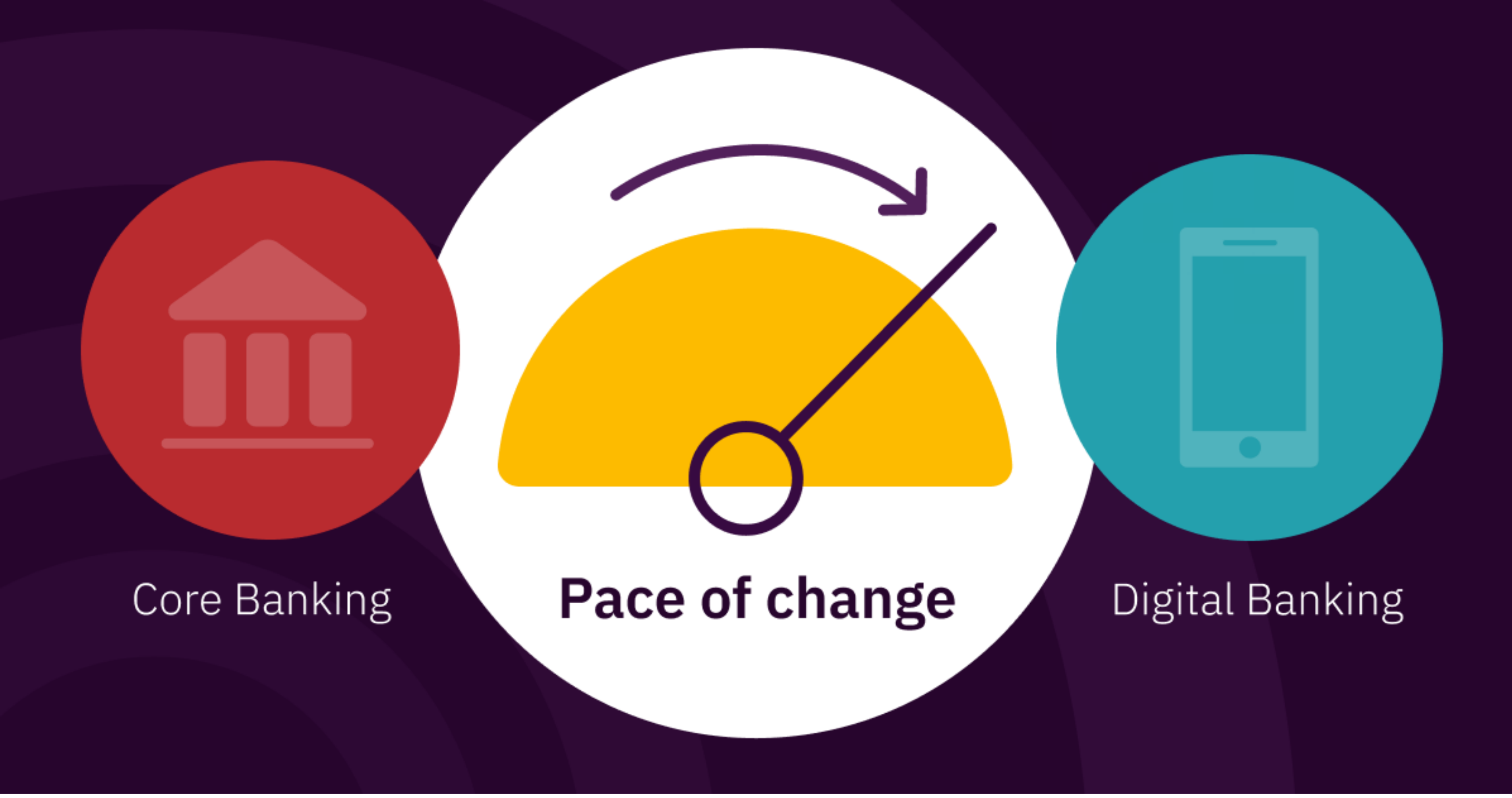
# Core Banking vs Digital Banking

# How to implement and govern two very different kinds of banking solution

Core banking systems and digital banking suites are very different beasts. They may both be software genres, but they change at such different speeds that they demand a different governance approach. Read on to learn about a pace-layered application strategy and how that applies to banking and financial services software.

# The difference between core banking and digital banking software

Like two nations separated by a common language, core banking and digital banking systems share less in common than you might imagine. Skip ahead if you don't need a definition.




# Core banking and digital banking defined

**Core banking system**

IT industry analyst, Gartner[1], defines a core banking system as a back-end system that processes daily banking transactions and posts updates to accounts and other financial records. Core banking systems typically include deposit, loan, and credit processing capabilities, with interfaces to general ledger systems and reporting tools.

**Digital banking system**

A digital banking system is a frontend system that aims to serve customers with all the banking services that traditionally required a visit to their bank. Such services include:

- **Opening an account**
- **Applying for additional services**
- **Account administration**
- **Money payments, deposits, withdrawals, and transfers**

[1] Gartner – Definition core banking system

# Core banking and digital banking software are differentiated by their pace of change

A crucial difference between these two genres of banking software is their pace of change. Core banking software has a slow pace of change. The rules of arithmetic don't change. So, you wouldn't expect software engineers to toil every month with new ways of calculating an account balance.

Conversely, digital banking benefits from a fast pace of change. Because products, marketing promotions, competition, and customer preferences are like shifting sands.

Account opening is a superb example. By constantly monitoring user behaviour through web analytics, it's possible to fine-tune the customer onboarding journey and user experience to optimise conversions.

Financial services organisations that constantly optimise such digital experiences gain a competitive advantage over their rivals. A digital laggard suffers from inertia. Much of their marketing budget is squandered due to customers and prospects abandoning the onboarding journey.

Digital leaders have the agility needed to outsmart the laggards. They extract the maximum value from their marketing budget by maximising conversions.

# Different beasts require different governance regimes

The different speed of change of core versus digital banking explains why there's a broad range of digital banking software providers. Instead of just a few large core banking software providers dominating the market from back-end to frontend, there's a wide array of alternatives on offer.

Buyers of banking software are getting something different from dedicated digital banking providers that they struggle to get from the larger core banking software providers. That something is agility.

# Pace layering your software assets

The idea that assets should be categorised by their speed of change is a long-established architectural principle, first described by Stewart Brand in his book "How Buildings Learn[2]."

Gartner[3] adapted Brand's ideas to apply them to another kind of asset—business software. Their analysts advocate that enterprises establish a pace-layered governance strategy for different software categories.

These are:

- **Systems of record**
- **Systems of differentiation**
- **Systems of innovation**

They propose that businesses benefit from using different sourcing, governance, and financing approaches for systems that are more or less prone to change. The following table adds more detail to that picture.

| | |
|---|---|
| **Systems of record** | These represent common ideas where businesses are happy to follow commonly accepted ways of working. Very often, systems of record are regulated or foundational to running the organisation. So, changes should be carefully controlled to ensure that processes perform well and emain compliant. |
| **Systems of differentiation** | These represent aspects of the business which, if done differently to comparable organisations, might infer competitive advantage. Such differentiations tend to be incremental, making it comparatively easy for business stakeholders to describe their requirements. |
| **Systems of innovation** | These represent new ideas — potentially things that haven't been tried before in a specific industry. Consequently, businesspeople are less confident of the requirement, and an experimental "test and learn" approach (also known as "Lean start-up") is most appropriate. Anticipate rapid iteration and even the disposal of the idea if the experiment doesn't work out. |

[2] en.wikipedia.org/wiki/How_Buildings_Learn

[3] Gartner - Accelerating Innovation by Adopting a Pace-Layered Application Strategy

# Core banking and digital banking software seen through a pace-layered lens

Seen through a pace-layered lens, it's clear that core banking systems are systems of record. Their implementation and subsequent changes are cautious and heavily regulated. Luckily, considering this heavy-handed governance, once up and running, only a slow pace of change is usually required.

The owner of a core banking system is more likely to be concerned about the solution's availability, performance, and security rather than constantly iterating to add features.

Correspondingly, vendors of core banking systems typically have upgrade releases once or twice a year.

Digital banking suites transcend differentiation and innovation. As such, they benefit from an agile development and governance approach. Agile development is business-led, and a typical approach is to appoint product owners for specific customer journeys.

So, for example, there will likely be a product owner for customer onboarding, another for internet and mobile banking, and owners for digital experiences related to specific products, such as mortgage applications or different savings products.

The different products within a digital banking suite share interdependencies and are integrated into the core banking system. But they can, to a large extent, follow individual release plans with varying degrees of experimentation.

Whilst enterprise-grade performance and security are crucial for all genres of banking software, digital product owners are much more focused on features than engineering. Constant iteration is the norm —

- **In the case of differentiation, customer-facing products and their associated digital experiences continually evolve as living products.**

- **And in the case of innovation, rapid iteration is required to test hypotheses and move from minimum viable products to transformative propositions.**

In short, digital banking suites are managed as products. By comparison, changes to core banking systems still tend to be IT-centric projects.

# Digital Banking in the digital-urgency era

It's said that the COVID crisis fuelled a seven-year leap in digital adoption in a matter of months[4]. That frenetic pace of change shows no sign of slowing up—particularly in the financial services sector.

The rapid rise of inflation, interest rate hikes, and customers squeezed by the cost-of-living crisis makes this a torrid time for digital laggards. Financial services providers that are slow to launch new products or unable to rapidly improve their digital experiences are likely to haemorrhage increasingly "switchy" customers.

In this "digital-urgency era", digital leaders that outpace slower rivals have even more of a competitive advantage:

- **They will launch new products, rates, and promotions sooner, at lower cost and effort.**
- **They will quickly and more easily react to opportunities and competitive threats.**
- **They will provide the frictionless digital experiences that customers and prospects value—thus grabbing more market share.**
- **They will benefit from channel shift, with more customers and prospects favouring low-cost digital interaction, while laggards face increasing workloads and costs at branches and contact centres.**

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In this context, the glacial progress of core banking software improvements isn't the answer. Financial services organisations need to be able to respond in hours or days, not weeks or months. ieDigital provides a **digital banking platform** and change management expertise to help organisations embrace that degree of agility.

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[4] Covid-19 accelerated digital transformation by seven years

# Related reading - Embracing a digital mindset

Building agile culture and capabilities can be daunting for small to mid-sized financial services organisations that have not yet mastered agile development. Our related post, “Four Priorities for Financial Services Organizations to Embrace a Digital Mindset,” explores the transition from projects to products and three related cultural differentiators needed for digital transformation success.

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