How Banks Are Fighting Back Against Disruptors With Real-Time Payment Platforms

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A Shifting Landscape

Increased digitisation has seen many banks and corporates alike engage with customers and supply chains across the world. In today's competitive marketplace, firms need to be able to offer products and services not only domestically but beyond their borders. As such, being able to send and receive funds on a 'real-time' basis utilising user-friendly tools is critical for firms wanting to stay ahead of the competition. Our research has shown the following to be the main drivers in transforming the way banks service their customers when processing payments;

- **Regulatory reform** has helped to level the playing field by attracting disruptors into the payment landscape to offer services which were traditionally monopolised by banks;
- **The rise of challenger banks** and disruptors has altered traditional distribution channels;
- **Growth in firms adopting 'Marketplaces'** to increase revenue streams has resulted in the need to send and receive payments as close to real-time as feasible;
- **The growth in cross-border activity** is forecast to account for around 20% of all e-commerce activity; totalling $630 billion by 2022.

The economic theory of perfect competition teaches us that firms are attracted to markets where the incumbents are enjoying monopoly profits. The cross-border payment space is no different as recent years have seen disruptors enter the market which is causing banks to lose a grip on a significant revenue stream.

Banks are finding that their share of SME activity is falling. Surveys have indicated that they currently account for less than 65% of market share related to total SME activity, and more than half of these customers are unhappy; feeling that the banks do not understand their FX requirements. Conversely, it has been reported that fintech solution providers are offering superior services at a fraction of the cost.

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1 - https://assets.publishing.service.gov.uk/media/57ac9667e5274a0f6c00007a/retail-banking-market-investigation-full-final-report.pdf

How Are Banks Responding To The Competition?

The possibility of declining margins and volumes has forced banks to respond. Many have already turned to technology which under normal circumstances would be a positive step. However, with the current uncertainties looking to continue for a protracted period and combined with recent regulatory changes, banks are having to respond. Greater emphasis on achieving transparency for customers concerning fees they charge, as evidenced by the Dodd-Frank consumer protection act, has become more of a necessity for banks to invest in their infrastructure platforms to protect future revenue streams.

However, banks are struggling to adapt to the new challenges they face for the following reasons;

Legacy Infrastructure & Processes

The problem is compounded where banks still own and maintain many of the platforms which were developed decades ago and have become "legacy" systems. These legacy systems are heavily customised and expensive to replace or migrate to new technology.

Traditionally the default position is for front office business units to operate within silos; detached from downstream payment processing activities. Bridging this divide is often seen as extremely challenging hence the need to be able to communicate with both worlds without any requirement to change underlying infrastructure and business processes.

Real-time Rates

As a result of the absence of integration, another stumbling block is the inability to stream prices within a bank's payments department to replace "rate cards". The lack of real-time rates can both impact customer comfort around the prices quoted and can also make regulatory compliance more difficult.

Fee Transparency

Banks relying on their legacy infrastructure are simply not set up to provide transparency around how fees are structured and are unable to demonstrate what impact the speed and method of payment selected has on the overall fee charged.

> "While some banks have responded with an attractive online presence or new technologies, such as voice or facial recognition, most are well behind their retail counterparts in introducing digital tools. In fact, many still operate as they always have—gathering documents with cumbersome, manual processes and relying on meetings, calls, and emails alone to interact with customers.[5]"

5 - https://www.bcg.com/en-gb/publications/2018/what-do-corporate-banking-customers-really-want.aspx

Competition

It's not uncommon for the above factors and others to combine and result in banks fees not being competitive in comparison to fintech's that are concentrating on customer acquisition growth.

The regulator is being driven to protect the consumer; it is responding to reasonable demands from them adding further levels of protection in the payments industry. It is forcing banks down a route to have a proper strategy and prompting engagement with technology providers who can supply a full solution while building the required bridges across bank silos.

At this juncture, it is worth looking at the shopping list customers have, which is driving through sweeping changes across the payment landscape.

Multiple language settings: Where banks have a global footprint and deal with customers in regional locations. It's imperative that as part of the enhanced customer experience any application, whether connecting via mobile or the web should be available in the customer's native tongue.

Real-time streaming of currency rates: Features high on the wish list of corporate customers who are extremely sensitive to price movements.

Transparent bank fees: The Dodd-Frank consumer protection act in the US has forced banks to disclose their fee structure upfront as part of their terms and conditions.

Forward contracts: To provide the ability for firms to hedge against receivables and payables by securing an exchange rate to provide certainty on future projected cash flows.

Time options: (Window) Forwards to enable timely payment to suppliers on receipt of goods/services.

Autofill orders and rate alerts: Ability to track rates and receive alerts when an exchange rate hits the desired target and auto-fill orders when predefined rate thresholds are activated.

Batch payment processing: File uploads by API and batch scheduling of payments. Full automation of the payment process alongside a manual payment option.

Drawdowns: Ability to top-up/reduce the balance of Forward contracts and create drawdowns and resultant payments online.

Manage SSI's: User-friendly UI allowing customers to manage beneficiary data within a secure and structured workflow.

Integration: Full integration with accounting systems such as Sage or Xero, allowing payment instruction from within a corporates ERP solution.

Payment tracking: SWIFT has launched a merchant offering (SWIFT GPI) to provide greater visibility on payment processing status.

Transaction screening: To comply with recent AML regulatory changes, and reduce issues requiring difficult and often complicated resolutions.

The Impact Of Regulation

Regulation has been one of the principal catalysts for change within the international payments sector. The first notable regulatory change was the Dodd-Frank Wall Street Reform and Consumer Protection Act in the USA, which set a precedent for the protection of the consumer by mandating transparency around fees charged. Closer to home the latest EU payments service directive, otherwise known as PSD2, has forced banks to open their APIs to third parties with the sole objective of increasing competition, enhance products and services and drive down costs. These reforms make it essential that a bank has a cutting-edge international 'ePayments' platform to stay relevant at the point of access to their customers.

> "Unlike their traditional counterparts, challenger banks and neobanks aren't burdened by legacy systems and cumbersome organizational structures such as major branch operations.[7]"

7 - https://home.kpmg/xx/en/home/insights/2018/02/rise-of-challenger-banks-fs.html

What Is The Benefit To The Bank?

An obvious benefit given the above statement would be regulatory compliance. Innovative payment platforms are usually ahead of the curve with their ability to provide a solution for a transparent fee structure and adherence to the latest developments centred around PSD2.

Collaboration

Banks have been encouraged to open their existing API's and build strategic partnerships with fintech's with the primary focus on customer retention and delivering superior products and services. Santander U.K., part of the Spanish banking group, ranked as the largest in the eurozone by market value, has become the first of its kind to use distributed financial technology to facilitate international payments, through its new mobile application powered by Ripple. Another example is Revolut who are busy rolling out a consolidated balance reporting initiative which will allow their customers to link balances from external sources to provide a holistic overview of their financial position.

Joint Ventures

The open banking directive has seen banks partnering with fintech's to deliver products and services and in some cases buying fintech's proprietary technology to integrate into their technology stacks. The recently announced partnership between Bankhaus Hauck & Aufhäuser, an established German private bank, and fintech firm Raisin, will deliver a higher yield alternative on cash deposits to customers by integrating Raisins savings products.

"Payment as a Service "platform

Another platform approach was featured in a McKinsey Digital report recently, which posited an era of the platform-based company. In this model, IT is described in the report as "organised around a set of modular 'platforms', run by accountable platform (or product) teams". Each platform consists of a logical cluster of activities, and associated technology that delivers on a specific and can, therefore, be run as a business or "as a service" as technologists say.

In the report, they cite a leading global bank that created multiple platforms, one of which was a payments platform. This platform acted as an internal "payments-as-a-service" business for the rest of the bank. Having a solution which is both outward-facing for customers to use and inward-facing for other areas of the bank would drastically produce efficiencies and replace multiple legacy payment architectures.

> "The benefits of digitizing corporate banking include lower cost-to-serve through new coverage models, economies of scale and automation leading to reduced costs, as well as significant revenue opportunities. A digitized banking relationship increases customer touch points and cross-sell opportunities and provides a bank with a better understanding of client transaction behaviors. Digitization also improves the customer experience by enabling flexibility, tailored services and fast response times.[8]"

8 - https://www.mckinsey.com/~/media/McKinsey/Industries/Financial%20Services/Our%20Insights/Leveraging%20the%20digital%20potential%20in%20corporate%20banking/McKinsey_CIB_WP8_Leveraging%20the%20Digital%20Potential%20in%20Corporate%20Banking_2015.ashx

A Glimpse Of The Future

Blockchain technology promises to facilitate fast, secure, low-cost international payment processing services (and other transactions) through the use of distributed ledgers that provide trusted real-time verification of transactions. This technology comes without the need for intermediaries such as correspondent banks and clearing houses. Blockchain technology was initially used to support the digital currency Bitcoin. Now distributed ledger technology (DLT) is being explored for a wide variety of applications that don't involve digital currency. According to a survey published by IBM, 65% of banks were expected to introduce full-scale commercial blockchain/distributed ledger solutions by 2020.[9]

A well-known European Investment bank has noted that two specific business operations are ready for disruption. Bank to bank transfers and trade financing. These business areas particularly suffer from old, slow and costly infrastructure where resultant cross-border payments can take days to settle and involve fees as high as 10%.

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9 - https://www.ibm.com/downloads/cas/8RQVD7RN

Conclusion

So, for banks that have not yet launched a modern 'ePayments' platform, it is imperative to examine the customer experience they offer. As without a strategy and an identified project they may need to act in great haste if they want to retain their customers.

Africa and Latin America will likely see the most extensive mass adoption of innovative payment solutions. Both continents have a young population who are thirsty to embrace technology, and due to large parts of the population being financially excluded from mainstream financial services, this could potentially become a lucrative market for banks and fintech providers.

Financial intermediaries are already providing corporate and retail customers with the possibility to hold multi-currency e-wallets facilitating the ability to pay for goods and services in a currency different to their regional location.

In conclusion, traditional banks have some important decisions ahead. The fintech threat means embracing change will be key to mitigating any potential loss of market share and profit erosion.


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