icon solutions

COMPETING IN PAYMENTS

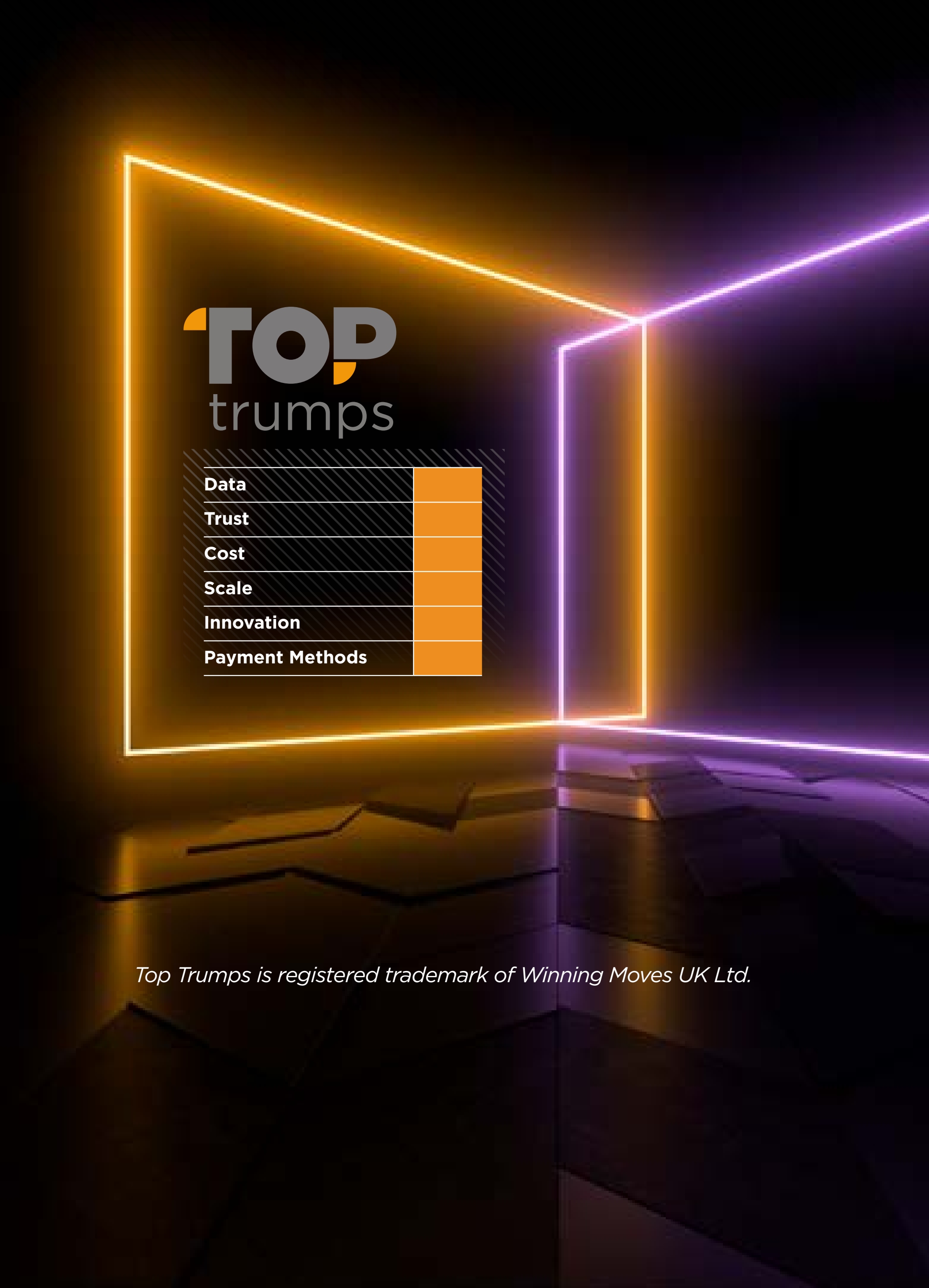
Playing Payment Top Trumps®

Competing in payments is a mission-critical priority for incumbent banks. But with new market entrants rapidly gaining ground, defining strategies to compete in an increasingly congested and complex ecosystem presents various questions. Who is the competition? What are the key competitive battlegrounds? How do strengths and weaknesses compare? What do banks need to do to stay ahead?

This is where a simple card game called **Top Trumps®** comes into play. Each card in the pack has the same categories, and numerical values are assigned for each category (the higher, the better). The aim of the game is to 'trump' your opponent by choosing a category with a higher value.

Success is dependent on two factors. Firstly, the cards with the highest values across the different categories hold the biggest advantage over the competition. Secondly, players must have a clear understanding of their opponents to be able to pick the right battles.

As competition in payments has intensified in recent years, incumbent banks are faced with the exact same considerations. By identifying the players (the cards in the deck), competitive areas (the categories on each card) and relative strengths and weaknesses (respective scores for each category), this ebook will enable incumbent banks to clearly see how they stack up against the competition. And by identifying how payment transformation strategies can boost scores across every category, it will provide a clear roadmap to help banks trump the competition.



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1.

Introduction – A Changing Field

For several decades, incumbent banks have held a comfortable leadership position in the payments business and enjoyed high fees, healthy margins and limited competition.

The rapid growth of digital payments has signalled opportunity for new market entrants to attack this status quo. And the impact has been considerable, with increased competition reducing banks' market share of the global banking and payments industry **from 96% in 2010 to 72% today.**[1]

This does not mean the death-knell is sounding for banks. Their systemic importance to the global economy and societal order ensures they are not going to disappear. But the fact is that payments should be considered as the most important part of retail and corporate banking, representing 80% of all interactions and providing critical customer touchpoints, data and service opportunities.[2]

96%

2010

72%

TODAY

Put simply, remaining competitive in payments is the key to future relevance and profitability across all banking operations. Yet, as the payment ecosystem has expanded, incumbent banks find themselves competing on multiple fronts.

Card Networks

As the global real-time payments infrastructure has advanced, and with industry efforts such as the European Payments Initiative (EPI) promising a viable instant payment alternative at the point-of-sale, the global card networks have diversified through investments and mergers to support end-to-end payment services and multi-rail offerings. As a result, credit and debit cards have evolved from a plastic payment mechanism to a form of overarching digital ID, which can be used to instigate different payments and access multiple services. This increasingly places global card networks in direct competition with banks.

Payment Platforms

As the payments ecosystem has expanded and digital volumes have increased, there has been a widescale unbundling and commoditisation of core products and services throughout the payments value chain. Organisations like PayPal, Stripe and Square have evolved from single specialised propositions into comprehensive payments platform businesses, providing previously bank-led offerings such as SME lending and corporate treasury services directly to their customers, while Buy-Now-Pay-Later (BNPL) entrants like Klarna have upended traditional credit products.

Challenger Banks

Challenger banks can best be described as banks without the baggage, unburdened by 50-year-old legacy infrastructure, sprawling bureaucracies and siloed departments. Most don't even have to worry about turning a profit (at least for now) due to the reliable influx of venture capital. This has enabled challengers to establish significant momentum, a strong marketplace presence and a growing number of customers, often deliberately positioning themselves as the direct antithesis of incumbent institutions.

Big Tech

The potential of full-scale market entry from one of the GAFA (Google, Apple, Facebook, Amazon) players has been the elephant in the room for many years. So far, they have been content with relatively limited plays, such as overlaying services through their mobile wallet platforms or partnering with financial institutions on limited offerings (such as Amazon Lending). Yet the full impact of full-blooded, independent big tech market entry can most clearly be seen in China, where Tencent and Alibaba have established dominant positions and massive payment volumes through WeChat and AliPay.

Of course, the intensity of this competition varies across different customer segments. Consumers, corporates, SMEs and merchants all present different requirements that suit the propositions of different players. Card networks are a better option for merchants than for global corporates (currently), for example. Similarly, payment platforms have so far made a more significant impact in the underserved SME market than the big tech giants. But regardless of the market they serve, there are key common battlegrounds that players are targeting to establish competitive advantage.

2.

What are the competitive battlegrounds?

There are six areas that will make the difference between getting ahead or falling behind in payments.

- **Data**
- **Trust**
- **Cost**
- **Scale**
- **Innovation**
- **Payment Methods**

1. Data

Payments provide a treasure-trove of contextual data. Yet, data in itself has no real value. With individual data points increasing exponentially with the growth of digital economies, it is the ability to organise, translate and deploy this data as detailed customer insight and value-added products and services that is the key competitive differentiator.

2. Trust

Trust is a layered concept. On a purely practical level, it stems from transactions being reliably processed when needed. But the impact of broader societal trends is becoming an increasingly critical consideration in the competition for payments business.

3. Cost

As competition has intensified, traditional fees have evaporated as payments become instant, invisible and free. And with global macro-economic factors escalating pressure, there is an increasing premium on low cost-bases.

4. Scale

Payments is an industry where competitive advantage stems from the ability to efficiently manage large volumes, in addition to the capability to bring products and services to market quickly to meet emerging requirements.

5. Innovation

Increased competition drives rapid marketplace innovation. Although a broad term, perhaps the most fundamental market innovation across the payments industry has been the emergence of platform business models to address the market opportunity presented by embedded finance.

6. Payment Methods

The accelerated adoption of digital payments is creating the potential for alternative methods, such as mobile wallets and cryptocurrencies, to circumvent traditional rails.

3. Incumbents vs the Competition

Banks

Incumbent banks' competitiveness is underpinned by very strong scores across trust and scale, but these advantages can no longer be taken for granted. Banks also score relatively highly on data due to the goldmine of customer information they have access to, but must start using it more effectively to gain a meaningful advantage.

Legacy infrastructure makes it difficult for banks to compete on cost, hampers innovation and limits the opportunity to explore alternative payment methods, which impacts scores across these areas. However, partnerships with fintechs are creating opportunities for banks to improve rapidly.

TOP trumps

INCUMBENT BANKS

Data	7
Trust	8
Cost	5
Scale	8
Innovation	6
Payment Methods	4

Card Networks

Card payments are a trusted method for millions of consumers and businesses worldwide, with card networks managing huge volumes, which secures a strong score across trust and scale. Recent acquisitions also demonstrate a drive for innovation across digital identity and infrastructure, bill payments and fraud management.[4]

Like incumbent banks, card networks have access to large amounts of customer data but are not taking full advantage. Card networks are also expensive for merchants which impacts their cost score, and support for alternative payment methods remain relatively limited compared to their core business.

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CARD NETWORKS

Data	6
Trust	9
Cost	4
Scale	9
Innovation	6
Payment Methods	5

Challenger Banks

Challengers have built their reputation through innovative, experiential products and services, and have been more willing to embrace new payment methods than traditional institutions. Challengers also benefit from a low-cost infrastructure to bring products to market quickly. And although challengers are using data relatively effectively, as with all the competition there is room for improvement.

Challengers do not currently enjoy the same level of trust as incumbents. This lack of trust impacts scale, as the number of customers does not translate to volumes, assets, deposits or revenues. But this is changing. At the end of 2020, 15% of Gen Z and millennial consumers considered their 'primary' account to be with a challenger, up from 4% at the start of the year.[6]

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CHALLENGER BANKS

Data	6
Trust	5
Cost	7
Scale	3
Innovation	8
Payment Methods	6

Platforms

Payment platforms score strongly across the board. They manage high volumes to realise scale advantages and are effective at driving innovation in specific market segments (such as the SME sector). Platforms have also moved more quickly than the competition on new payment methods.

Their use of data is improving, but there is the potential for further advances. And although brand recognition and trust is growing, platforms still trail behind established banks. Costs are also generally higher, but are reducing as competition increases.[5]

TOP trumps

PAYMENT PLATFORMS

Data	6
Trust	5
Cost	5
Scale	6
Innovation	8
Payment Methods	7

Big Tech

Big tech are the 'wild card' entrants that represent the greatest competitive threat to incumbent banks across all categories - if they choose to fully take on this market. Big tech companies are likely to continue investments and acquisitions to promote data-driven, experiential products and services, so score highly in data and innovation. They also have the scale to match the card networks.

Trust remains an ongoing issue for big tech (85% of Americans think they are being spied on)[6], but these concerns do not impact the uptake of their services and consumers willingly trust big tech with extremely sensitive personal data. Indeed, as many as 50% of young consumers would be willing to switch to banking services provided by big tech companies due to brand recognition and familiarity.[7]

The closed ecosystems that big tech companies operate offer little flexibility for supporting alternative payment methods. Similarly, regulatory trends will make it difficult for big techs to undercut the competition by subsidising services below cost.[8]

TOP trumps

WILD CARD

BIG TECH

Data	8
Trust	6
Cost	7
Scale	9
Innovation	8
Payment Methods	5

4.

How can banks compete in payments?

Payments transformation programmes – defined as "technology initiatives that modernise the payments infrastructure of a financial institution" – can enable incumbent banks to boost their scores across the key battlegrounds to compete more effectively.

Data

With margins squeezed by high-volume, low-value transactions, data provides a path to long-term payments profitability.

There are significant opportunities across all market segments, but it is arguably the corporate banking space that provides the greatest revenue generation potential for incumbent banks. For example, real-time payments capabilities combined with rich datasets presents a huge opportunity to improve liquidity management and cash forecasting offerings, with the potential to drive 10% revenue growth.[9]

But despite the clear opportunities, potential has not translated into action for many banks. A 2019 survey by Aite Group and Icon Solutions found that only 18% of banks were moving from a transaction-based revenue model to a data-based approach.

Although banks are sitting on a wealth of customer data, the key factor inhibiting progress is that it is unstandardised and spread across multiple product and operational silos. In contrast, the competition has developed established and sophisticated data operations. Big tech companies in particular have demonstrated an unparalleled ability to leverage data to inform products and services.

There are, however, concrete steps that incumbent banks can take to close the gap. The ISO 20022 messaging standards present an opportunity and allow banks to generate consistent data to provide targeted insight. By enabling banks to leverage richer, standardised data sets, ISO 20022 migration will allow banks to improve and extend the payments-related services they provide to customers, supporting the move from pure transaction-based services to value-added insights.

And to break down silos, it is critical to first understand the data types needed to deliver different value-added products and services, identify the custodians of respective data types, and then map this data throughout the organisation. Payments architecture can then be enhanced and optimised to facilitate data flow.

POWER UP DATA

Commit to a long-term transition from a transaction-based revenue model to a data-driven approach underpinned by the delivery of value-added products and services.

Create data initiatives that directly benefit customers to improve retention and realise new revenue streams.

Prioritise strategic ISO 20022 migration to benefit from standardised, enriched datasets that are directly associated with the payment message.

Understand the processes and architectural requirements needed to break down product and operational silos and create data flow throughout the organisation.

Trust

Trust is one area where banks have the edge over the competition and, as the European Banking Authority (EBA) notes, there is a clear opportunity to leverage this "inherent trust advantage to differentiate from non-banks."[10] But this advantage is precarious and cannot be taken for granted.

Firstly, increased competition has intensified the reputational and commercial damages inflicted by outages. This is reflected in generational shifts, with only 53% of Gen Z customers trusting their primary financial institution the most with their money, compared to 72% of so-called 'baby boomers.'[11]

Although the competition is by no means immune to outages, every period of downtime accelerates demographic shifts, undermines hard-earned institutional trust in traditional banks and plays into the hands of alternatives and non-bank providers.

Overworked and outdated legacy core infrastructure is the primary cause of resiliency challenges for incumbents, but big-bang replacement projects present their own risks. In comparison, lightweight solutions leveraging cloud technology present a cost-efficient and low-risk approach to payments transformation.

Beyond simply maintaining service availability, trust is also dependent on various societal factors. With data privacy poised to become one of the defining issues of the 21st century, for example, shifting from a transaction-based to a data-driven model raises serious implications.

Happily, incumbents enjoy a high degree of trust in this area – with 94% of customers trusting their bank to protect their data and use it responsibly – so have an opportunity to establish a global leadership position.[12] In comparison, big tech is facing fierce scrutiny into their data practices. Payment platforms, having benefited from relatively light-touch regulatory oversight to promote competition, can also expect increased focus on their use of customer data as their marketplace position strengthens.

Finally, incumbent banks must confront the uncomfortable fact that they are not trusted to act in their customers' long-term interests.[13] Core traditional revenue streams such as FX, overdrafts and high-interest products are reliant on hidden fees and limited financial education, creating a widespread perception among some customers that banks are not on their side. In fact, a key differentiator for challenger banks has been the broad rejection of this punitive approach.

Banks must therefore focus on an improved advisory capability to build trust-based propositions that focus on reinforcing the long-term customer-bank relationship. For example, salary advance lending schemes can help employees stay out of the clutches of loan sharks, while spending analytics can promote good financial practice. Accenture predicts this could increase incumbent banks' revenue by an average of 9%, and lead to significant gains in underserved but large customer segments such as "SMEs, the youth market, international travellers, migrant workers and low-income customers."[14]

But by very definition, advisory services require a high degree of personalisation to assess and serve the needs of individual customers. So again, the ability to organise and deploy data effectively comes to the fore.

POWER UP TRUST

Transform payments infrastructure and adopt modern reliable technologies such as cloud-native, agnostic solutions to enable a low-risk approach to delivering operational resilience and zero downtime.

Use experience of highly-regulated environments and robust compliance procedures to ensure industry-leading best-practice in the storage and deployment of customer data.

Leverage customer data to improve and enhance advisory capabilities to support longer-term customer acquisition and retention.

Costs >

When it comes to cost-bases, incumbent banks face intense competition. For example, payments can represent up to 40% of total operating costs.[15] In contrast, digital-only challenger banks can operate at a 70% lower cost than incumbents.[16] Given the razor-thin margins at play, this wildly unsustainable cost-base puts incumbents at a massive competitive disadvantage.

Cost pressures have also been intensified by Covid-19. Incumbents face the prospect of operating in low-rate interest environments for the foreseeable future, in combination with the need to insulate exposure to loan losses.

The source of the problem is not hard to find. The majority of incumbent banks' costs are absorbed by the ongoing maintenance of legacy infrastructure to simply keep the lights on, with knock-on impacts that cascade down the organisation. For example, a lack of straight-through processing (STP) capability creates the need for manual processes, which in turn requires the deployment of more human resource.

For banks, this means grasping the nettle. Flexible payment solutions can streamline back-end systems, helping to rapidly reduce total cost of ownership (TCO) by more than 50%.

Another crucial consideration is to ensure that ongoing technology investments deliver concrete value, rather than simply maintaining the status quo. Less than 10% of technology spend at an average bank increases value-added business functionality[17] and, in the search to enhance their infrastructure, there is a potential for incumbents to get locked into equally costly and damaging cycles of restrictive vendor dependencies.

On the other hand, the right service provider partners can help banks to simplify complexity and drive efficiencies that enable resource to be focused on delivering for customers.

Scale >

Extensive merger and acquisition activity across the payments industry in recent years reflects a drive for scale across volumes, customers, geographies, value chains and vertical markets.

Although incumbents have millions of customers and do benefit from this scale, this must be placed in context. Big tech and the card networks have billions of users, while the payment platforms have also consolidated advantages. For example, PayPal has the same payment volume as the top ten banks in Europe, and Square has more customers than most banks.

Facing such extensive competition, incumbents must improve their ability to effectively leverage their existing scale advantages. With digital payments poised for significant and sustained increases, and combined ongoing global circumstances raising the potential for huge and unpredictable fluctuations in payments activity, flexible, interoperable payments solutions are critical to equip incumbents with the capability to handle massive volumes efficiently.

And although facing a scale disadvantage, cloud-native challenger institutions have demonstrated an ability to respond quickly and flexibly in a way that many incumbents have not (think of the spare debit card that Starling Bank produced in a matter of weeks for customers who had to self-isolate).[18]

Again, incumbent banks are constrained by inflexible legacy infrastructure that is difficult to scale and cannot support rapid change. Protracted development cycles for new products and services are no longer feasible, and incumbents must have the ability to go-live in weeks, not years.

Transitioning to core architecture based on cloud-native, open-source technology helps incumbents respond quickly to meet new requirements, and prevents the need to reinvent the wheel every time a new product or service is launched.

POWER UP COSTS

Prioritise and accelerate strategic payments transformation initiatives to reduce TCO, while retaining full control.

Unlock legacy siloed systems by adopting modern, component-based technologies such as cloud-native, agnostic solutions to improve STP and interoperability.

Define clear business cases to ensure technology spend contributes to long-term revenues and resource is focused on delivering for customers.

POWER UP SCALE

Consider core architecture based on cloud-native, open source technology to promote agility and independence to help realise existing scale advantages and accelerate time-to-market.

Develop a plan for evolving around existing systems through modern, cloud-based, component-based technologies to create a modular approach.

Innovation

Perhaps the most fundamental innovation driven by the competition has been the move towards platform business models to address the massive $3.5 trillion market opportunity presented by embedded finance.

Put simply, embedded finance is the concept that "finance appears at the point of need" to remove the friction from payment processes. And although embedded finance use-cases have primarily focused on retail customers, the potential to embed payment services within business processes presents opportunities for corporates.

So far, it has been the big tech and payment platforms that have excelled in creating ecosystems servicing different customer segments. For incumbents to compete, they should look to build their own marketplaces by identifying and realising partnerships with fintechs who specialise in niche categories, in addition to other players such as large merchants and telcos. This will help deliver the diverse, innovative suite of value-added products and services that customers expect at low-cost, while banks can still retain the core relationship.

This approach requires a cultural and technical shift. Firstly, incumbents should see regulation such as PSD2 as an opportunity to establish meaningful competitive advantage, rather than a regulatory headache or encroachment on their territory. And from an architecture perspective, enabling easy connectivity with these third-party providers is essential.

POWER UP INNOVATION

Enhance the ability to create ecosystem platforms and forge meaningful and profitable partnerships with fintechs through a modular core architecture that integrates microservices and APIs.

Embrace the opportunities presented by regulatory and industry initiatives.

Payment Methods

Global momentum for real-time payments has posed its own challenges for incumbents, but they now must consider how the accelerated adoption of alternative payment methods is creating opportunities to circumvent established rails altogether.

Increased mobile wallet uptake is supporting new use-cases for retail and corporates, in some cases enabling banks to be bypassed altogether. Indeed, the future potential for mobile wallets can be seen in China, where 70% of consumers use wallets on a regular basis.[20]

Momentum is also building for cryptocurrencies as an alternative payment method as the technology matures and mainstream institutions become increasingly comfortable with the concept. For example, PayPal announced support for cryptocurrencies in 2020, while the card brands have expressed an intention to be the network of choice for crypto transactions.[21] Elsewhere, Facebook's crypto ambitions through Diem (rebranded from Libra) are considerable.

For incumbent banks, the focus should be on flexibility. It is unlikely that alternative payment methods will usurp traditional processes any time soon, but customers will increasingly demand support for multiple options to deliver convenience and choice, such as enabling corporates to pay out directly into consumer mobile wallets.

This requires a flexible architecture that enables incumbents to respond to emerging trends and build alternative capabilities quickly.

POWER UP PAYMENT METHODS

Ensure architecture is agile to support the rapid adoption of multiple alternative payment types and methods.

Understand requirements and strategy to respond to the drive to increase digital wallets provision by corporates and large retailers.

5.

Conclusion

It is clear that incumbent banks are under significant and sustained attack from various competitors. And the reality is, this competition is only going to intensify. As J.P. Morgan CEO Jamie Dimon notes, incumbent banks should "expect to see very, very tough, brutal competition in the next 10 years."[22]

Banks' ability to compete effectively is dependent on making changes that enable them to serve their customers better, and urgently addressing the significant challenge of transforming business models and legacy technology systems to meet new expectations.

Indeed, the right approach to payments transformation is imperative. By combining a clear, executable strategy with flexible technology solutions and expert partners, banks can improve data-driven propositions, promote trust, reduce costs, realise scale advantages, drive innovation and support alternative payment methods. This will ultimately help banks to trump the competition.

6.

About Icon

Icon Solutions empowers banks and payment service providers to realise the potential of payments in the real-time, 24/7, open, data-driven world.

Icon is a leading global provider of payments technology and expertise, with a proven track record developing, implementing and running innovative, mission critical transaction banking solutions.

IPF is Icon's cloud-native, highly cost-effective, configurable payments platform that combines out of the box functionality with extensibility and lightweight integration. Unlike traditional payment 'hubs', IPF empowers our clients by enabling a low-risk approach to payments transformation and aids the deployment of new products and value-added services quickly, cost-effectively and resiliently.

Discover how Icon can help with your payments transformation today:

+44 20 7147 9955

info@iconsolutions.com

iconsolutions.com

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