HOW TO BECOME A GLOBAL NICHE PLAYER?
Preface

On a pleasant Friday morning in August at Vienna Airport, Tamás Erni, the CEO of Loxon was thinking about his recent call with Kristóf Farkas, his partner, the founder of Loxon. Although they had multiple topics to discuss, they had to conclude their call, as Tamás had to pass through customs. He joined Loxon in 2002 and since then he has traveled all around the globe selling Loxon’s products, and implementation services. He had just arrived from Dubai and was on his way to Prague, but did not miss the opportunity to grab his favorite brioche on his way to his car. His thoughts were all around the potential sales opportunities which could bring new clients and projects to Loxon.

Meanwhile in Budapest, Kristóf was sitting at his desk in Loxon’s brand new office. It has been almost 16 years since he founded Loxon right after his graduation. Over the past 16 years, the company has grown dramatically, employing 170 people and selling integrated IT solutions to more than 60 banks in 25 countries.

Both were proud of their past achievements and results, however now they had to concentrate on Loxon’s future opportunities and potential strategic options.

Tamás raised several questions around Loxon’s business strategy during their call. How can Loxon maintain its growth rate, and how can the company become a global player? What are the most important growth directions? Should the company focus on further market expansion or product development? Loxon is still a niche player in its specific segment, but how can it grow up to the giants? Should the company’s strategy be affected by recent trends in the industry?

Kristóf stood up and started to pace around his office. He knew that people were the most valuable assets to Loxon. Most employees cited the people and the team as the company’s key advantages. How can Loxon maintain its talent and individual performance based organizational structure in the longer term? The rapid organizational growth required stable structures.

Kristóf stopped for a minute, and finished the call. Loxon’s annual employee meeting was scheduled for next week, and the management team had to be prepared to answer questions about the company’s future. To set up Loxon’s next five year strategy, the management has recently hired some external consultants around the world. Both Kristóf and Tamás were keen to receive some inputs from the consulting teams. They had high hopes that the consultants’ outside-in view could provide novel answers to their questions.
Trends in the financial services industry

Loxon offers software and IT solutions to banks, lenders and leasing companies, therefore it is closely tied to the wider trends and general business cycles in the financial services industry.

The financial services industry includes banks, credit unions, credit-card companies, insurance companies, mortgage finance companies, consumer-finance companies, stock brokerages, investment funds. All of these players have been heavily affected by the recent financial crisis in 2007-2008, and by a growing trend of digitalization in the last few decades.

Changing regulation of the financial services industry after the global crisis

The latest financial crisis hit the global banking sector through severely increasing default rates, freezing interbank lending, and decreasing number of credit consumers and businesses.

Furthermore, the financial crisis fostered new regulatory actions internationally through Basel III, and in the United States through the Dodd-Frank Wall Street Reform and Consumer Protection Act.

The Basel Committee\(^1\) introduced a set of proposals for new capital and liquidity standards to the global banking sector in 2009 to increase its resilience and ability to absorb shock. The reforms, known as Basel III were endorsed by the G-20 in November, 2010, member nations were left to translate the requirements into national laws and implement the standards in their own countries, while the local banking industry prepared its internal policies and monitoring systems for the implementation.

The Dodd-Frank Act, which was passed in the U.S. in 2010, expects all bank holding companies with $50 million or higher assets value to implement stringent capital and liquidity standards, and it sets new restrictions on incentive compensation.

Besides international regulations, the public sentiment has also become ever less tolerant of the failures of financial institutions, and the use of public money to salvage them. The new regulatory framework was devised to prevent another depression like the 2008 financial crisis. However, the future of banking models and the calculation of regulatory capital, as the potential use of a standardized approach as a floor (Basel IV), is yet to be decided. The proposed changes could have substantial implications,

\(^1\) An international committee of banking supervisory authorities that aims to enhance understanding of key supervisory issues and improve the quality of banking supervision worldwide.
especially for low-risk portfolios such as mortgages or high-quality corporate loans.

Beyond the above, the governments expect other forms of prudent operations too. Banks and financial institutions are requested to monitor and prevent illegal and unethical financial transactions by detecting signs of money laundering, sanctions busting, fraud, and the financing of terrorism, and to facilitate the collection of taxes.

**Trends in digitization**

**Changing customer needs**

The financial services industry, chiefly banks, recognized that a new, younger generation of consumers has entered the consumer base. They are technologically savvy and highly adapted to the online world.

This trend is particularly apparent in emerging markets, where the lion’s share of the population is under 30. In Africa for example almost 50% of the population is below 19 and most young adults have mobile phones. Furthermore, the younger generation owns smartphones which they use for banking as well.

This generation see the online banking solutions as reliable, but expects easy to use online platforms and mobile applications.

This technological innovations has brought to life a new set of competitors; the financial-technology companies, or fintechs. These companies do not want to provide solutions for all banking activities, rather they offer their services to the most lucrative part of the value chain—origination and sales. These activities accounted for almost 60 percent of banks’ profits in 2014. They also earned banks an attractive 22 percent return on equity, much higher than the gains they received from the provision of balance sheet and fulfillment, which generated a 6 percent return on equity.

These simple apps and online services offered by fintechs are beginning to lure away more and more customers from the incumbents. Most fintechs start building their portfolio brick by brick, adding one service to another.

Banks’ response to this new threat is to develop and implement their own applications and software, offering higher customer experience, such as instant response to retail and corporate credit decisions, or rapid online account-opening process. Although these innovations often require banks to redesign their internal processes from a customer experience perspective, and digitize them to be able to manage the required scale.
From the banks’ perspective, the new technologies enable them to offer increasingly customized services by tailoring prices and products to each individual. This degree of customization is expensive for banks to achieve, due to the complexity of supporting processes required, and their legacy IT infrastructure (most major banks still run core banking systems that were implemented in the last decades of the 20th century). Regulatory constraints might well be imposed in this area, however, to protect consumers from inappropriate pricing and approval decisions.

**Big Data opportunities for the financial services**

The emergence of faster and cheaper computers and Big Data analysis techniques will enable banks to use reams of structured and unstructured customer information to:

- help make better credit risk decisions,
- detect early evidence of problems in the portfolio,
- reveal financial crime,
- predict operational losses
- etc.

Similarly to other industries, the question remains whether the regulations will allow banks to leverage social media data and online activity.

**Players in the financial services software industry**

Loxon provides IT solutions to the credit side of banking operations. These software solutions are highly integrated into the banks’ IT systems, which often have more than 100 different software components with multiple interfaces. One of the key challenges for the industry players is that their products’ success does not solely depend on the product itself, but also on how easy it is to integrate it with the banks’ legacy systems. The software integration can take up to 1 year, and is usually done by the suppliers.
Competitors

Loxon is facing several competitors for all of its products in all the regions where it operates, as can be seen in the following table:

<table>
<thead>
<tr>
<th>Central and Eastern Europe</th>
<th>Commonwealth of Independent States</th>
<th>Middle East and North Africa</th>
</tr>
</thead>
<tbody>
<tr>
<td>Assecco SEE, FICO, Experian, SAS, CRIF, Rockall, Lombard Risk</td>
<td>Experian, SAS, FICO, CRIF, IBM (Algorithmics products acquired by IBM), Prognose, Wolters Kluwer</td>
<td>Moody’s, SAS, Sungard, IBM (Algorithmics products acquired by IBM), FICO, Newgen, Wolters Kluwer, Nucleus, 3i Infotech</td>
</tr>
</tbody>
</table>

Chart #1: Loxon’s key competitors by region
Source: Loxon Solutions

FICO

FICO is a US based, publicly traded software company, offering IT software solutions in 90+ countries. The company uses Big Data and mathematical algorithms to predict consumer behavior. FICO provides analytics software and tools to manage risk, fight fraud and build more profitable customer relationships, optimize operations, and meet strict government regulations.

FICO is known for its excellent track record and strong knowledge base within the industry. One of their most successful product is FICO® Score. This is widely used in consumer credit risk in the United States. FICO solutions leverage cloud computing and open source to maximize flexibility, speed deployment and reduce costs.

The company was founded in 1956. FICO introduced analytic solutions such as credit scoring that have made credit more widely available, not just in the United States but around the world. Their solutions include predictive analytics, business rules management and optimization primarily for banks and other financial institutions.
Nucleus

Nucleus Software is an Indian company founded in 1986. It provides lending and transaction banking products to the global financial services industry. The company benefits from a lower cost base, and primarily competes on price.

Nucleus has 2 main products FinnOne and FinnAxia.

FinnOne is an integrated lending solution, covering the lending processes, while FinnAxia is an integrated global transaction banking solution used by banks to offer efficient and innovative global payments and receivables, liquidity management and business internet banking services.

The Loxon story

Loxon Solutions was founded in 2000 in Budapest in a special economic situation. Since the beginning, the founder, Kristof was clear about his ambitions, and knew that he wants to build a startup. The first months were raised a number of important questions particularly regarding the potential services or products.

Finally, time helped reach a decision. In 2000, he founded Loxon, a company providing software for banks. These years were turbulent times in the IT industry. As the result of the dot.com crisis, there were thousands of developers on the labor market without any jobs, providing a relatively easy access to smart and experienced IT developers.

Furthermore, as a startup Loxon could take advantage of the paradigm shift in the industry, and introduce their thin client (browser) based solutions. The company grew rapidly during its first years. Raiffeisen Bank, Loxon’s first client ordered several custom development projects from the young startup. These projects were complex, Raiffeisen specific and required a high amount of working hours. The whole team was stretched, working 24/7. In 2002, the company had 30 employees, and opened its first real office in the Bank Center in business heart of Budapest.

During these first years however the whole company was built on one customer, posing significant risk. Tamás and Kristóf realized this on time, and established a new “Loxon approach” around three strategic values:

People: The employees, their competence and attitude are the key to Loxon’s historic success. The respect of the talent and the performance based approach is the basis of Loxon’s core competences.
**Strategy:** Loxon had limited resources so its daily operations required a certain focus in the corporate strategy. These were the years when the management made the basic decisions about the company’s strategy. This was the time when Loxon became a niche player in the risk management and lending segments. While in the first years the main message was about the general IT development skills and the individually developed projects, the team started to focus on its risk management and lending competences. During the summer of 2003, this key strategic focus was decided by Tamás and Kristóf after analyzing the core competences of Loxon, to determine the best way for Loxon to keep its comparative advantages compared to its competitors for the foreseeable future. Interestingly, the physical location for this decision later proved to be a key factor. It happened on a bench in London’s Hyde Park, where they were invited to present Loxon’s skills around Basel II to an international audience. ‘We have to focus on the lending and risk management areas, gain a deep understanding of the business processes and be the world’s best in this field.’ mentioned Tamás and Kristóf several times during the management meetings. This strategy still determines the key management decisions and provides a clear guideline to the employees.

**Sales:** Without heavy sales, a company cannot grow. Fortunately, Tamás proved to be an outstanding talent in sales and business development. Thus the company started to grow outside its core region and acquired new clients. This move helped to build a diversified client portfolio over the past decade.

**Balanced product portfolio**

As a niche player Loxon is specialized in risk management, and lending and credit scoring. Regarding the economic cycles, the current portfolio is quite balanced. When an economy is growing, banks are lending more, so they prefer to invest more in lending related software. When a country is in an economic downturn, the need for risk monitoring, early warning or collection modules increases. Finally, due to the ever growing regulations, the demand for Basel III and IFRS9 software grows in any part of the economic cycle.

Loxon’s products cover the entire lending cycle and the credit management processes. It offers one of the most complete solution package for lending processes.
<table>
<thead>
<tr>
<th>PRODUCT</th>
<th>DESCRIPTION</th>
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<tbody>
<tr>
<td>Retail lending</td>
<td>Control of the entire lending lifecycle from the sales and decision steps all along to contracting, monitoring phases till expiry. Flexible support of all steps in sales, risk management, loan administration and other departments.</td>
</tr>
<tr>
<td>Corporate lending</td>
<td>Control of the entire lending lifecycle from the sales and decision steps all along to contracting and the maintenance of flexible product parameterization.</td>
</tr>
<tr>
<td>Rating / Scoring</td>
<td>Centralized financial and non-financial data capture, flexible engine calculating various financial and nonfinancial indicators for credit risk assessment, financial analysis and spreading. Based on the quantitative and qualitative measures, the banks can get the relevant rating/scoring values.</td>
</tr>
<tr>
<td>Collateral management</td>
<td>A tool which monitors and manages the collateral portfolio of the banks. It keeps the record of the collaterals and optimizes the regulatory and economic requirements.</td>
</tr>
<tr>
<td>Early Warning</td>
<td>Prediction of the probability of default using behavioral approach on expert or statistical base and the automated management of the entire monitoring process.</td>
</tr>
<tr>
<td>Collection</td>
<td>Broad and flexible support for managing bad credits. It handles any delinquent deal through the whole default life cycle, from the date of delinquency up until the date of repayment or until resolving the claim in any other way.</td>
</tr>
<tr>
<td>Basel II/III.</td>
<td>State of art capital adequacy calculation and reporting system, which is fully Basel II/III compliant for all types of risks.</td>
</tr>
</tbody>
</table>

Prior to the global financial crisis, the lending processes related products gave the lion’s share of Loxon’s revenue growth. This has changed since the crisis as the industry is now focusing more on risk management and loss reduction software and initiatives.
Growing markets

For a niche player, Hungary is not a big enough market, thus Loxon needed to widen its geographical reach. Its first international project was implementing a market risk system for a bank in Romania. After the first pilot project, the bank started to order new lending modules too. The partnership with Oracle was another significant step on the road to becoming a global company. During the past two decades, Loxon's market entry strategy went through four phases:

1. Get to know the local market, build up a network, and customize the solutions to meet the local market need.
2. Contract with the first reference client to deliver a smaller and more standardized solution.
3. Work with the biggest actors on the local market, providing standardized solutions.
4. Deliver complex IT systems to the biggest players on the local markets.

Currently, Loxon has a geographically weighted sales portfolio, but obviously it changed significantly over the past 16 years. The different geographical regions are at a different maturity level.

Central and Eastern European (CEE) region

CEE especially Hungary is Loxon Solutions’ core market. The market leading bank in Romania was the company’s first international client in 2004. These were the years when the management had to learn how to sell its products outside Hungary, and how to tailor them to the local needs. Even though Loxon had 9 clients after 4 years, the break-through moment in the company’s life did not arrive until 2006. This was the year when the company contracted with two new clients in two new countries (Serbia and Albania), and with one more in Hungary.

A year later Loxon successfully entered the Croatian and Ukrainian markets. These important steps were followed by others in the Czech Republic, Bulgaria and Slovakia. Nowadays the CEE region is considered as a mature market for Loxon Solutions.

Middle East and Africa (MEA)

Middle East and Africa is one of the fastest growing regions of the world. Banks in the region are looking for international best practices, thus Loxon has a natural advantage with its best in class technology, deep lending and risk management know-how. The European suppliers traditionally have a good reputation. The Middle East and Africa region has turned into the second most important market for the company starting from 2007, and is the source of a significant portion of its revenue growth.
The Commonwealth of Independent States (CIS)
Loxon has been present in the CIS market since 2007, when the company signed its first contract in Ukraine. In 2010, Loxon opened its Russian office in Moscow. In 2010, the Russian economy had just recovered from the financial crisis and started to grow again.

Today, Loxon is present not only in Ukraine or Russia, but in Kazakhstan and Azerbaijan as well. The CIS market is considered a great market opportunity (based on the size of the market), albeit with significant political and economic risks.

Asia-Pacific (APAC)
Although the company has already had projects in Singapore, India, Indonesia, and Vietnam, the Asia-Pacific region is still considered as an exotic market for Loxon. Currently, this region is not in the focus of the strategy, however if a customer requires a project in the area, the company is able to deliver it.

Loxoners: The people behind the scene
In the past 16 years, the organization was continuously challenged by rapid growth. The organizational structure had to follow market needs and efficiency principles as well. In the first years, Loxon had a flat organizational structure. The main projects were led by the key managers. When the company grew to 30 employees, it needed another level within its structure. The management created product specific pools, and the project leaders were members of these groups. When the size of the company reached 100 employees, a new organizational level, the program directors line appeared between the pools and the project leaders.
Talent is a key asset for the company. Loxon currently has 170 employees, and the average age is 27 years within the organization. Loxon invites the most talented fresh graduates from business and economics studies to work as business analysts in the implementation and product development projects, and programmers from the technical universities to join its software engineering team. The management team developed a mentor program to support the younger colleagues’ work and development. This mentor provides continuous feedback and a clear career path for the younger team members.

**Strategic dilemmas**

The annual meeting is getting closer. As Tamás sat in his car, he called Kristóf, and they started to take notes on the most important questions to Loxon’s future.

How can Loxon maintain its growth in the long run? Can Loxon grow further with the current product portfolio? What should be the best operating structure, and how should the company maintain the current engagement level of employees? Should the company react to the recent emergence of the fintech companies?

All these questions affected Loxon’s mid and long term strategy and operating model. Although they had some initial answers, they were looking forward to the recently hired consultant teams’ inputs and implementation strategy.
Appendix

**NUMBER OF CUSTOMERS (BANKS)**

Appendix #1: Number of customers
*Source: Loxon Solutions*

**NUMBER OF EMPLOYEES**

Appendix #2: Number of employees
*Source: Loxon Solutions*
REVENUE SHARE BY REGION

Appendix #3: Revenue split by regions (2000-2015)
Source: Loxon Solutions

<table>
<thead>
<tr>
<th>COUNTRY</th>
<th>REGION</th>
<th>YEAR</th>
</tr>
</thead>
<tbody>
<tr>
<td>Hungary</td>
<td>HU</td>
<td>2000</td>
</tr>
<tr>
<td>Romania</td>
<td>CEE</td>
<td>2004</td>
</tr>
<tr>
<td>Albania</td>
<td>CEE</td>
<td>2006</td>
</tr>
<tr>
<td>Serbia</td>
<td>CEE</td>
<td>2006</td>
</tr>
<tr>
<td>Croatia</td>
<td>CEE</td>
<td>2007</td>
</tr>
<tr>
<td>Ukraine</td>
<td>CIS</td>
<td>2007</td>
</tr>
<tr>
<td>Jordan</td>
<td>MEA</td>
<td>2007</td>
</tr>
<tr>
<td>Palestine</td>
<td>MEA</td>
<td>2009</td>
</tr>
<tr>
<td>Czech Republic</td>
<td>CEE</td>
<td>2010</td>
</tr>
<tr>
<td>Russia</td>
<td>CIS</td>
<td>2010</td>
</tr>
<tr>
<td>Bahrein</td>
<td>MEA</td>
<td>2010</td>
</tr>
<tr>
<td>Egypt</td>
<td>MEA</td>
<td>2010</td>
</tr>
<tr>
<td>Bulgaria</td>
<td>CEE</td>
<td>2011</td>
</tr>
<tr>
<td>Pakistan</td>
<td>MEA</td>
<td>2011</td>
</tr>
<tr>
<td>Turkey</td>
<td>MEA</td>
<td>2011</td>
</tr>
<tr>
<td>United Arab Emirates</td>
<td>MEA</td>
<td>2011</td>
</tr>
<tr>
<td>Vietnam</td>
<td>APAC</td>
<td>2012</td>
</tr>
<tr>
<td>Slovakia</td>
<td>CEE</td>
<td>2012</td>
</tr>
<tr>
<td>Singapore</td>
<td>APAC</td>
<td>2013</td>
</tr>
<tr>
<td>Kazakhstan</td>
<td>CIS</td>
<td>2013</td>
</tr>
<tr>
<td>Lebanon</td>
<td>MEA</td>
<td>2013</td>
</tr>
<tr>
<td>Azerbaijan</td>
<td>CIS</td>
<td>2014</td>
</tr>
<tr>
<td>China</td>
<td>APAC</td>
<td>2015</td>
</tr>
<tr>
<td>India</td>
<td>APAC</td>
<td>2015</td>
</tr>
<tr>
<td>Indonesia</td>
<td>APAC</td>
<td>2015</td>
</tr>
</tbody>
</table>

Appendix #4: Date of Loxon's market entries
Source: Loxon Solutions
1. Nemere II, sailing boat, an iconic boat at Blue Ribbon, Balaton Lake

2. Budapest office – friendly and comfortable
3. ttBudapest office – 30% of the space serves relaxation

4. Coffee break
5. Team activity, CSR – painting the tables in Duna-Ipoly National Park

6. Team activity, CSR – building the playground for a nursery school
7. XBOX – Playing FIFA after work

8. Islamic Banking Forum, Dubai
9. Debrecen office – creative space

10. Java Challenge – an internal competition
11. Middle East Retail Banking Exhibition

12. Solving project issues
13. Winners of Student Management Championship joining Loxon as business analysts

Appendix #5: Life in Loxon

Source: Loxon Solutions
Appendix #6: Loxon organizational structure

Source: Loxon Solutions

Loxon Solutions

- Sales & Marketing
- Business Development
- Professional Services
  - Product Development
- Development
- Oracle Practice
- HR
- Finance & Operations
  - Project & Account Management
    - Lending - RSS lines
    - Basel - Collateral Line
    - Collection Line
      - Project Manager

Appendix #6: Loxon organizational structure
Source: Loxon Solutions