering extension/platform monetization</li> <li>Capability sourcing</li> </ul> </li> </ul>	<b>2</b> Go-to-Market Model <ul style="list-style-type: none"> <li>Build</li> <li>Partner</li> <li>Collaborate</li> <li>Acquire</li> </ul>	<b>3</b> User Category <ul style="list-style-type: none"> <li>Verticals: Manufacturing, financial services, real estate, etc.</li> <li>Size: SMBs vs. enterprises</li> <li>Partner type: Agents vs. industry consortiums</li> </ul>	<b>4</b> Service Offering <ul style="list-style-type: none"> <li>Insurance products</li> <li>Other financial products: Lending, payments</li> <li>Other non-financial products: Product warranty (POS), import/export licensing and legal assistance, HR</li> <li>Other services: Pricing analytics</li> </ul>
<b>5</b> Monetization <ul style="list-style-type: none"> <li>Revenue sharing</li> <li>API calls/subscriptions</li> <li>Advertising/affiliate models</li> <li>Licensing &amp; maintenance</li> <li>New digital revenue</li> <li>Incremental revenue</li> </ul>	<b>6</b> Management Capabilities <ul style="list-style-type: none"> <li>Inourced/outourced operations</li> <li>Team structure</li> <li>Processes (partnership, vetting, onboarding, billing, conflict management)</li> <li>Performance measurement</li> </ul>	<b>7</b> Build Capabilities <ul style="list-style-type: none"> <li>API management</li> <li>Billing/reporting</li> <li>Business process design</li> <li>Data analytics</li> </ul>	<b>8</b> Technology Vendors <ul style="list-style-type: none"> <li>Insurance megavendors</li> <li>Ecosystem/API providers</li> <li>Other technology vendors</li> </ul>

Gartner Insights 2017

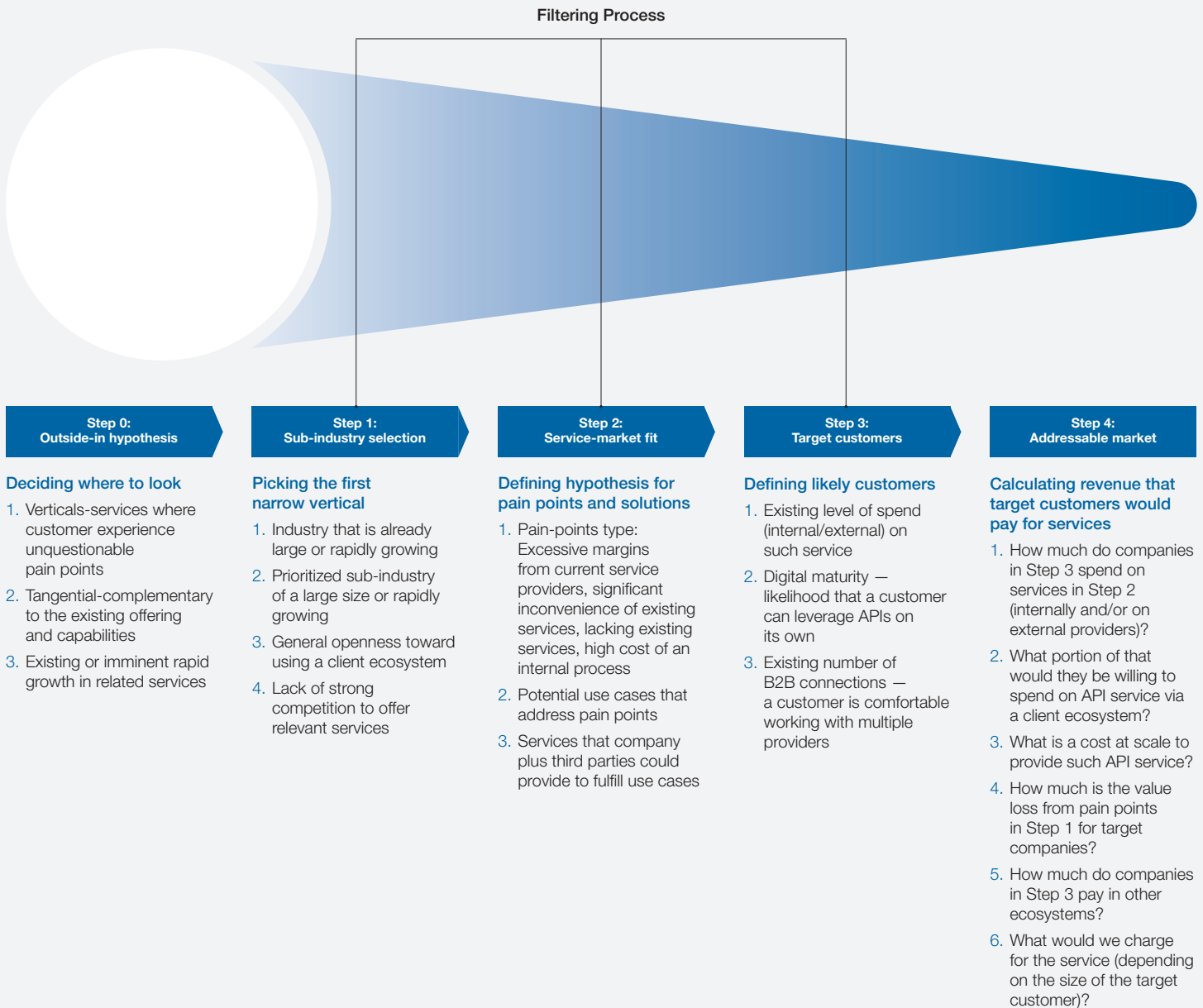
It seems reasonable to tackle one block at a time and then iterate across blocks based on lessons learned. But almost all the leading banks, insurers and payment providers we speak with are spending most of their effort on the easier blocks, 7 and 8 (see Fig. 2).

## Here's why skipping ahead backfires

Most FSIs are unwilling to even quickly estimate an addressable market before starting to deploy an ecosystem use case, not helping themselves to avoid low-impact pursuits. What we call a “mini-business-case” approach for doing this should be fairly easy to grasp and execute (see Fig. 3).

FIGURE 3

### Filtering process to estimate an addressable market



Crunch just enough numbers to figure out a magnitude of the potential business impact, if everything goes well. Then experiment with the MVP for a few months to see whether the imagined use case has any relevance in the real world. Such a high-level framework enables a relatively easy go/no-go decision. Instead, financial institutions keep running in the dark, hoping that their ecosystem initiative will have a material impact.

How do most financial institutions approach monetization opportunities? The decision-making process should be quite straightforward (see Fig. 3), but most FSIs don't follow this logical sequence, jumping instead straight to signing monetization agreements and proceeding with a technical integration. Why? Because they think that doing "digital stuff" means doing things without upfront thinking and basic governance processes. Although an emphasis on revenue makes it tempting to skip to partnership and monetization options, it's better to know whether the ecosystem is easy to connect to and use first. Partnership and monetization discussions, with a focus on co-creation and risk sharing, should only happen when the ecosystem is ready to scale.

### Beware of the anti-ecosystem bias, and get back to basics

Typically, FSIs are risk-averse closed systems, hands-off with their customers. A siloed ecosystem initiative might be considered great for PR, but the idea of scaling a digital ecosystem into the core organization will encounter steep obstacles at multiple levels. And even if everything goes right, the impact on revenue won't be noticeable in the first few years.

So what are the basic capabilities required for building a digital ecosystem? The organization must have in place a minimal level of advanced foundational capabilities (API, data lakes, cloud), have the ability to rapidly test MVPs, and have a keen understanding of the needs of both end users and the developer community.

When it comes to talent, process and performance measurement, a couple of full-time teams of agile and scrappy entrepreneurs with the most basic governance overlay can effectively pursue MVPs in the early stages. In those early days, the performance management only needs to track the frequency and extension of a customer engagement with the ecosystem (see Fig. 4).

FIGURE 4

#### How to get started with ecosystem initiatives

**Hustle**

- Setup a Lab room
- Meet weekly with dozens of clients and their developers
- Identify ideas they love
- Build products they love

**Keep it very simple**

- Forget "digital" "scaling" "vendors" — make it work with manual bootstrapping first
- Pursue one idea at a time; kill it before starting next one
- Each team member is responsible for one thing and doesn't stop until it is improved
- Team size: Absolutely minimal
- Metrics: Features used by customers, hours since a customer used each feature

Directional milestones	3 months	18 months
Concurrent MVPs	1	5
Number of Labs/MVP team members	10	100
Free referrals from customers	2	100s
Working in full agile/DevOps	10	200
Approved digital ideas from employees	1	10

# Is your organization **ready?**

Our discussion of the required capabilities could be synthesized as the maturity of your organization. Is it mature enough to undertake a digital ecosystem initiative (Level 4, Progressive), or do you need to get more basic digitalization right first?

Whether you're just embarking on the ecosystem journey, looking to make necessary midcourse corrections or just want a second opinion, Gartner Consulting is ready to jump into the trenches with you.

Because one day everything just might be one big API portal.

## **Gartner Consulting supports the universal needs of senior leaders in the digital age**

Powered by the world's most comprehensive collection of technology research and data, Gartner Consulting helps CIOs and IT leaders address mission-critical priorities to achieve stronger business outcomes in a digital world.

### **Contact Gartner Consulting**

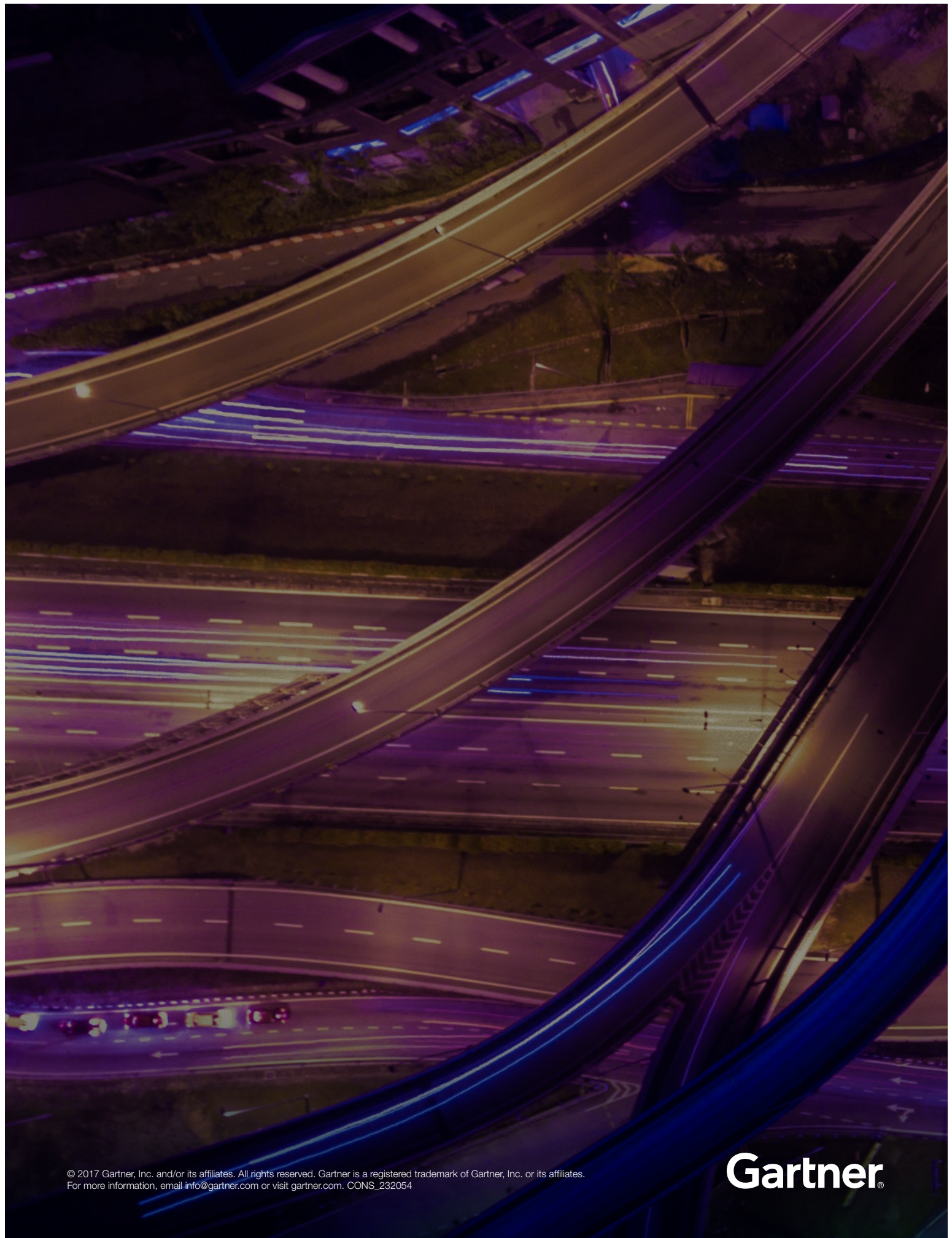
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