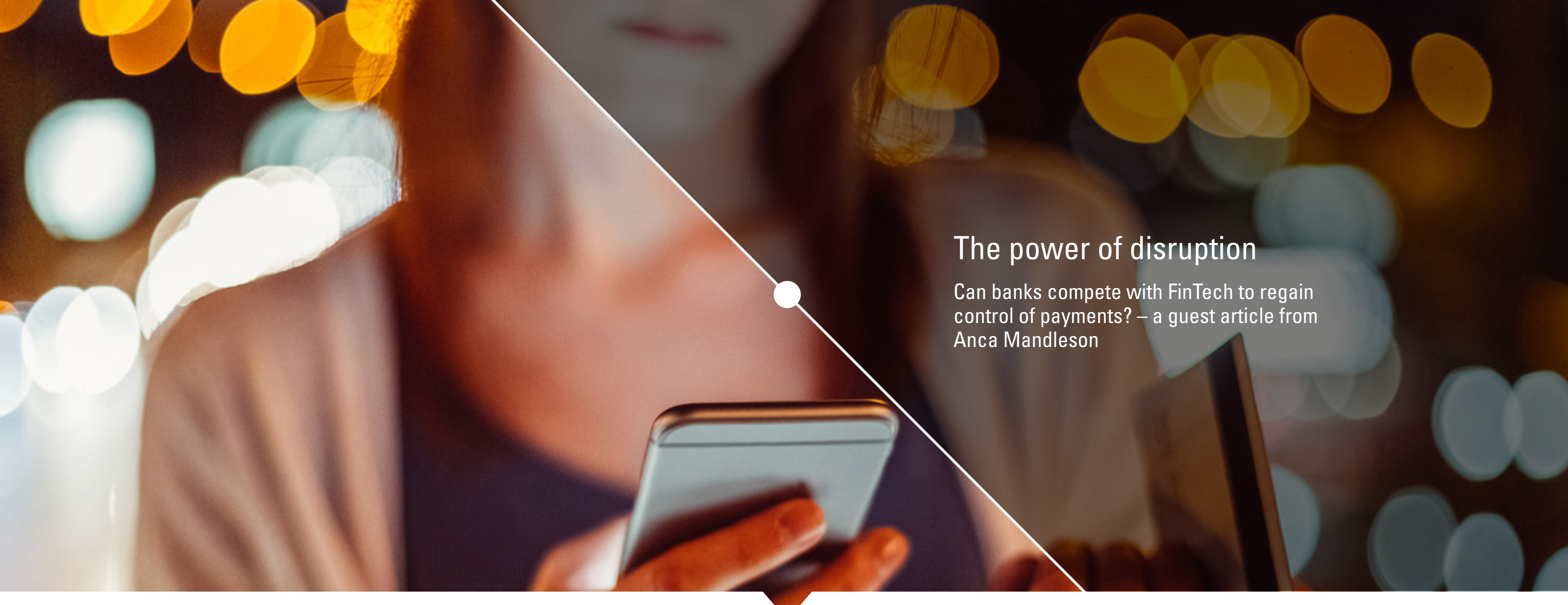

Here are the simple facts:

- Even though retail remains the most innovative part of banking, banks have slowly seen their share in payments erode from 80% in 2009 to 46% in 2016.
- While the banks' focus has remained on generating revenue from card interest and payment processing, the fragmentation of the value chain has prompted a decrease in margins for both payment processing and merchant acquiring – with even big banks like Barclays unable to buck the trend.
- Consumer behavior has changed, with key players like Amazon, Netflix and Apple Pay increasing the expectation for instant gratification ('I saw something that I could buy instantly') and personalized suggestions (often with a high degree of accuracy).
- Payments have become the epicenter of FinTech innovation, accounting for 40% of new FinTech companies/disruptors. (Source: McKinsey FinTech Database, 2015)

So, we have to ask the question: have banks simply given up on their dominance over payments? And, more importantly: can banks stop themselves from losing further ground?

I'll venture a guess and say that, yes, banks have simply given up – though some of them, particularly global banks, may argue that their ability to service retail and corporate clients continues to ensure that they're uniquely positioned to deliver to a broader client base. I'll also say that, no, they won't stop losing further ground – not with their existing mindset and their current approach to running their payments businesses.

Here's why:

- Banks have had to face tighter regulation, over the past 8 years, which made it easier for FinTech challengers to enter the market under more favorable conditions.
- Regulators want to see increased competition. In many European countries, banks own the payment scheme as well as the payment processor. It's just a matter of time before banks will need to concede control, because regulatory intervention will trigger governance reform of payment systems and direct participation by non-members into payment schemes.
- The widespread adoption of digital tools by customers, plus the banks' inability to provide compelling digital platforms, even for e-banking, have eroded customer trust and created brand detachment regarding the digital experience that banks can offer.

- Payment companies are essentially technology companies – banks are still grappling with their legacy infrastructure and have not been successful at identifying and implementing new technologies. In addition, many merchants and payment providers have moved to a cloud-based infrastructure, while banks are typically slow at implementing cloud technology.
- The digitization of the payment industry has made it possible to add value using customer and merchant data. However, while banks hold enormous amounts of valuable data, they have been unable to meaningfully extract value from it for three key reasons: lack of adequate technology; lack of data science capability at scale; and lack of organizational support, including the decision-making impetus required to generate value from big data.

MEETING THE FINTECH CHALLENGE

So where does this leave the banks? I see four potential ways for banks to take action. These are not necessarily exclusive, however, and banks may benefit from combining some of these approaches in various markets:

1. Banks can come together to create a joint, industry-wide, market-wide infrastructure, rather than try to invest in their own legacy payments platforms. Sharing the capital expenditure will allow them to reduce the costs and share the risk, enabling them to focus on delivering front-end payment capabilities to customers and merchants.

2. Banks can become individual utility providers. To do so, they will need to leverage their strongest competencies – that is, risk management and their balance sheet – especially as these are capabilities that challengers are unlikely to invest in. Banks can then step back from fighting for customers and instead lend their expertise to players who are more able to innovate, can deliver faster, and will provide a better customer experience.

3. Banks can define their value chain in a way that allows them to extract value from partnerships with FinTech providers, while maintaining some of their core capabilities in-house. In fact, many banks are already involved in collaboration with FinTechs (through accelerators, innovation labs and VC arms), but this effort has not led to systematic, consistent change in the industry, or to the kind of high-value partnerships that also benefit customers and merchants. Therefore – although I am a great believer in well-constructed partnerships – I would not advocate that banks acquire FinTech companies, as I have seen too many cases of innovation being killed post-acquisition, with neither party able to extract value in the end.

4. Banks can invest in building their own data science capability; indeed, this is the best way for them to extract value from 'owning' the customer and merchant relationships, and to genuinely exceed their clients' expectations. Banks don't necessarily need to build their data science capability in-house, either – it could instead be achieved through a strategic partnership or joint venture. Regardless of the model, banks need to equip their C-suite with the knowledge required to understand data science, artificial intelligence and related technologies. This understanding will help the management team figure out the importance of these capabilities within the organization. It will also force banks to reconfigure their organizational and delivery models in a way that allows them to compete effectively with their more agile, more innovative competitors. This final option is the most sustainable way for banks with payment capability to compete effectively and buck the trend that sees them losing share to a wide range of challengers.

At a-connect, we understand the intricacies of this evolving competitive landscape – and how important it is for senior management to be well-equipped for the changes ahead. Our specialist team of independent professionals can help you meet the challenges posed in the payments sector, and to develop effective and sustainable approaches to doing business. Contact us today to find out more.