Making the Business Case for Payment Transformation

Lessons from the field

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Foreword

Like Google and Instagram, Venmo is now a verb!

If you are wondering why "Venmo," then it just speaks to the pace at which the payments market is changing. Banks, today, are juggling with multiple challenges ranging from the end of the batch processing paradigm and the need to provide secure and frictionless customer journeys to retaining customers who now have an ever-expanding choice of innovative solutions from fintechs, big techs, and even telcos.

In addition to these market challenges, when engaging with banking leaders, we, at Temenos, often hear about another significant "internal" hurdle they are facing. This hurdle is around building more compelling business cases that can underpin their payment transformation vision and withstand scrutiny over a variety of applied business scenarios, assumptions, and perspectives.

Banks usually have robust governance processes for approving initiatives (and rightly so), based on detailed reviews of business cases. This, however, can have an unintended consequence of slowing down their pace of action, especially in comparison to fintechs and big techs that thrive on making decisions with high velocity and agility. At Temenos, we saw a need to understand more, particularly in reference to the following questions:

- **What can banking and payment leaders learn from the experiences of those who have made a head start on their payment transformation journey?**
- **What advice would they give to their peers looking to embark now?**

The above questions motivated Temenos to engage with Ovum to carry out this research. Through a series of interviews and surveys with payment leaders from banks around the world, this paper brings together a first-hand perspective on the various challenges and lessons learnt from those who have "been there, done that"!

Equally, to support banks in building their business cases with speed and reliability, we invested our expertise and knowledge in developing a ROI Model for Payment Transformation. This tool, now available, provides a flexible framework to help banks visualize the business and financial impact of their chosen transformation strategy (further details on our ROI model are provided on page 10 of this report).

A big thanks to Kieran Hines and David Bannister from Ovum for bringing out engaging "lessons from the field" in this report. We sincerely hope you will find it insightful.

Happy reading!

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Summary

In brief

Bank processes for justifying technology investments are still largely driven by a return on investment (ROI) calculation. To complicate matters, making a case for investment in modernizing payment systems involves answering more complex questions as rapid technological advances, changing regulatory frameworks, the move toward real-time payment infrastructures, and increasing customer expectations put pressure on banks' payment capabilities and force a long-overdue replacement of technology.

Through a combination of interviews with experienced banking practitioners and Ovum's existing research on the topic, this paper explores how banks are addressing the issues raised by these conflicting demands and evolving an approach that is both broad in its scope and flexible enough to adapt to priorities that reflect the bank's wider digital strategy and relationship-management approach, and provides a flexible platform to enable the launch of yet-to-be-determined future product offerings.

Ovum view

Drivers for change in the global payments industry are now coming from many different directions. Financial institutions must consider all aspects of their response to these challenges in order to properly formulate a transformation strategy that can support their medium- to long-term ambitions, as well as the immediate needs of compliance and technical capability. Successfully responding to these challenges will require banks to focus on transformative rather than incremental change, and those that deliver a step change in performance and capabilities stand to gain most in the coming three to five years.

Key messages

- **Banks must build holistic, flexible investment cases that address a range of business priorities.** This is essential, both to reflect the impact of payment systems transformation on the bank as a whole and to give the ability to pivot in response to any swift changes in its environment.
- **65% of banks say their payment infrastructure will need significant renovation in the next three years, and 14% in the next year.** Banks are investing in payment modernization to meet compliance requirements, drive efficiencies, and better compete. Those that delay or defer this work risk falling behind the rest of the market.
- **Payments are moving away from a back-office function into a strategic area.** Given the degree to which payment systems investments will impact on other areas within the organization, plus the need to move quickly to keep pace with peers and new competitors, banks must build their investment plans to take into account the impact on all affected products and services.
- **Customer impact is now key to a modern payment transformation investment case.** Bank executives are increasingly recognizing the need to improve customer service and the essential role that new payment services can play here. More than 88% say that it is more challenging to win and retain new client business now than it was a year ago.
- **Building real-time capabilities and adaptability to future innovation is becoming increasingly important.** New architectures need to leverage APIs and microservices to deliver a foundation for future product and service innovation.

Introduction: The need for payment system investment

Significant payment platform investment is anticipated by 2021

The pressures facing banks are growing. The industry faces the challenges of rapidly growing customer expectations, competitive pressures, domestic and region-level regulation, as well as payment infrastructure changes. As a direct result of these challenges, the majority (65%) of banks surveyed by Ovum expect their payment systems to need significant upgrade work or even replacement within the next three years (see Figure 1).

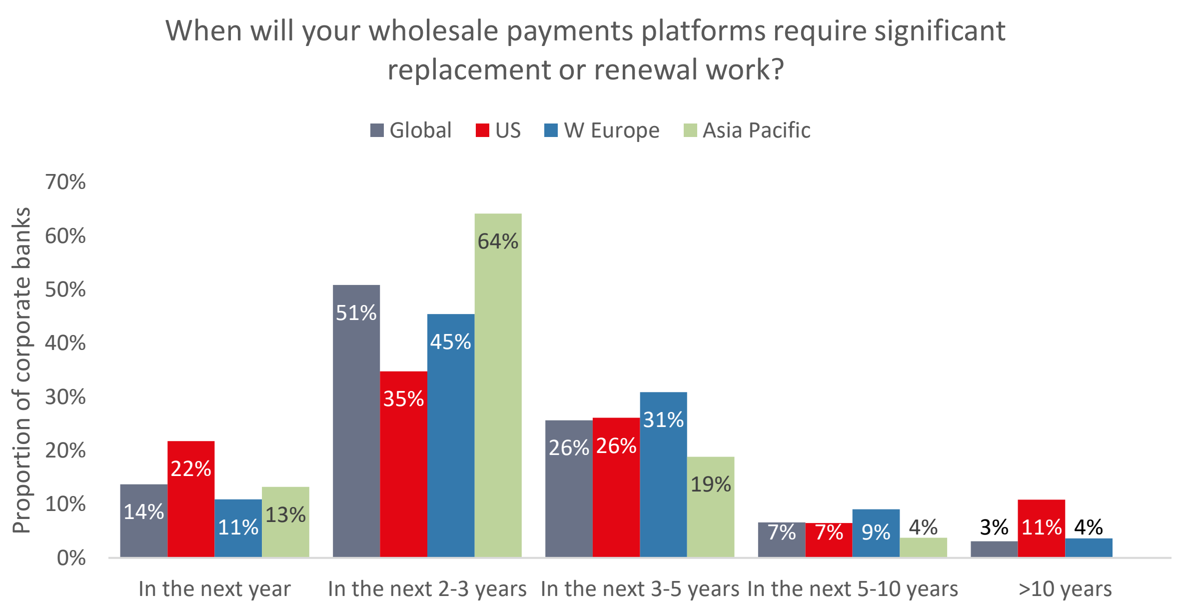
"Delivering payments capability as a series of services will provide new channel opportunities and help power Open Banking and wholesale initiatives. Microservices will allow the creation of new 'curated' services and have the potential to create new products currently not in existence."

Leigh Mahoney, Head of Wholesale Digital, ANZ

These transformation projects are linked, at least in part, to national infrastructure changes. However, many banks view the limitations of their current payment platforms as an inhibitor to growth, particularly in line with developing customer requirements, including interest in Open Banking. Leigh Mahoney, Head of Wholesale Digital at ANZ, highlights this: "Delivering payments capability as a series of services will provide new channel opportunities and help power Open Banking and wholesale initiatives. Microservices will allow the creation of new 'curated' services and have the potential to create new products currently not in existence."

Interestingly enough, banks in Asia-Pacific see even greater urgency than their peers in Europe and the Americas. New infrastructures, such as the recent Hong Kong Faster Payments System (HK FPS) and plans around a pan-ASEAN infrastructure may be important catalysts here. In addition, there is a growing expectation in the industry that payment innovation in general in the next two years is set to be strongest in Asia-Pacific compared to other regions.

Figure 1: 77% of Asia-Pacific banks expect to replace or renew their payment systems by 2021



Source: Ovum ICT Enterprise Insights 2018/19 – Corporate Banking. Sample size: 226

Payment system investment competes with other priorities

A payment systems investment case must compete with others from across the organization. This is despite the importance of the project to a bank's ability to deliver on both its short- and long-term strategic objectives. This is further complicated by the fact that IT resources have to first and foremost be focused on regulatory requirements and other areas relating to a bank's ability to continue trading. Only once these priorities are covered can there be a discussion about investments in new platforms and customer propositions, which can often be a catalyst for innovation over and above compliance requirements.

"The prioritization of competing projects always presents challenges," says ANZ's Mahoney. Industry deadlines surrounding the implementation of the Australian New Payment Platform (NPP) real-time payment infrastructure and the Open Banking initiative that will come into operation in 2019 widened the scope of the project and "required enterprise calls to be made," he added.

The key payments business case questions and considerations

Ovum's interviews with individuals directly involved in validating business cases highlighted that any bank's overall investment budget will be divided into several pots: essentially, operating expenditure and discretionary spending.

The first pot covers items such as regulatory requirements. A former procurement executive at a UK bank interviewed for this study noted: "The first thing you ask is, if I don't spend this, will I go to jail? Then it's will I lose market share? Anything else is on the discretionary budget."

"The conversation has changed dramatically. It used to be that payments was seen as a back-office activity, but it has a lot more pull now. You need to have a business case, but there is a much wider view nowadays."

David Watson, Global Head of Digital Cash Products and Americas Head of Cash Management, Deutsche Bank

Nevertheless, the focus on payments within many banks has shifted, with wide acknowledgement of their inherent importance to the core functions of the institution. The move from seeing payments as simply a utility to seeing them function as a profit center has moved the focus from operational to strategic. This, coupled with the central role of payments in support of end-to-end digitalization, means the business case should theoretically stand up on its own, but theories are not enough to get approval; the ROI model is still dominant.

A business case for effective transformation must therefore ensure that the modeling and ROI projections are drawn from as wide a range of parameters as possible, and this shift in mindset regarding the role of payments has been an important factor in getting approval to invest in wide-ranging systems transformation projects. As David Watson, Global Head of Digital Cash Products and Americas Head of Cash Management at Deutsche Bank's Global Transaction Banking unit, notes: "the conversation has changed dramatically" over the past 10 years. "It used to be that payments was seen as a back-office activity, but it is actually front and center of all that we do, and has a lot more pull now. You still need to have a business case, but there is a much wider view nowadays," he says.

Lessons from the field: The case for transformation

Lesson one: Consider the bigger picture

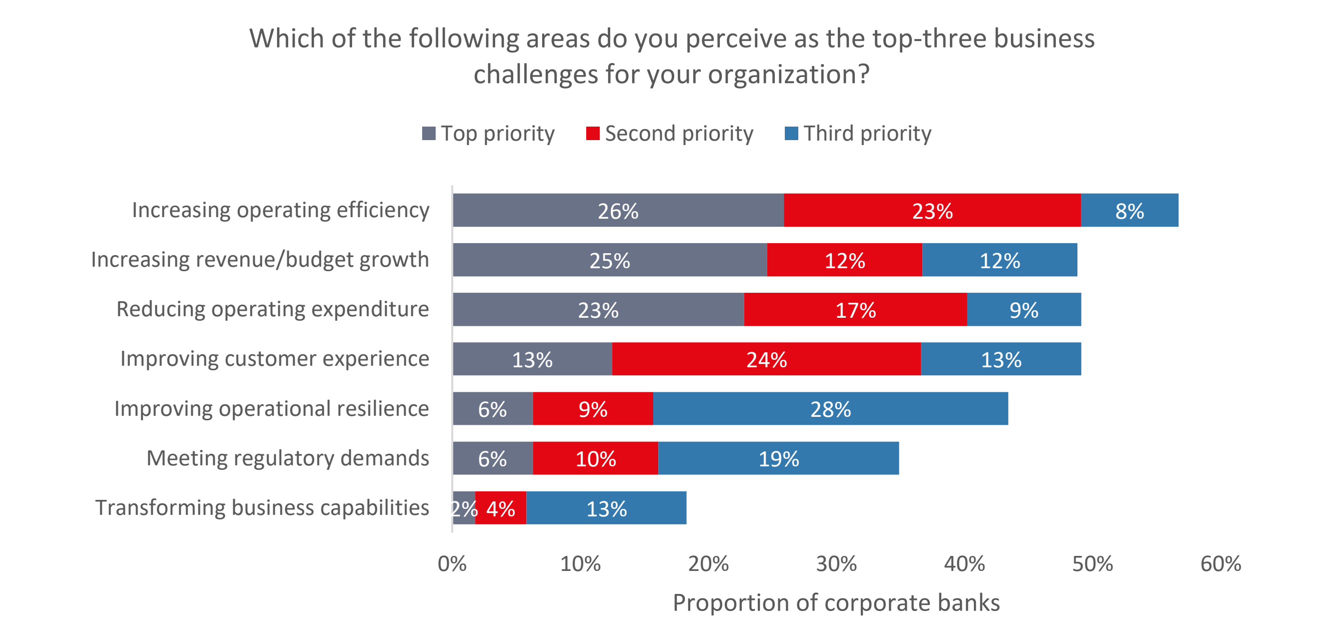
Payment revenues and margins are under intense pressure. Consequently, there is a focus on efficiency gains from IT investments as well as the effective measurement against these during the post-implementation phase. While incremental improvements are always welcome, many banks need to deliver a step change in operational efficiency as rapidly as possible. The scale of the challenge facing the industry means that taking too narrow or limited a focus now risks failure to deliver the gains in functionality and flexibility that will be needed to compete effectively in three to five years' time.

> **"The rate of change in the payments world is greater than at any time in the past few decades – we are in the middle of a collision between two worlds where the old batch processes are being replaced by real-time systems."**
>
> ***David Watson, Global Head of Digital Cash Products and Americas Head of Cash Management, Deutsche Bank***

Ovum's 2018/19 ICT Enterprise Insights survey highlighted banks' top three business challenges for 2019. At a global level, increasing operating efficiency and revenue while reducing operating expenditure are the three most important focus areas for the industry, but it should be remembered that they are not independent objectives and must be considered in the wider context of the strategic ambitions of the bank – particularly the degree to which payment systems will support the future operating model.

It is a point backed up by Deutsche's Watson: "You have to have the cost figures, but they only tell part of the story," he says. "The rate of change in the payments world is greater than at any time in the past few decades – we are in the middle of a collision between two worlds where the old batch processes are being replaced by real-time systems."

Figure 2: Banks' top challenges are still operational cost and efficiency



Source: Ovum ICT Enterprise Insights 2018/19 – Corporate Banking. Sample size: 226

Lesson two: Goalposts can and do move, so be prepared

The way that institutions manage and review investment cases varies considerably, but it is becoming increasingly important to ensure flexibility in the cost and benefit models underpinning any investment pitch. For banks' senior leadership groups to prepare for what is a potentially uncertain future, a more flexible business case framework, one that can scale up and down, is required. This allows all stakeholders to evaluate the potential outcomes under different scenarios and consider what inputs will affect those outcomes.

"Everyone who has been involved in a lengthy bank technology project will be familiar with the phrase, 'we'll rebase the parameters,' when you've missed a quarterly milestone."

Former head of procurement at a UK bank

There are also a lot more stakeholders involved in a transformation initiative today (from the digital layer to pricing, risk, and relationship management). This means many more variables to be considered, and some "what-if" mechanisms that allow the inevitable trade-offs to be evaluated.

Unfortunately, lengthy budgetary approval processes and (often arbitrary) milestones can bring projects back to the start if teams are forced to redesign their modeling from the ground up. "Everyone who has been involved in a lengthy bank technology project will be familiar with the phrase, 'we'll rebase the parameters,' when you've missed a quarterly milestone," says a former head of procurement at a UK bank. "You can't do that if you're moving to a monthly release cycle supporting apps – and we've seen a few big banks find that out the hard way."

That has been one of the limiting factors of the traditional investment and procurement cycle, says Deutsche's Watson. In a world where smartphones apps are routinely upgraded in weekly development cycles, a quarterly development cycle is not appropriate, but international payment systems need to be highly robust. "The fail often, fail fast mode of operation doesn't quite work in this world at the moment but it is where we are going as we move to the real-time environment – it's what customers expect."

Lesson three: Ensuring agility is vital for future innovation

The market landscape is changing, altering the relationship between participants in the financial value chain. Deciding what role an institution will play in the future has a direct implication for its technology choices, and vice versa: the wrong choices will severely limit its options and ability to compete. A highly agile platform is needed to allow the bank to respond to unforeseen challenges or opportunities in the future.

"With our digitalization strategy, we are seeing more and more opportunities, none of which would have been part of a business case for making the investment, but if we hadn't made that investment we would certainly be missing out."

Alan Lin, Global Head of Cash, Transaction Banking, Standard Chartered Bank

"Payments are front and center of what we do at Deutsche Bank," says Watson. "Certainly, margins in payments are shrinking, but volumes are growing as retail payments move away from cash and the Internet of Things will have a massive impact on that. By having a flexible approach, we can capitalize on opportunities – such as our payment initiative with IATA, which we'd once have thought of as a card acquirer function and not a business we would want to be in."

Alan Lin, Global Head of Cash, Transaction Banking, at Standard Chartered Bank, agrees: "With our digitalization strategy, we are seeing more and more opportunities open up, none of which would have been part of a business case for making the platform investment, but if we hadn't made that investment we would certainly be missing out."

The need for a flexible solution isn't just limited to new product development. Expanding into new territories or market segments must also be considered. Lin highlights this need: "We take a double-headed view of investment here, on the one hand you have the performance and reliability requirements that are a given across the board, and on the other there is the market knowledge of the business and what we want to do – if we move into a new geography, can we leverage existing technology there? Perhaps a cloud-based approach would work? We have to consider all of these things."

Lesson four: Customer impact is key to the overall investment case

Previously, customer satisfaction was more of an afterthought in terms of the payments business case. However, senior executives now realize that offering a truly digital experience is essential. According to the latest Ovum Transaction Banking survey, 88% of corporate banks say that it is more challenging to retain and win new client business now than it was a year ago.

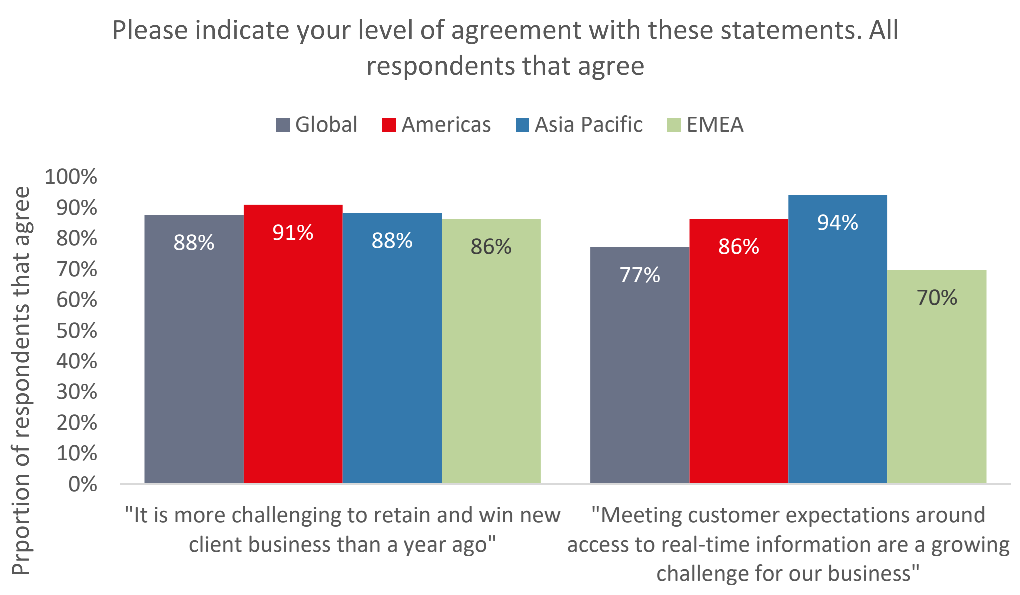
"The payments business model is evolving to focus on capturing digital primacy in customer payments, enabling greater capture and analysis of transaction data which in turn aims to enhance customer experience and loyalty."

Leigh Mahoney, Head of Wholesale Digital, ANZ

Modeling of performance can play a role here, in terms of benchmarking against peers, quantifiable service levels such as straight-through processing (STP) rates, and the less definable yet measurable customer satisfaction metrics such as Net Promoter Scores (NPS).

ANZ's Mahoney says making and accepting payments remains a core customer need, but expectations are increasing across a range of requirements – from customers paying each other and businesses to businesses accepting and making payments, and to institutions moving goods and capital across borders. "Payments have a significant role to play in our customer relationship and value proposition," he says. "The payments business model is evolving to focus on capturing digital primacy in customer payments, enabling greater capture and analysis of transaction data which in turn aims to enhance customers' experience and loyalty."

Figure 3: Banks are facing growing retention challenges, with access to real-time data cited as a pain point



Source: Ovum ICT Enterprise Insights 2018/19 – Corporate Banking. Sample size: 226

Conclusions

A recurring view among the bank executives interviewed for this paper is that the perception of the value of payment services to a bank has fundamentally changed. Where many viewed payments as a back-office function, forward-looking banks now recognize it as a central enabler of their digital strategy, touching all aspects of their business and customer interactions. As a consequence, payment services are now a significant competitive differentiator.

Indeed, one common theme, among the most innovative banks in particular, is that real-time payments are not simply seen as an additional rail, but as the way in which the bulk of domestic and cross-border payments will move in the near future. Moving to capitalize on the opportunities this will present and avoid being left behind is therefore a clear priority. To do this, the banks we spoke to are taking a two-pronged approach to the evaluation of investment proposals: working on the nondiscretionary regulatory projects but also finding funding and, more importantly, human capital to build new capabilities that will allow them to remain competitive.

Overall, given rising payment volumes, higher customer expectations, and increased margin pressures, the vision and underlying investment case for payment modernization initiatives need to be truly transformative. To successfully achieve this, banks need to improve their planning processes, starting with building holistic and more robust business cases to give stakeholders a full view of all the business and financial impacts, before they finalize whether their approach to their payment transformation strategy will be progressive renovation, build and migrate, "big bang," or a combination of all of these.

Stress-testing of business cases with a variety of scenarios and input metrics is to be expected, and banks need to consider using a well-defined modeling framework to ensure their outputs are consistent and comparable when interrogated by different stakeholder groups.

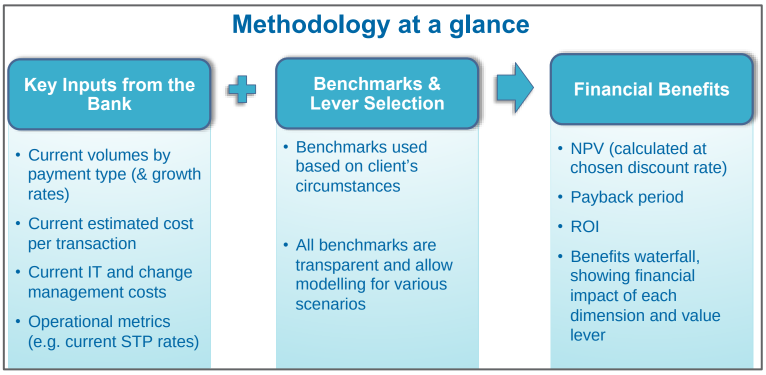
One modeling framework that we have seen is Temenos' ROI Model for Payment Transformation, which is based on its experience of working with banks internationally. The model aligns with the challenges highlighted above and provides a flexible approach for banks to build and test payment transformation business cases, tailored to their specific requirements and future ambitions. An overview of this tool is provided at the end of this report.

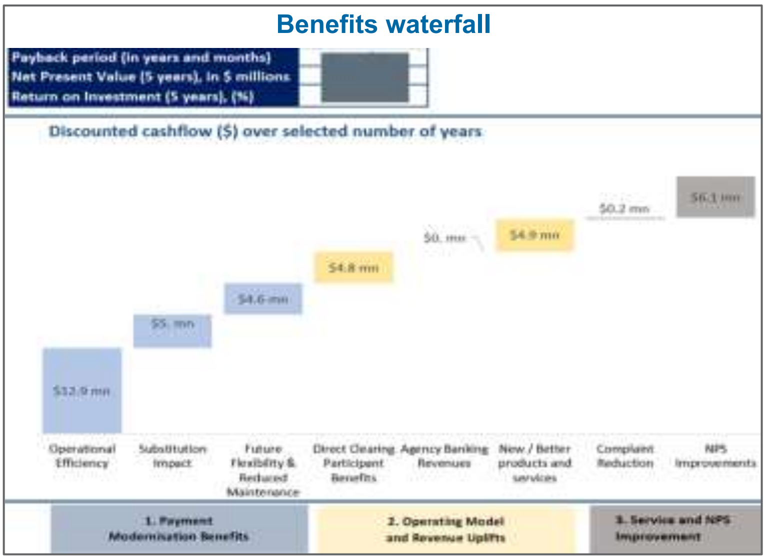
Temenos' ROI Model for Payment Transformation

Overview

To support business leaders in building a more robust business case for their payment transformation, especially with the rise of Instant Payments, Temenos has developed a ROI model. This provides a holistic framework to quantify all the business benefits while factoring in all relevant software, implementation, and maintenance costs.

The ROI model can act as a "crystal ball" for all stakeholder groups – providing them with a reliable and consistent approach to test various business scenarios (e.g. cost-benefit accruing over different time periods, with different inputs and assumptions), thus providing flexibility and speed to the business case development and decision-making process.





The model uses a discounted cash flow (DCF) technique to calculate financial impact (expected ROI, NPV, and payback period) over the chosen time period across three mutually exclusive benefit dimensions:

1. Payment system modernisation benefits
2. Operating model benefits & revenue uplifts
3. Customer experience & service improvements

Each of these three dimensions is underpinned by multiple value levers that ensure a holistic view of business impact(s) is captured (note: all benchmarks and assumptions used in the model are transparent to the bank and can be modified, as required, to ensure outputs reflect their ground realities).

In addition to quantifying financial benefits by chosen dimensions and value levers, the model also provides a "benefits waterfall" that helps to better visualize and articulate the financial benefit story to all stakeholder groups.

If you are interested to learn more about how our ROI model can help you, please contact us at info@temenos.com

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Appendix

Methodology

The content for this paper was drawn from both existing Ovum research and a series of in-depth interviews with senior practitioners in the payments industry. These were conducted both on the record and on a non-attributable basis during September and October 2018.

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We hope that this analysis will help you make informed and imaginative business decisions. If you have further requirements, Ovum's consulting team may be able to help you. For more information about Ovum's consulting capabilities, please contact us directly at consulting@ovum.com.

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