Payments Innovations Force an Inflection Point

Financial institutions are being disrupted on multiple fronts. There is a push for greater financial transparency, channel integration, innovation and rapid response to new regulation. New payment types are proliferating, and consumer and business demands are rapidly changing, straining legacy payments platforms. We talked to payments expert Steve Lomax and our own Michael Engel on how the payments market is transforming.

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Q&A

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WHAT DO YOU SEE GOING ON IN THE BANKING/ PAYMENTS INDUSTRY?

In the future, banks will not need to perform many of the functions of the past, and there are going to be certain functions we don't need anymore. Banks need to provide extensive capability in terms of function and the ability to move outside of cards: challenges like PSD2, SCA, open banking, digital currency, and instant payments. A lot of organizations are now seeing these as bedrocks for being able to lay new payment products on top.

In many cases, banks' core business processes are embedded in millions of lines of code developed for the needs of previous decades; this makes it extremely hard to adjust to new customer and market demands. But people are starting to realize that change is happening all around them. All of the legacy banking systems are card based. It's the next-gen instant-payment instruments; token-based payments, mobile, loyalty points, instant payments. Banks need to become more flexible in how they enable people to authenticate, authorize and finalize transactions because no one wants to carry a card.

DO YOU THINK THAT BANKS UNDERSTAND THE NEED TO FUTURE-PROOF OR ARE THEY SITTING COMFORTABLY WITH THEIR INFRASTRUCTURE?

Yes, they are seeing this as a problem, but because these systems have become more complex over the years, the time it takes to migrate is several years, with the inherent risks of modifying existing systems and code causing unintended consequences. When payments platforms go down, the reputational and commercial damage can be irreparable (e.g.,TSB UK). So what tends to happen is there's a contract negotiation instead of thinking "perhaps we should do something different." It's not that they are comfortable, it's that they've already lost the window.

Banks are all facing the same challenges. At the top, people understand that future-proofing is their biggest challenge. But change always has risks. And the question is: does the benefit of a more agile lower-cost ecosystem outweigh the risk of change? If you go two levels down, many are feeling warm and cozy with their legacy system; it feels safer to do nothing. No one was ever fired for buying IBM, right?

WHAT WILL MOVE A BANK TO TRANSFORM AND OVERCOME THE PERCEIVED RISK?

The TCO of older technologies is high. If they actually did an analysis of the cost per transaction—not just software, but maintenance, hardware, and other resources—change can be justified. Newer technologies can lower costs and enable quicker time-to-market. Challengers are already eating into their customer base and revenue. While keeping the key fundamentals of trust and reliability, banks need to become technology companies that meet customers' aspirations and serves their lives.

Silo-based IT systems burdened by technical debt are holding back many organizations from transformation. Banks are starting to realize that their products are digital. A mortgage, or a payment, is just zeroes and ones on a computer and, if they are not careful, some fintech will give the same services much faster at a better price. The world is changing; banks have to do something. And if they are not agile enough to adapt, that could literally be their death.

HOW DO YOU THINK THE INDUSTRY CAN BE DISRUPTED?

It's the ability to deliver innovation more quickly to market, and subsequently nurture new or enhanced revenue lines. If you look at the current state, most providers will be cutting code, some have configurable ways of doing this or scripting stuff. But to get ahead, someone will need to implement a sustainable and scalable way to deliver things faster.

It's the ability to drive change with speed and scale. And be more of an Amazon-type IT organization. Amazon literally has no legacy in their IT universe, their code is constantly renewed by massive parallel automated development pipelines. So, to disrupt and be successful, banks need to adapt to market needs and trends, and come up with new financial services that serve consumer demands.

DO YOU FEEL LIKE DIGITAL TRANSFORMATION HAS BEEN FORCED BY THE PANDEMIC?

COVID has catalyzed the behavioral and cultural changes driving digital transformation. The volume of contactless payments has gone through the roof. But it's more than just contactless. Payments is now part of commerce properly. When you use Uber, you call up a car and the payment is an implicit part of the service.

None of these developments is new; COVID has only accelerated the development of end-to-end digital journeys with integrated payments. People now want banking and payments that are convenient, easy and anytime anywhere.

THE TAKEAWAY

Changes to consumer demands and competition from fintechs are forcing banks to reconsider their existing products, delivery infrastructures, systems and processes. Financial institutions are at a critical inflection point: evolve their payments and transaction systems or risk becoming outperformed by more agile providers.