ALLOY LABS / Banking, unbound.

A new playbook for The Next Era of Banking

Executive Briefing

About Alloy Labs

An ecosystem of community and mid-size banks working together to develop insights that drive partnerships, product development, and strategic investments to better serve evolving customer needs and win in a rapidly changing world.

The Alloy Labs Alliance

Member-Driven Bank Collaboration

A consortium of banks from across the country with combined assets totaling $470+ billion, giving members the insights and resources of a top 10 bank.

The Alloy Alchemist Fund

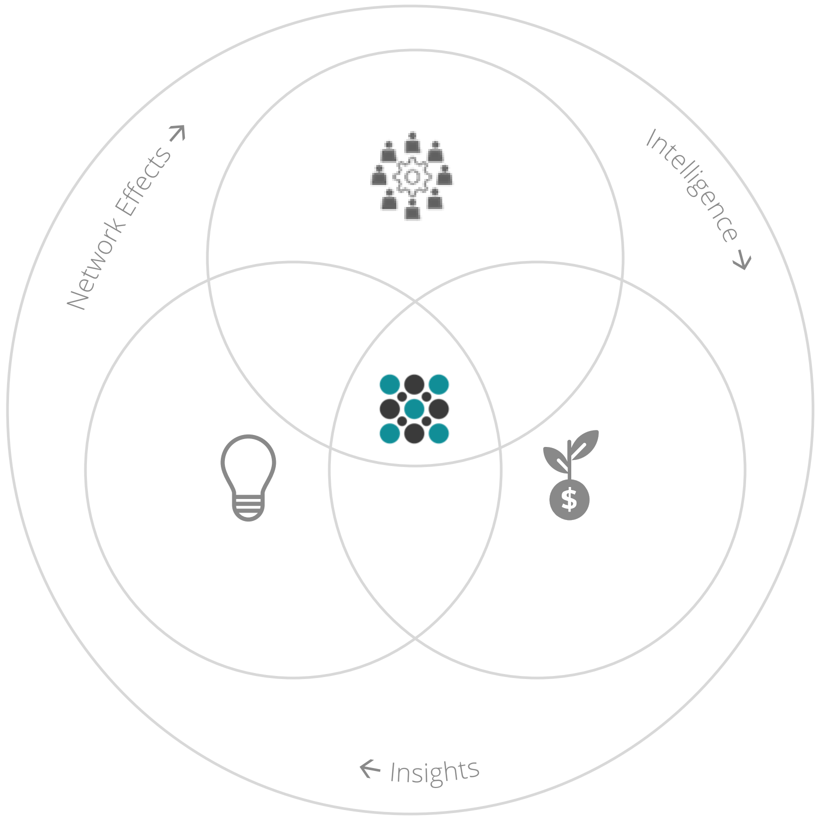
Strategy-Led Corporate Venture Capital

Strategy-led venture capital fund where banks gain inside access to game-changing fintech companies who are reinventing, not just replumbing the industry.

The Alloy Labs Institute

Industry-Leading Tools and Best Practices

Industry-leading best practices, tools, and frameworks to help leaders counter disruption risk, unbreak the bank, and unlock new sources of growth.



A new playbook is needed for The Next Era of Banking

"In times of change learners inherit the earth; while the learned find themselves beautifully equipped to deal with a world that no longer exists." – Eric Hoffer

- Banks have long relied on tried-and-true playbooks to weather cyclical downturns.
- These include well-developed systems for managing specific risks in a relatively stable and predictable competitive environment.
- Current systems often fail to adequately recognize systematic risks of doing too little to blunt competitive forces and/or create competitive differentiation.
- Secular tailwinds are subsiding (ZIRP, low inflation, government stimulus, credit quality, reserve releases, etc.)
- Headwinds are increasing (the digital arms race led by largest players, exponential increase in competition, rising customer expectations, etc.)
- Much of the old playbook no longer works. Banks must update their playbooks to not just survive, but thrive in The Next Era of Banking

Uncommon Principles of Digital Leaders in this Next Era

Technology is just a Tool
Strategy First, Technology Second

Continuous Improvement
There is no finish line

Data > Opinions
Strong opinions, loosely held

Exploration Before Execution
Nail it, then scale it

Agility > Plans
Progress will not be linear

Action > Talk
The answers aren't in the room

This executive briefing is designed to share a new playbook for banks to compete and win in a rapidly changing environment. It is based on insights synthesized from research and intelligence generated from the Alloy Labs ecosystem of banks, partners, and portfolio companies.

Executive Summary

There is no offseason. Playbooks must be updated while the game is in progress.

Embrace VUCA as the new normal. With changes comes opportunity, but you must have a growth mindset to test and learn throughout the organization.

- Reduce reliance on spread income and look for opportunities to create competitive advantage through differentiation
- Measure and grow your speed and agility by increasing the organization’s innovation maturity

Old definitions of ‘service’ and ‘relationships’ are no longer sufficient. Prioritize creating a sustainable competitive advantage.

- Consider fintech partners as a source of delivering non-rate customer value propositions
- Prioritize testing customer desirability before expending resources on technical and vendor due diligence (are you solving the right problem?)

Invest in foundational capabilities to support your strategic vision. Maintain agile internal structures that drive agility and growth.

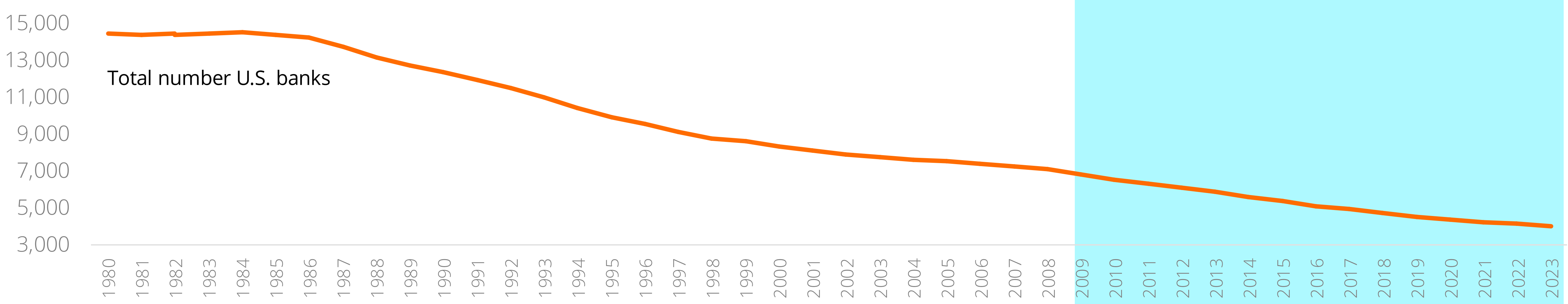
- Prioritize speed and experimentation from the top, and
- Create ad hoc FIRE Teams close to the customer to conduct fast, iterative, responsive experiments

Allocate limited resources wisely, understanding where you’re playing defense to stay in the game and where you can play offense to win the game.

- Allocate resources to exploring viable new options while defending and extending legacy businesses
- Avoid the DROID (the dreaded ROI discussion) with an empirical approach to value creation that starts with testing quickly and cheaply to build business cases

Situation: Headwinds are increasing, while tailwinds subside

7,357 banks closed or were acquired during a long period that was generally conducive to the traditional banking business model, another 3,041 have gone since the global financial crisis

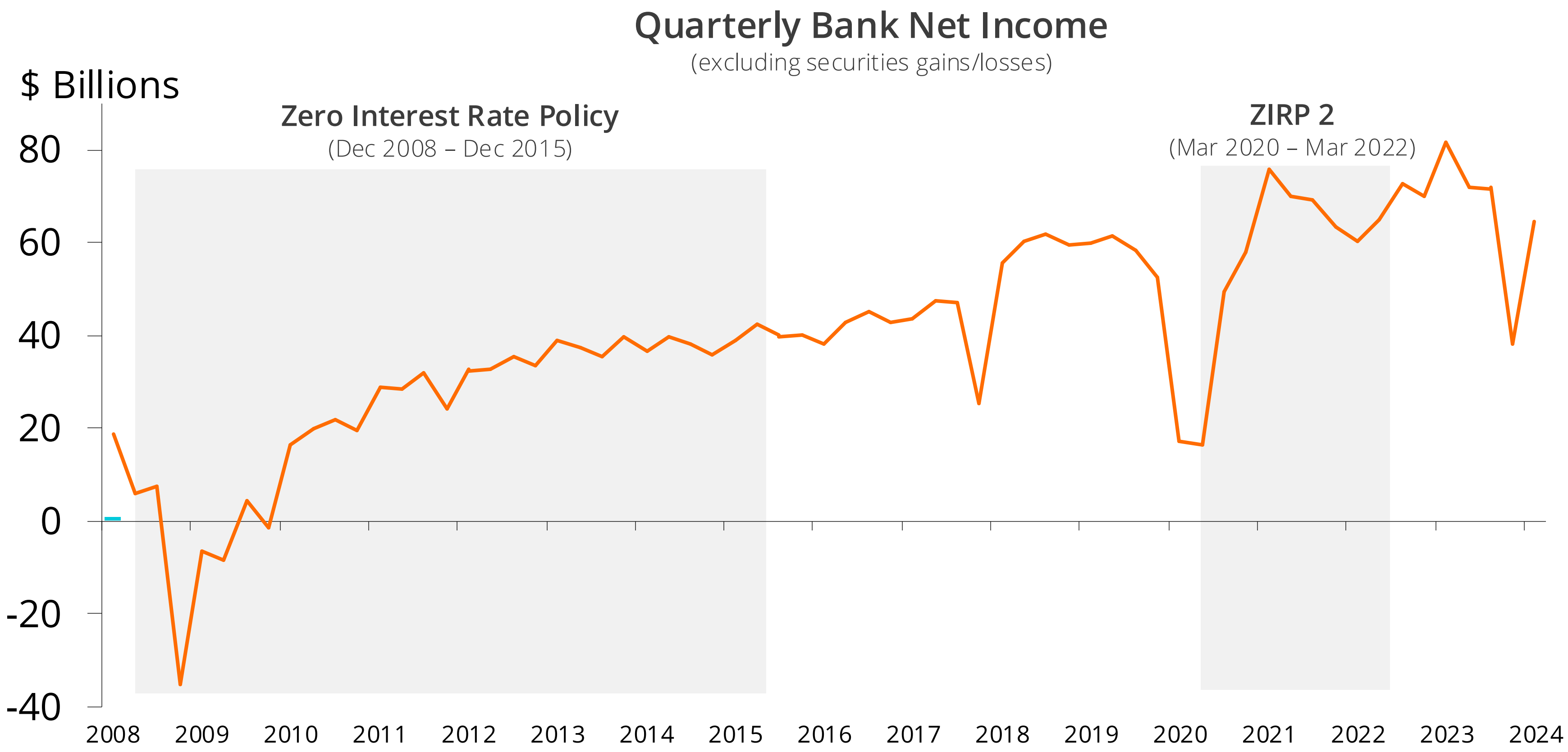


Source: FDIC

	The Last Era of Banking		The Next Era of Banking
Defining Characteristics	• Rising asset prices • Falling interest rates • Deregulation	• Regulatory Moats • Geographic Moats • Narrow scope of competition	• Exponential increase in competition • Increased buyer expectations/power • Increased regulatory complexity
Winning Plays	• Size and scale • Traditional M&A • Cost reductions	• Punitive and junk fees • Local relationships • Branch experience	• Competitive differentiation • True customer centricity • Effective resource allocation

Industry Profits have likely peaked for now…

Two rounds of ZIRP masked underlying weaknesses and risks of business models for many industries.
Tech's reckoning is well underway, but the banking industry's is just beginning



Source: FDIC

Secular Headwinds:

- Competition for deposits
- NIM compression
- Reliance on spread income
- Credit costs
- Increased regulatory pressures & costs
- Low multiples and M&A appetite from acquirers
- ROEs lagging cost of capital
- Digital arms race
- Commoditization of core products and services
- Asymmetric competitors

...with latent and emerging risks adding to the headwinds.

Current systems often fail to adequately recognize systematic risks of doing too little to blunt competitive forces and/or create competitive differentiation

- Banks have well-developed systems for managing specific risks in a relatively stable and predictable competitive environment
- **Managing these risks can prevent failure, but they do not ensure success**
- Current systems are often inadequate to identify and mitigate other types of existential risks
  - **External risks** such as disruptive innovations coming from both well-resourced incumbents and new asymmetric competitors, and changing customer demographics and expectations
  - **Internal risks** such as over-reliance on a fragile and undifferentiated business model and the growing gaps in talent and ability to execute on new priorities

This dichotomy must be managed to develop competitive advantage to win in a rapidly changing environment

Four Key Forces Shaping the Next Era of Banking

Some familiar challenges, with a few twists, plus some new ones that define the Next Era

External: Disruption and Attrition Risks

VUCA
(Volatility, Uncertainty, Complexity, Ambiguity)

- Capital Markets
- Regulators
- Customers
- Competitors

Attrition and Disruption Risks

- Aging customer base
- Ever-increasing customer expectations
- Increase in competition from all sides

Internal: Business Model and Execution Risks

Margin and Liquidity Pressures

- Competition for deposits driving up costs
- Non-interest expenses
- Loan/Deposit Ratio

Need for Efficiencies

- Non-Interest Expenses creeping up
- Efficiency Ratios too high
- Operational efficiency
- Customer acquisition costs

Much of the old playbook is no longer effective…

"Success is a lousy teacher. It seduces smart people into thinking they can't lose." – Bill Gates

Old External Plays

VUCA
(Volatility, Uncertainty, Complexity, Ambiguity)

- Slow down and wait
- Double down on analysis and planning
- Lobby to maintain status quo and punish competitors

Attrition and Disruption Risks

- Sell more!
- Cross-selling campaigns
- ROI Doom Loop to evaluate new spending

Old Internal Plays

Margin and Liquidity Pressures

- Try to lower deposit rates without losing volume
- Try to raise loan rates without losing deals
- Look for new ways to charge fees

Need for Efficiencies

- Close branches
- Exit business lines
- Reduce headcount
- Automation to reduce labor hours

...exposing new risks that are both cyclical and systemic.

"We cannot solve our problems with the same level of thinking that created them." – Albert Einstein

Commoditization has led us to the Red Ocean...

- Undifferentiated products and services
- Limited levers to drive new growth
- "Service" and "Relationships" no longer enough

...and the vicious cycle of expense cuts...

- Cutting expenses below current revenue rate has limited short-term upside
- Confusing investments in foundational capabilities needed to win with discretionary expenses

... keeps us stuck in a Doom Loop as we treat symptoms...

- Difficulty understanding ROI, especially on newer concepts
- Double down on meetings and spreadsheets
- Paralysis by analysis

...while under-diagnosing the underlying causes.

- Existential internal and external risks often overlooked and under-appreciated:
- Fragility of the core business model
- Reliance on spread income and cheap deposits
- Lack of differentiation

The New Playbook for
The Next Era of Banking

New outcomes require new approaches

Leaders must balance defending and extending legacy businesses with creating viable options for the future

- The financial services industry has well-developed systems to maintain predictable outcomes in a relatively stable and predictable competitive environment; ***extending the line*** of current results.
- These systems are often less effective at responding quickly to dynamic market conditions or changing the state to achieve higher levels of growth; or ***bending the line.***
- These challenges are even more pronounced in creating sustainable competitive advantage and driving exponential growth; or ***transcending the line*****.**

What's Now	**What's New**	**What's Next**
Improve day-to-day effectiveness and efficiency to defend and extend the current business.	Effectively allocate limited resources to bend the line to higher levels of growth and enterprise value.	Efficiently explore new opportunities to create sustainable competitive advantage and drive new growth.
Extend	**Bend**	**Transcend**



Relative effectiveness of…

The new playbook for the Next Era of Banking 3Q24

Today's (and tomorrow's) winners are not just executing the predominant business practices of the industry incrementally better, they're writing a new playbook.

1) Embrace VUCA as the New Normal

- Changes create new opportunities
- Increase speed and agility in decisions
- Small bets to test and learn (FIRE- Fast, Iterative, Responsive Experiments

2) Build Customer-Centricity Beyond "Service"

- Focus on jobs to be done, pains to be relieved & gains to be achieved from the customers' perspective
- Partnerships are critical to non-rate value propositions

3) Structure for Success

- Top-down strategy, support, and resources
- Bottom-up tactics and empowerment
- Agile risk management
- Avoid the DROID (the Dreaded ROI Discussion)

4) Build Unique Competitive Advantage

- Drive efficiencies in core business (defense)
- Allocate resources to build differentiation (offense)
- Explore new business models

1) Embrace VUCA…

New technologies have created new competitors and new risks, but also new opportunities for organizations that embrace agility and learning as they improve their innovation maturity.

Broad technological advances of the past decade and a half…

- Broadband and Wireless
- Battery tech and renewables
- Mobility, Smartphones & Apps
- Big Data, Machine Learning, and AI
- APIs, RPA, and IoT

…have led to new banking products and business models that have reshaped the landscape.

- Digital banking
- Neobanks
- Open Banking
- Real-time payments
- Banking as a Service
- Embedded finance
- DLT, blockchain, cryptocurrencies, NFTs

> *It is not the strongest of the species that survives, nor the most intelligent that survives. It is the one that is most adaptable to change.*

Leon Megginson
Professor of Management and Marketing
Louisiana State University
(paraphrasing Charles Darwin)

…and focus on improving speed and agility along the way.

Higher levels of innovation maturity mean lower disruption risk

Alloy Labs model identifies five levels of Innovation Maturity

1. Exclusion

- Efforts are few or non-existent
- Need for change not recognized or prioritized

2. Engagement

- Efforts are ad-hoc, informal, or inconsistent
- Change mandate may be new
- Challenged with alignment to strategy and across LOBs
- Paralysis by analysis

3. Emphasis

- Focused on extending and defending core products/ services
- Often playing catch-up from under-investment
- Stuck in ROI Doom Loop
- Current program ineffective or stalled
- Challenged to prioritize limited resources

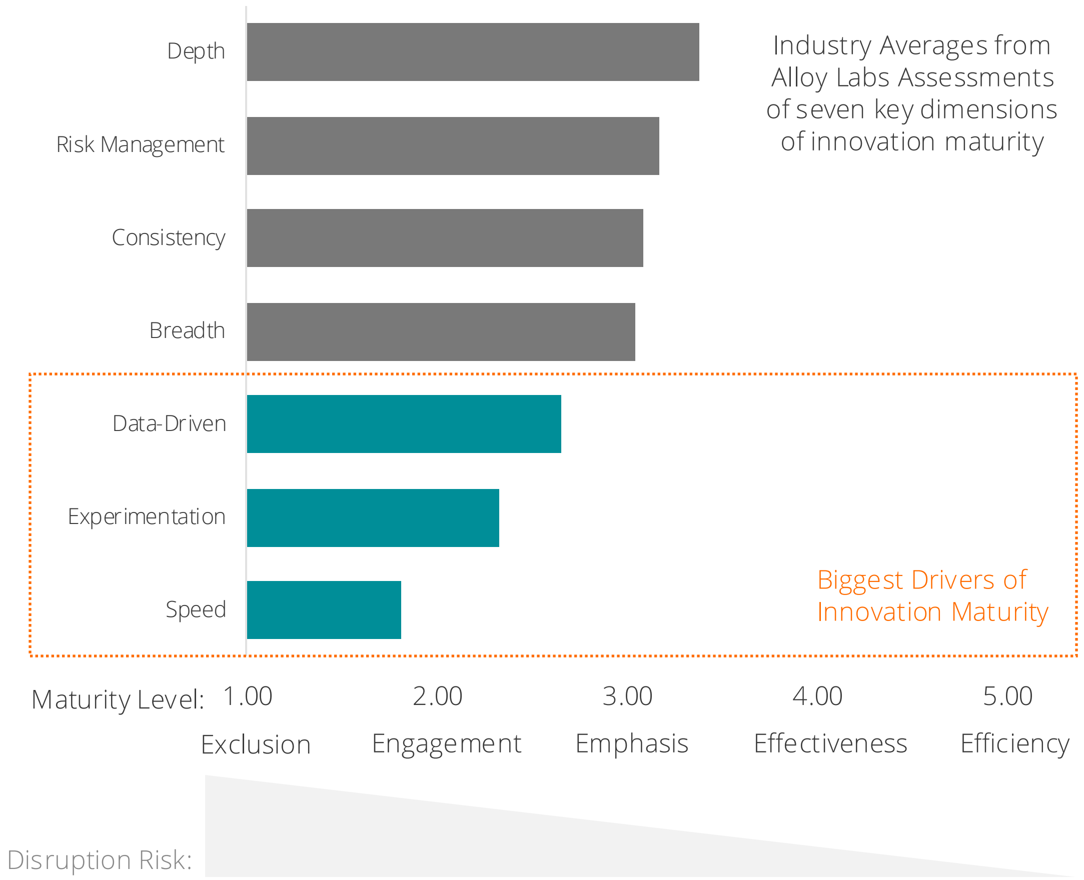
4. Effectiveness

- Focused on putting innovation into regular practice
- Building an agile and innovation culture
- Exploring viable future options
- Maturing risk/reward evaluations
- Regular testing through proofs of concept and pilots
- Realizing value sooner from partnerships

5. Efficiency

- Focused on big strategic or proprietary ideas
- Allocating more resources to emerging businesses
- Making more and larger bets across a wider portfolio
- Strategic partnerships with other institutions
- Policies and procedures optimized to drive speed as a competitive advantage

Experimentation, speed, and data-driven decision making are the biggest drivers



2) Customer-centricity must go far beyond "service"

People "hire" products to get specific jobs done. Fintechs have sliced and diced the market by developing a deeper understanding and creating more effective customer experiences.

Jobs to be Done

What is the job the customer needs done?

- What are the other products have hired to get the job done?
- What work-arounds are they using to get **all** of the job done?
- They likely can't articulate it directly
- "Getting a loan" is not a job to be done, it's a step in the process
- What's the why behind the why (behind the why)?

Pains

What pains are they trying to relieve?

- What's getting in the way of getting the job done?
- Annoyances and recognized points of friction
- Don't stop at incremental improvement
- The most valuable will be unarticulated or unrealized because they are status quo (e.g., taxis before Uber and Lyft)
- People buy pain relievers more than vitamins

Gains

What gains are they trying to achieve?

- Can be well understood and consciously sought out
- May be hidden or unexpected
- Often social and/or psychological (status, belonging, safety, etc.
- Almost always involve tradeoffs
- We are not the rational decision-makers we believe ourselves to be – we decide with emotion, and justify with facts

Fintech partnerships can be critical in creating new value…

Banks have structural barriers and constraints that limit the levers of the "Hierarchy of Powers" that drive enterprise value. Partners can improve Market Power and Offer Power for banks.

Execution Power

- Achieved through specific attention on transformational initiatives that realign the company around the next-generation capabilities required to execute its strategy

Offer Power

- Achieved through disentangling three distinct forms of innovation one from another, managing each separately, to achieve differentiation, competitive neutralization, and internal productivity

Market Power

- Achieved through targeting the most strategic customer segments and skewing offers and programs to ensure winning dominant shares in each

Company Power

- Achieved through highly asymmetrical allocations of resources to create "unmatchable" core capabilities

Category Power

- Achieved through proactively entering and exiting categories to participate meaningfully in the highest growth opportunities

Hierarchy of Powers

Must be refocused to execute on the right priorities

The right partners can help create competitive advantages to win most important customer segments

Generally low for banks due to regulatory and structural constraints

… but the the chasm must be bridged to maximize value.

Differing perspectives and risk/reward models can turn the chasm between banks and fintechs into an abyss without a structured approach to accelerate value extraction.

Differing Approaches

- Risk/Reward assessment and optimization is highly situational and contextual
- In general, entrepreneurs tend to operate more often with a left of chasm mindset
- In general, bankers tend to operate right of chasm
- Neither is right or wrong, but success requires bridging the chasm

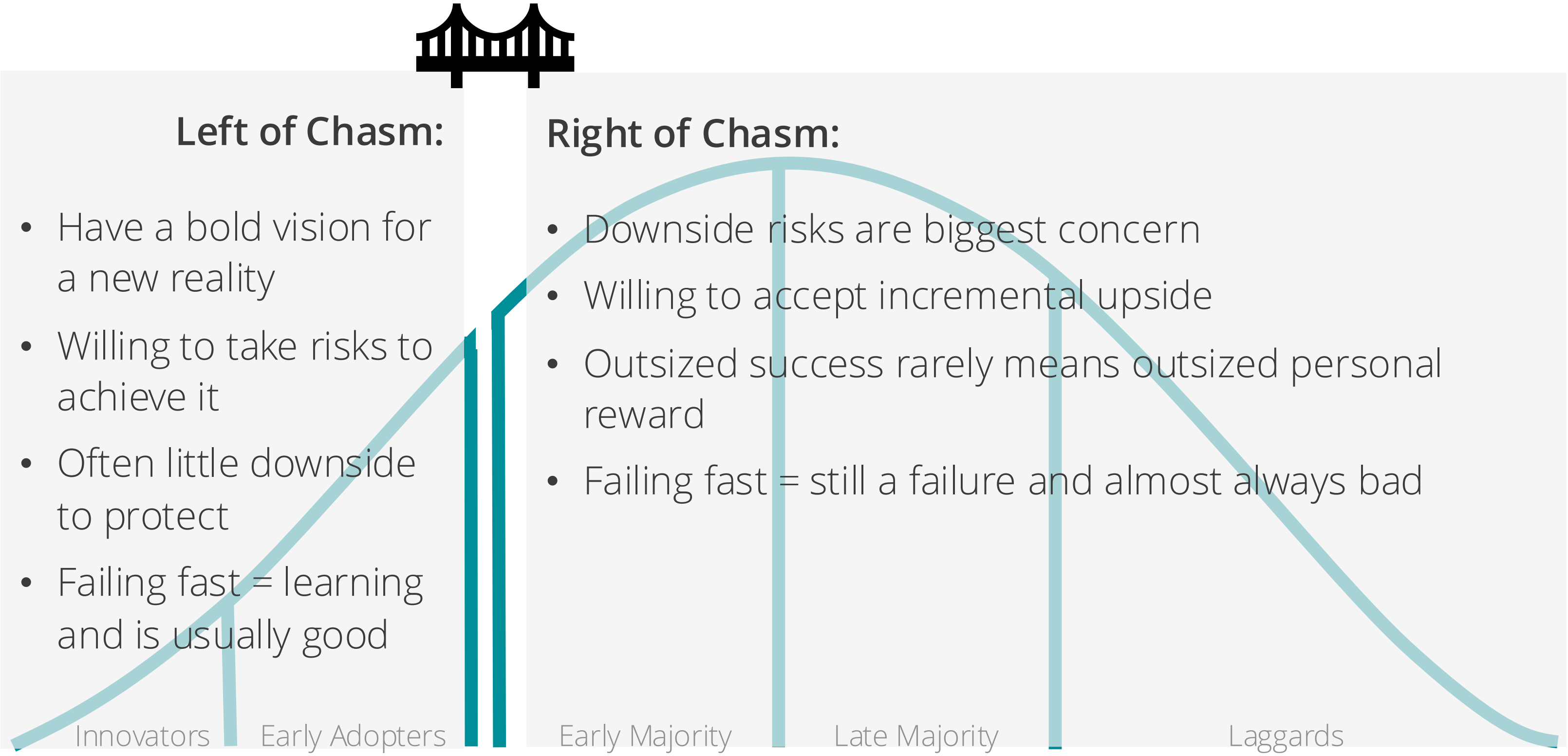
Fintech entrepreneurs are from Mars, bankers are from Venus

Left of Chasm:

- Have a bold vision for a new reality
- Willing to take risks to achieve it
- Often little downside to protect
- Failing fast = learning and is usually good

Right of Chasm:

- Downside risks are biggest concern
- Willing to accept incremental upside
- Outsized success rarely means outsized personal reward
- Failing fast = still a failure and almost always bad



In most cases adoption/disruption risk > technical risk

What if you build it and nobody comes? Vague notions of "service" are being redefined and expanded end-to-end as consumer expectations continue to rise and digital experiences dominate.

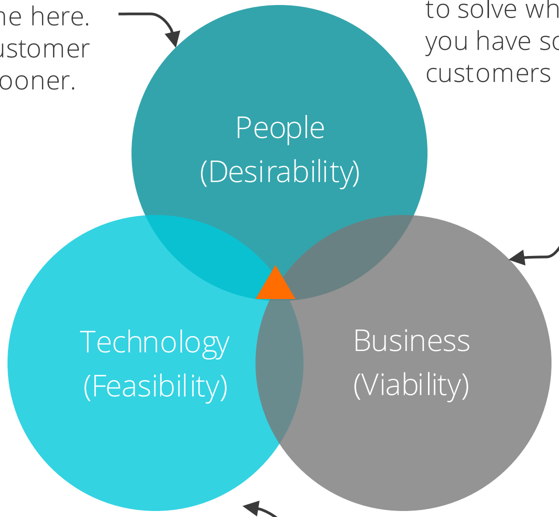
Look for fintech partners who are reinventing, not just replumbing

- Adoption risk is the hidden ROI killer (no one buys your product)
- Technical and compliance due diligence prevent failure, but do not guarantee success
- Test early, often, and late
- Launch date is the 50-yard line, not the end zone
- Going to the fintech petting zoo does not make you a farmer

All three matter but prioritize customer desirability first

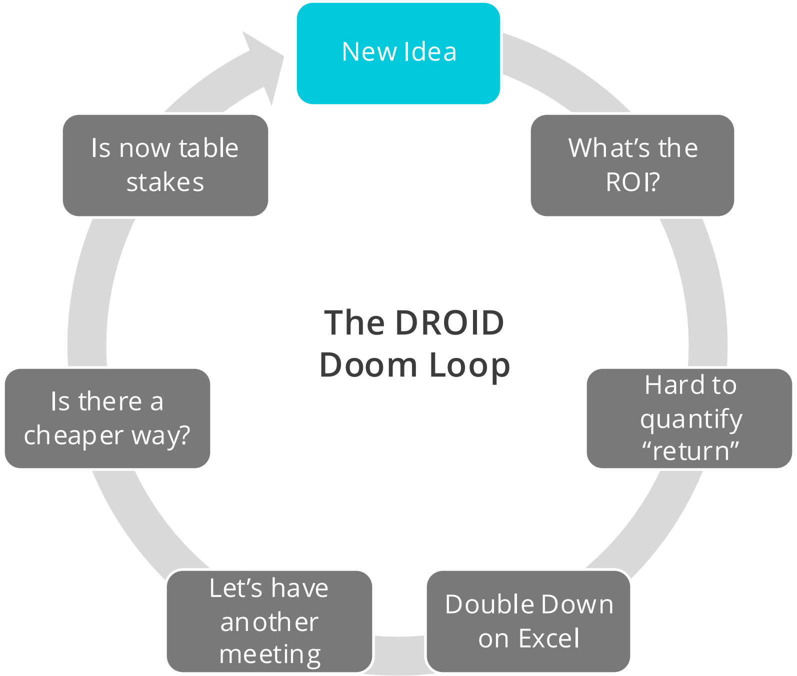
Banks tend to spend far too little time here. Prioritize customer validation sooner.

This becomes much easier to solve when you know you have something that customers want.



Banks tend to spend too much time here early on. Leverage others' experience.

Avoid the DROID (the Dreaded ROI Discussion)

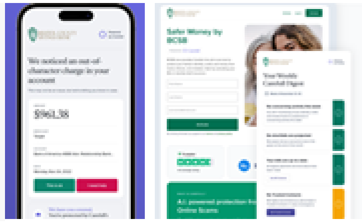


Case Study: Reinventing banking through partnerships

Products being sold direct to consumers can create differentiation opportunities for banks, but require robust vetting for strategic and operational fit.

Carefull

Carefull is an AI-powered digital platform built to protect the daily finances of older adults, along with the millions of U.S adults managing the daily finances of an older loved one. Their technology integrates senior-specific financial monitoring, identity theft protection, communication, and how-to content, replacing the ad hoc paper pile, spreadsheets, and hold music that today greets adults caring for someone else's money.



Market Opportunity

- $8.8 Billion in annual losses from senior fraud, scams, and identity theft
- 45 Million financial caregivers who currently have no tools to care for their aging parent’s finances

Strategic Value

- Provides a financial wellbeing solution to aging customers
- Enables financial caregivers to get a holistic picture of their parents’ finances; allows caregivers to support, manage and monitor finances
- Creates and deepens relationships with their financial caregivers (which can be 5-30 years)

Learnings to Date

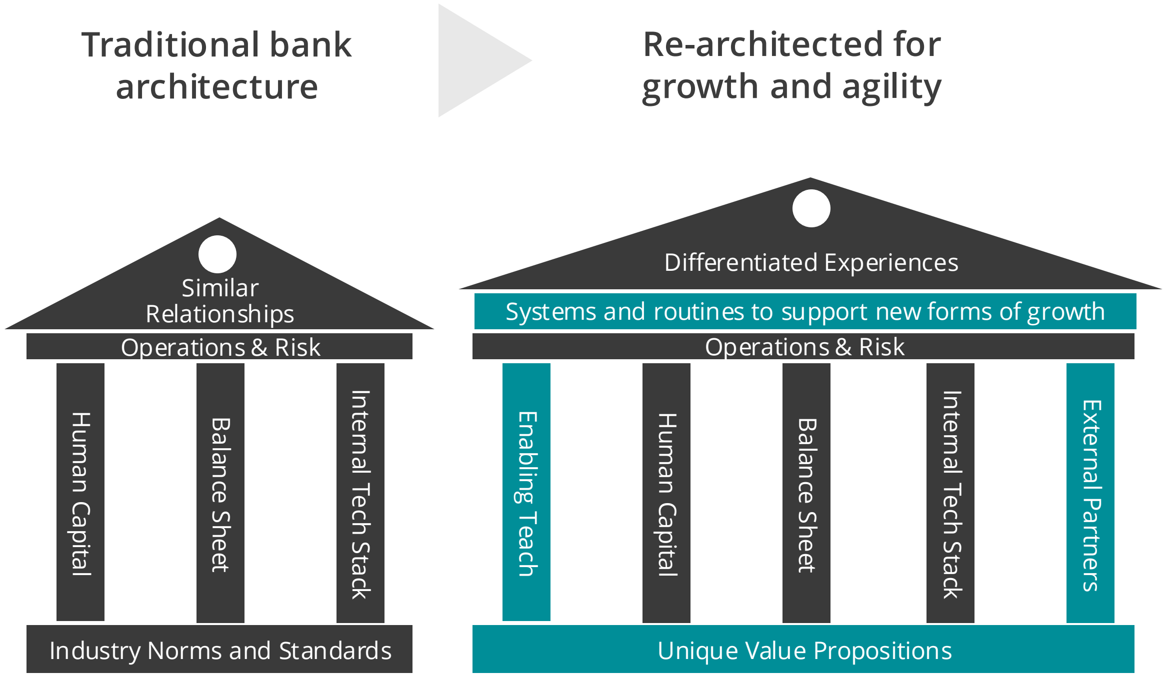
- 4+ accounts added per user, with 2+ institutions average
- Members open emails at 3x the industry average
- Becoming an effective new customer acquisition tool
- Reduces servicing costs

Disclosure: Carefull is a graduate of the Alloy Labs Concept Lab and an investment in the Alloy Alchemist Fund

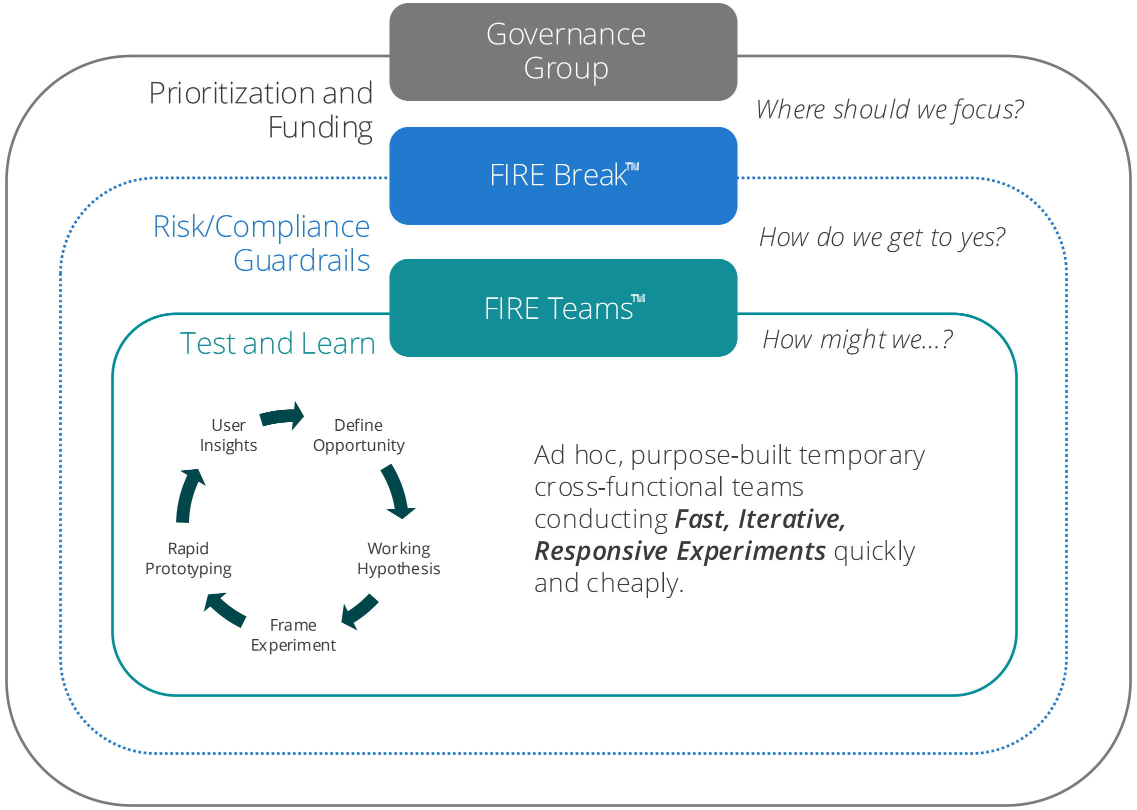
3) Structure for Success

Banks are built for safety and stability, leveraging the common practices and infrastructure of the industry. However, this is suboptimal for agility and growth and can be catastrophic when the future no longer looks like the past.

Traditional bank architecture augmented with new capabilities to support a differentiated strategy creates a stronger infrastructure



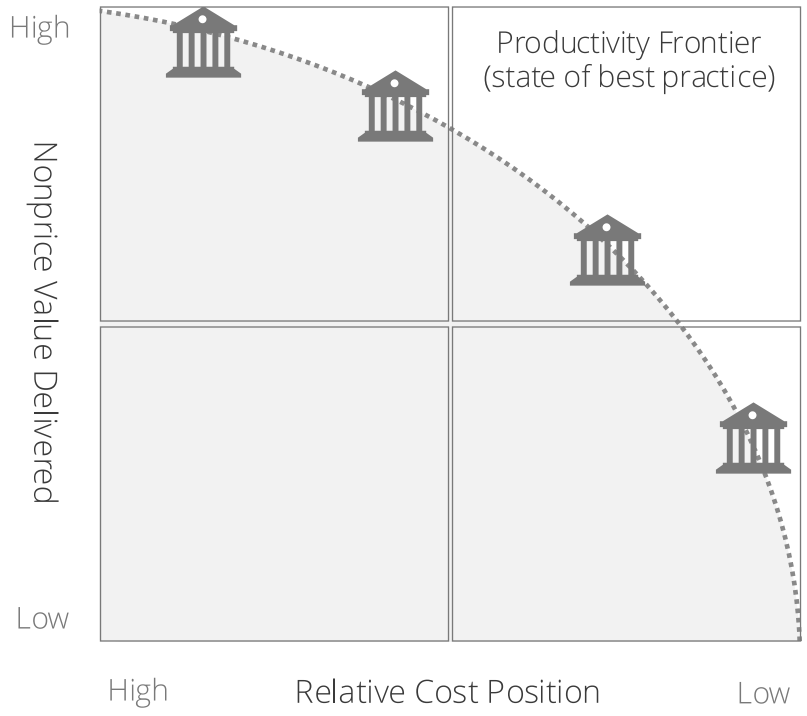
Internal structures must support testing and learning with the appropriate level of agile risk management controls



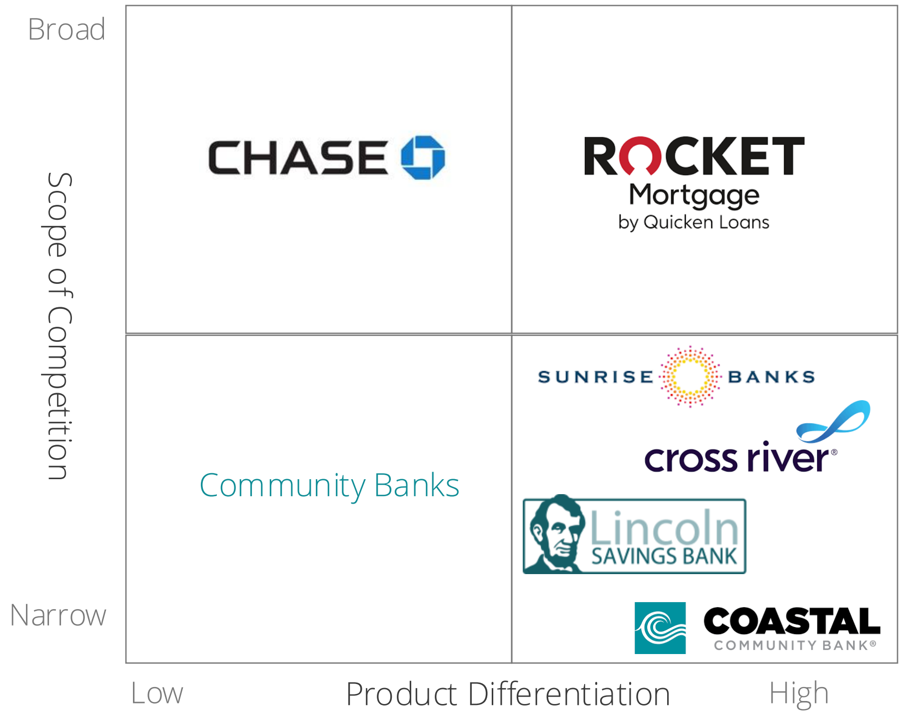
4) Build a Unique Competitive Advantage...

To win in the new era, banks must break the tradeoff of cost vs. value (and rate vs. volume) by narrowing their focus and and investing in differentiation opportunities that create a competitive advantage.

Merely having lower costs or providing higher value involve tradeoffs that leave most banks stuck along the productivity frontier

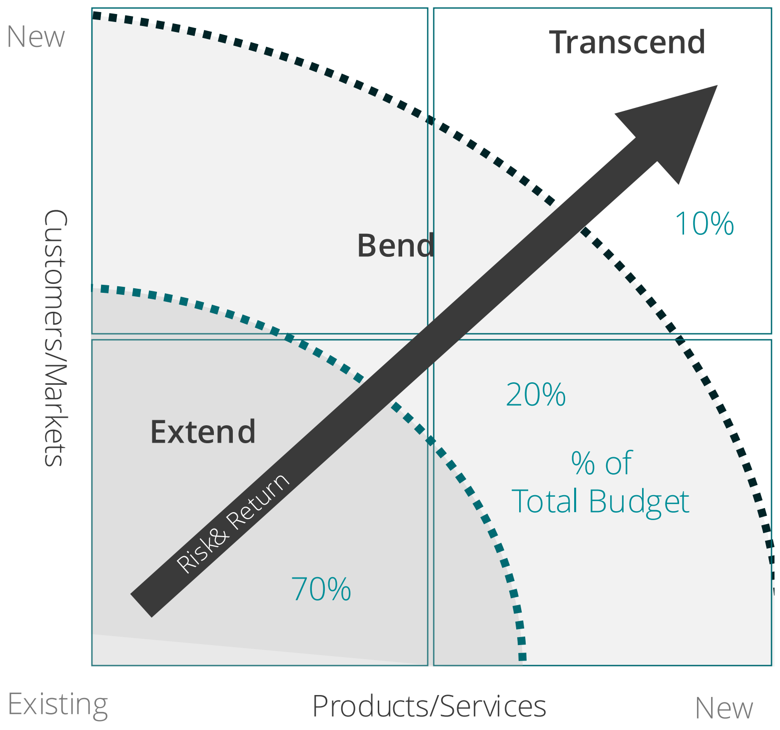


Being a smaller version of the biggest, most efficient banks worked when geography was a significant moat. Winners in the new era pick their spots and focus on differentiation



...and allocate limited resources wisely

Defending and extending the core business is necessary, but insufficient. Bending the line of current results requires new thinking and strategic allocation of limited resources.



Growth Objective	Time Horizon (months)	Allocation of innovation budget	Primary Objective	Key Characteristics	Key Challenges
Transcend	36+	30-40%	Develop viable options for the future	Learning metrics; small, diverse bets	Resource constraints; volatility
Bend	18-36	50-60%	Adjacent products/services and/or new customers/markets	Growth metrics; Highly customer-centric based on pains, gains and jobs to be done	Testing and learning quickly and cheaply
Extend	0-18	0-10%	Defend and extend the core business	Traditional metrics, focus on efficiency	Freeing up resources to reinvest

Sources: Monitor Group, Harvard Business Review, McKinsey & Company, Alloy Labs Institute

AlloyLabs.com/Resources

Questions? JP@AlloyLabs.com

[Read Our Blog]

Our team regularly shares insights on critical issues and strategic imperatives for leaders of financial institutions to survive and thrive in this era of digital disruption. Read here.

[Download our Industry Insights]

Leverage the insights and intelligence from 90 member banks of the Alloy Labs Alliance to unearth specific market opportunities, address critical challenges, and unlock new sources of value on topics like Banking as a Service, Third Party Diligence, Cybersecurity, Conversational AI, Fintech Partnerships, and more.

[What's Your Disruption Risk?]

Complete a free short assessment to help understand your organization's current disruption risk by measuring seven key dimensions that are critical to your ability to effectively and efficiently forge ideas into results.

[Industry-Leading Tools and Best Practices]

The best way to get started is with one of our (co)Labs, short collaborative virtual sessions designed to help leaders discover new insights and benefit from others' experiences to create and execute winning strategies and tactics with a minimum investment of time and resources.

[The Growth Atlas eBook]

The Growth Atlas is a set of strategic maps that serve as a playbook to help you move very quickly from strategy to execution on your most important priorities, and help you break down big projects with big risks into actionable steps with manageable risks.

[External Resources]

Some of the books, blogs, podcasts, conferences, and other external tools and resources we like, including some explainer videos on complex subjects.