Opinion piece

Banks taking back control

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Abstract

Banks are increasingly concerned that they are being driven by others — and they are right. Regulators, customer demands and new technology are increasingly driving the agenda. This paper examines why this is so and how banks can — and should — react in order to 'take back control'. Warning: This paper is written in plain language with little regard for readers' sensitivities.

Keywords: regulation, innovation management, European banking industry, open banking

BACKGROUND

In recent years, banks have become increasingly being driven by other parties and factors beyond their control, including:

- regulators (Stop thinking nationally! Do instant! Open up! Reduce interchange! Keep cash available!);
- customers (changing customer behaviours, merchants demanding pan-European solutions, etc);
- technological developments (mobile, application programming interfaces (APIs), distributed ledger technology etc); and
- new competitors (FinTech, challenger banks, big tech etc).

Faced with resulting high infrastructure and compliance costs, and the growing demands of other organisations' agendas, banks are struggling to keep up. Furthermore, there is no indication that the pressure on banks is reducing; quite the contrary in fact.

Among other things, banks are currently under pressure to:

- support the European Central Bank (ECB) in strengthening the role of the euro (the ECB agenda);
- provide novel end-to-end point-of-interaction solutions (the merchant agenda);
- develop an API access scheme (Euro Retail Payments Board agenda); and
- support account portability, account switching (user agenda).

This is in addition to ever-increasing technological developments, compliancy challenges and global competition.

Clearly, it is time for banks to become more proactive in setting their own agenda. In this regard, the present opinion piece discusses the options going forward.



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THE OPTIONS

Do nothing

The first option is to let events develop and await direction from the regulator —

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guidance that will be driven by increasingly unsatisfied customers demanding change.

This means that banks will have to implement changes, at high expense, under time pressure, under rules laid down by others.

Non-banks will also entrench themselves in key areas with customers and will be hard to displace later — the smart early moves made by PayPal provide a case in point. Much like the old proprietary German ELV standard, novel point-of-sale solutions are now again being developed by merchants as banks are seen as not providing a solution. On top of this, FinTechs are cherry-picking key opportunities left unclaimed by banks.

While some critics might suggest that the *modus operandi* has historically been to follow, it is clearly not an attractive option and will thus not be explored further.

Actively follow developments

A more proactive approach is to systematically follow changes in technology, user demands and market developments and actively consider which should be met.

The European banking industry has established world-class infrastructures and defended very well against a variety of onslaughts that many predicted would cause its demise. For example, it was variously suggested that online/direct banking, mobile banking, distributed ledgers, digitisation and FinTech would bring banks to their knees; instead, banks absorbed and embraced these developments. That said, this was usually done in 'catch-up' mode — after the pressure became too great.

It must also be objectively acknowledged that a number of obvious trends have not been systematically monitored, never mind addressed head on. For example:

- When it became clear that all systems were moving to real-time, banks could have considered moving to instant payments before being forced to.
- When it became clear that users were moving online and to mobile devices, banks could have offered new channels and solutions before being forced to. The German example of Paydirekt shows how much time, effort and cost (possibly in excess of €100m) are required when one is too late and tries to catch up (in this example against Sofort, PayPal, etc in the online payment market).
- When open systems were becoming the norm in all industries (telcos were opened up in the 1970s; open APIs, open protocols/identity, post-batch real-time architectures have also been available for decades) banks could have considered the advantages of opening up before being forced to.
- When Europe and the world are becoming ever more integrated, banks must develop pan-European/global solutions before being forced to — it cannot be that the only way to pay in a truly pan-European way is via cash or a US card scheme like VISA/Mastercard/AmEx.

In short, banks have a mixed record when it comes to adapting to coming changes. However, the fact remains that actively following developments and making a conscious decision regarding whether or not to engage with the changing environment provides strategic insight and, crucially, options. In this respect, sophisticated filtering solutions, such as the Innovation Radar and Innovation Sounding Board, are available to guide decision-making regarding coming changes and are thus provide an excellent first step to asserting one's position. Nevertheless, this is hardly 'taking back control' as it in no way shapes the industry, but rather is a *follower* position with, at best, optional engagement.

Take back control

Taking back control means not only being aware of what is needed, but acting upon it

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in a timely manner and actually shaping the developments oneself.

This is not easy in a network economy, such as payments, where all actors generally have to move together. However, if banks are not willing to move together of their own accord, they *will* be forced to — by the regulator, by new entrants taking the new market spaces or by public pressure.

Banks will never turn from the tortoise into the hare — nor should they, as reliability, solidity and compliance are great assets over other market players. However, banks can and should become more active, and regain the initiative through smart approaches, and stop chasing the hare's tail.

IS THERE A BUSINESS CASE?

A frequently perceived impediment is that it is not easy to find a clear business case in emerging trends. This is especially the case when developments are still uncertain and revenues not guaranteed. For example, there appears to be little business case for cross-border payment as it still accounts for only circa 3 per cent of the payment market. Certainly, customers will continue to behave nationally (eg RIBA, Bulletino in Italy) for a good while yet. However, international merchants like Carrefour (and its banks), FinTechs and competitors like PayPal *do* see the need. Despite the lack of immediate business case, banks must occupy this space.

As banks cannot operate here as they do in the traditional loan business, it is critical to break out of the current cycle (Figure 1).

The business case for actively moving in these dynamic times is given by two factors:

- If the development is inevitable, it is better and cheaper to start early. The active, timely implementation of *own* smart solutions is to be preferred over the later, costly, stressful implementation of regulations imposed by others. For example, a timely pan-European iDeal solution might have avoided having to invest billions in SCTinst, solving the key merchant problem of instant guarantee without replumbing the whole infrastructure.
- Payments is not a zero-sum game — smart new business models will dramatically increase the size of the market. If everyone works together to make the tide rise (eg with a secular shift from cash to electronic payments), this floats all boats so that existing and new players alike will find bigger markets, giving incumbents a large slice of the *bigger pie*. For example, the open economy will be much larger, with the banks well positioned to take the biggest slice of the benefits. In other words, all will win.

So, a *strategic* approach is required, which balances potentially large future gains, such as the bigger prize of the open economy with financial services at its centre, against current uncertainties and maybe initial sacrifices, such as offerring a few APIs for free. Thus, rather than being dragged grudgingly into API compliance, banks should embrace the open API economy. True entrepreneurship and leadership is about making choices without all the facts and without any guarantees. We need to look at the bigger picture.

Selected financial services communities have shown that this is possible — and with great success. Over ten years ago, when it was becoming likely that online payments were going to be big and that nimble competitors might occupy this increasingly significant space, the Dutch banks created iDeal — a world-leading solution, which has prevented competitors such as PayPal, Sofort, US card schemes and the like from attaining the kind of market share within the Dutch online payment market that they enjoy elsewhere, by virtue of being the best available offering. Similarly, the Nordic banks were among the first to recognise the importance of moving up the value chain with respect to payments and created world-leading solutions for identity

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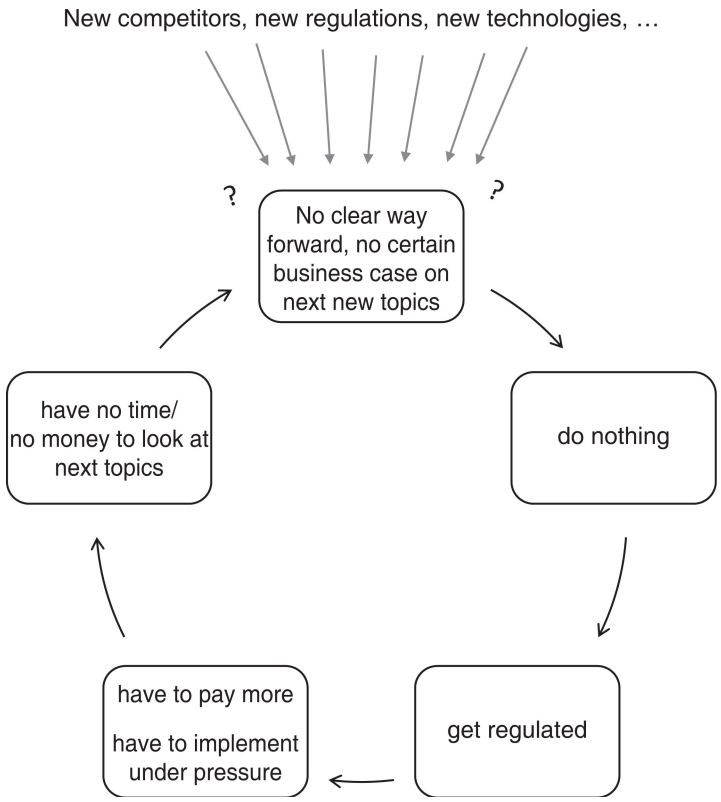

Figure 1: The current vicious circle

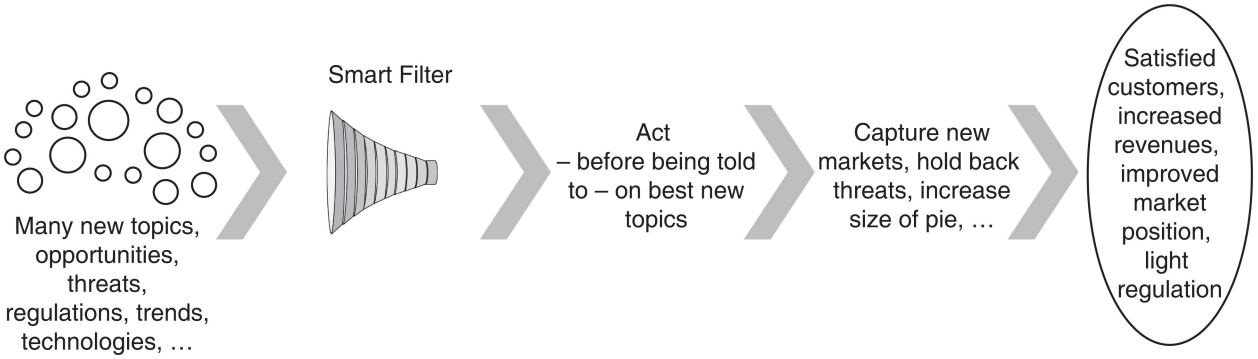

Figure 2: Moving forward under control

(BankID), mobile (Swish), invoicing etc, all of which have ensured that customer relationships, data and profits stay with banks. Thus, seeing the writing on the wall and acting upon it is the clear and proven way forward (Figure 2).

Although this does require some initial investment, banks that embrace modern open banking have the opportunity to take the pressure off themselves. FinTechs can supply solutions that use the latest wearable gadget; RegTech can help make compliance

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easier; and smart partnering with solution companies can spread the burden of satisfying the latest customer/regulator/technology demands. Banks no longer have to take care of everything themselves. Indeed, banks themselves can cherry-pick which propositions they want to address themselves and which to leave to others.

Thus, paradoxically:

- by *investing*, banks can save money and indeed open up new revenues;
- by smart *partnering* with those who used to cherry-pick, banks can become cherry-pickers themselves; and
- by *opening* up to others, banks can reduce the pressure on themselves and take back control.

In this new world of digital infrastructure and physical clients, the opportunities for banks are truly exceptional.

RECOMMENDATION

If banks really are willing to consider taking a more active role in regaining the initiative and taking back control, then the following approach is suggested:

- *The diagnosis* (understanding why financial services companies often fail to see the writing on the wall, and what prevents them from acting) — in other words, the *why*.
  - — *Concrete recommendation:* Open discussion is needed *within* key banking communities (eg savings/cooperative banks, merchant banks, national banking organisations) regarding the analysis and the genuine appetite for taking back control, with assurances of proactive investment in potentially uncertain developments well before banks are driven down this path. This must be done conducted in an open, inclusive manner while observing horizontal competition guidelines. Even within communities, there will be divergent views and preferences which may require fore-runner banks to form a 'coalition of the willing'. (This coalition could then be extended even beyond banks: IndiaStack is perhaps a poster child for this redefinition of such competitive/collaborative boundaries.)
- *The cure* (what a new approach would look like (ideally based on current European leadership assets such as Open Banking, 'SEPA 2.0' — see appendix for concrete examples) and a coherent recovery plan to get there) — in other words, the *what*.
  - — *Concrete recommendation:* Joint workshops across banking communities should explore the joint appetite for actively bringing the industry forward. Such an open collaborative forum could possibly be facilitated by a third party. Naturally, there will be divergent views between communities and among banks. For example, the more commercial private banks may wish to be more active for their international merchants than local retail banks. However, it is imperative to put local and individual interests aside for the greater good of the industry, and of Europe.
- *The recovery* (what 'medical team' should take leadership on administering the cure — banks themselves or under leadership from EU institutions for the benefit of Europe?) — in other words, the *who* and *how*:
  - — *Concrete recommendation:* if there is indeed the appetite to move actively, the results of this process should be conveyed both forcefully and publicly to and with regulators. When regulators see that banks are stepping up to the changes, they will have much less motivation to develop pre-emptive regulation or act on what they see as a (coming) market failure. Indeed, regulators may wish to step up to moderate the process and be a greater part of the solution.

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SUMMARY

Throughout the development of modern electronic payments, the writing has frequently been on the wall. Anyone without their head in the sand could see that inevitable changes were afoot, from batch to real-time, national to global, physical to online, online to mobile and now proprietary to open systems.

Yet the financial services industry has repeatedly had to be pushed into these changes by outsiders, especially regulators and nimble competitors. Thus, despite the clear warning signs, the banking industry has repeatedly, and for decades, found itself on the back foot, on the defensive. This means that banks have had to implement changes driven by others, under timetables determined by others, with massive catch-up costs.

Meanwhile, other competitors, some even from other industries, have embedded themselves so deeply with customers and within the infrastructure that it has been impossible to reclaim the lost terrain.

This paper has argued that the industry needs to change its strategy from defensive/reactive/driven to being *in control*.

There is no sign of an end to these clear, inevitable changes. On the horizon today, there are the many topics shown in the appendix — and more.

The banking industry must no longer wait to be driven by others, but instead embrace the new changes — even though all questions may not yet be answered, and even though the business case may not yet be fully clear.

In this way, the industry can choose its own timetable, develop answers according to its own rules and maybe even spend its money more wisely.

It is time for banks to take back control.

APPENDIX: COMING TOPICS FOR A PROACTIVE APPROACH

This appendix lists some of the trends that banks need to address shortly if they really want to take back control, shape their own agenda and invest in their future:

- Drive the open mashup economy with financial services at its centre ('own' the API economy, be the platform).
- Be clear that future propositions will be aggregated/customer-centric rather than current view of 'only the accounts at this bank'. This may mean a redefinition of the collaborative/competitive space with other banks and other industries.
- Provide new data-driven services to customers (do not leave this to Google, Amazon, Facebook, Apple, AliPay etc).
- Provide value-added services based on payments (eg unbundle the four-corner transport network for e-invoicing, unbundle know-your-customer services to provide bank-based identity to all industries, rather than Facebook/Google/Amazon/Microsoft/Alipay-based identity, as is currently emerging).
- Move up the value chain and provide complete end-to-end solutions (eg for the lucrative and currently underserved business-to-business market).
- Leverage European assets such as open banking and instant payments towards global standards. Europe is the global leader in payments and should play a shaping role in the world (the Mexican FinTech charter and Mojaloop are perhaps some other interesting parallels in other regions).
- Develop an end-to-end scheme based on instant and open banking (not on cards) to cover the European and global market (including not only clearing and settlement, but also end-end aspects, governance, banding, refund/dispute management etc, learning from what paved the way for the success of the global card schemes).
- Consider what resources (especially data) the financial services industry could use from other industries (turning the tables on PayPal, EMV and the FinTechs using the bank infrastructures for free).

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Developing the above areas will allow banks to offer new services to customers, attain new sources of revenue and become the driving industry of the future. By contrast, failure to address these topics will surely lead to problems down the line.

These necessary actions will need to be complemented with organisational changes such as agile development, and modern IT and processes.

Across all these content topics, banks may also wish to consider new governance models and new key performance indicators to drive transformation. The former will facilitate true leadership from the top, drive a change of mindset and make transformation a business science. The latter, meanwhile will provide a more useful and realistic way to forecast bank performance — eg using average revenue per user (as used in the mobile industry), new business vs legacy profit and loss (as used in all other modern industries) — instead of the legacy bank performance measures commonly used today, such as assets, liabilities, cost-income ratios, personnel costs etc.

Banks have an excellent base of capital, customers, regulation, secure IT, infrastructure and data. These will provide an excellent foundation to address the above topics.

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