Payments

Are you on a winning curve?

Thinking strategically about your Payments business

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We are in a period of unprecedented change in Payments and Transaction Banking. Our industry faces a significant number of disruptive factors including regulation, ISO20022 and scheme-transformation, alongside challenges from neo-banks and FinTechs.

Customer behaviours are being influenced by evolving expectations, shaped by digital technologies such as eWallets and contactless cards as preferred methods of payment. The use of traditional payment channels, notably cash and cheques, is declining – a trend that is being accelerated by the COVID-19 situation. The regulatory opportunity created by Open Banking is encouraging market newcomers to develop innovative and convenient payment experiences at a time when mobile personal devices such as smartphones and tablets are perfectly placed to deliver such offerings.

Meanwhile, the potential for Big Tech to move into the role of payment providers and innovators looms large. Facebook has signalled its strategic intent, shown by its attempt to launch the Libra digital currency, while the clear fit between the Amazon business model and payments processing may prove decisive in persuading them to enter the field.

We see demand for FinTech-related services in areas such as consumer banking and wealth management, opening new opportunities for revenue generation. For example, FinTechs such as Yolt and Bippit offer advice to customers on how they can save or spend more effectively, as well as marketplace platforms allowing product comparisons between third parties. New players are using the digital-only model to reach millennials and, increasingly, other segments of society too. At the same time, traditional players are employing this approach to reduce their operational costs and finding more cost-effective ways to comply with new regulatory mandates. This could potentially help banks to re-invest their cost savings to drive revenue generation activities, thus enabling payments to become a strategic function within or outside their own organisations.

Now is the time for banks to re-evaluate their strategies for payments, drive further cost optimisation, respond to competitive challenges and understand the opportunity to increase revenues, potentially running payments as a business with its own P&L.

Cost reduction in payments transformation

Market leaders are adopting digital pathways as well as simplifying their underlying legacy infrastructures. A few of these banks are also re-focussing on upskilling their people, consolidating siloed teams into multi-functional teams and driving intelligent automation to improve productivity and create capacity.

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Banks in other economies are adopting technology based on a native ISO20022 data model which helps in improving STP and reconciliation, in addition to improving efficiency through automation and lower costs.

As an example, a mid-sized UK bank is investing in technology-led innovation by setting up a Payments Hub for all domestic payments. This will create a single point of future investment across all customer and payment types, while also creating the opportunity to redesign its payments operating model and to simplify its enterprise architecture. A significant driver of payments costs is the prevalence of multi-siloed manually-intensive operations and legacy systems to provide anti-fraud, fincrime, AML and Sanctions, and error processing capabilities. Elimination of these costs through operational and system consolidation is a major cost lever.

Payment scheme consolidation and ISO20022 implementation will support these objectives. Rationalised scheme structures will improve interoperability among banks by simplifying technical, operational, governance and liquidity requirements. Enhanced payment messages will also improve interoperability and will enhance data quality, allowing more efficient exception processing and payment reconciliation, increased straight-through processing (STP) and simpler cross-border payments.

Unlocking additional revenue streams

Amidst all the cost take-out initiatives, banks are having to invest in addressing payments-specific industry mandates such as the global ISO20022 roll-out, PSD2 and Open Banking. However these changes present banks with an opportunity to enhance their Payments offerings to their customers.

Moving the decades-old payments business model to the digital age creates a number of major challenges, as few banks are in a position to operate such an ecosystem at scale. They are having to build new digital architecture and innovative products, while keeping a close eye on risk management and security. But if financial service providers embrace the new digital ecosystem model they can look to take advantage of new revenue opportunities alongside accelerated cost reduction.

For example, the digital ecosystem will enable a new 'marketplace' model. Think Apple iPhone here. Despite all the hype at its unveiling, the iPhone launched with just 16 apps. The real point of take off for the iPhone was the introduction of the App Store a year later, with a billion downloads after only nine months. Through Open Banking, enhanced by the data enrichment afforded by ISO20022, banks can revolutionise their customer propositions through a similar model, by effectively distributing third-party products and services via their own platform. On the flip side, banks will be able to use their APIs to extend their reach beyond their existing customer base, perhaps offering products such as travel money or loans to established digital marketplaces in the banking ecosystem.

Customers have become accustomed to convenience across their banking lives.

While many economies and large banks have struggled to justify investment in new payments systems, contactless cards have become the norm, smartphones have powered the proliferation of digital wallets and online banking has become more prevalent.

The speed at which the Fintechs and challenger banks have been able to respond to customer needs has set an expected pace for change to which traditional banks have so far struggled to respond. While these newcomers are able to address customers' needs, such as ease of use, better accessibility, faster transactions and spend analytics, it is far from clear that they have, so far, been successful in becoming primary service providers for all banking needs. The increase in current accounts among challenger banks has not been matched by a corresponding decrease in current accounts among traditional banks.

Traditional banks have begun to capitalise on this opportunity by setting up their own digital banks to retain customer loyalty and drive in new offerings. As an example, a pivotal area for banks to respond to customer demand is payment security. As cyber security in general becomes more mature (biometrics, voice recognition), both customers and regulators expect banks to apply more advanced countermeasures to address payment fraud in all its guises.

Changes in the payments industry and advances in technology are also creating opportunities for non-bank platforms. For instance, TransferWise has developed a highly competitive customer offering using a peer-to-peer model, which has global coverage and is also faster and more cost-efficient than the correspondent bank model used by traditional banks.

Some banks are leveraging regulatory mandates to drive innovation, in turn leading to better customer experience and new revenue offerings. With ISO20022 implementation in the UK, banks will have enriched data in the new message formats giving them opportunities for increased data-monetisation and to have the most comprehensive view of their customer behaviour, thus enabling them to offer customer focussed/tailored products and services.

We believe that Data holds the key to turning Payments from a cost centre to a real revenue driver and differentiator. The implementation of ISO20022 gives banks the opportunity to monetise a highly enriched dataset from their customers' payments behaviour, so emulating the business model used by Google and Facebook. This dataset can be used to build enhanced customer payment services and can also be used to support propositions such as internal cross sell.

The Open Banking era has the potential for banks to offer customers a one-stop solution to access multiple products/services from a central platform. This will enable them to offer better deals on an array of products ranging from mortgages and overdrafts to insurance and broadband services, and improve overall digital customer experience. Digital banks are offering value added services such as spend analytics, finance management, zero FX fees on international travel up to a defined limit. For customers this removes a need to go to a physical branch to setup and go through KYC checks and makes their journey easy, smart and convenient. This could act as an advantage for the traditional banks to leverage their existing customer base and insight into customer behaviours, leading to better revenue prospects.

Customer-centric payments business

Payments have often been run as a pure service – the plumbing within banks. However, by operating Payments as a business in its own right, banks will have the opportunity to focus on revenue and profitability by leveraging customer insight and relationships. This will also provide a multichannel, connected and collaborative ecosystem for customers, third party service providers and other banks. Such a model will not only drive more accountability and focus but also innovation. With evolving customer needs, regulatory changes and technology advancements, the key question is whether to run 'Payments' as a 'Business' or to remain as a 'Service'? In either route, to stay relevant and respond to changing market needs, customer centricity is key and will help Payments function drive profitability.

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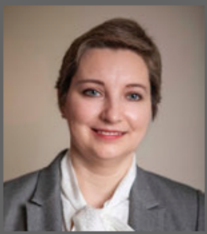

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