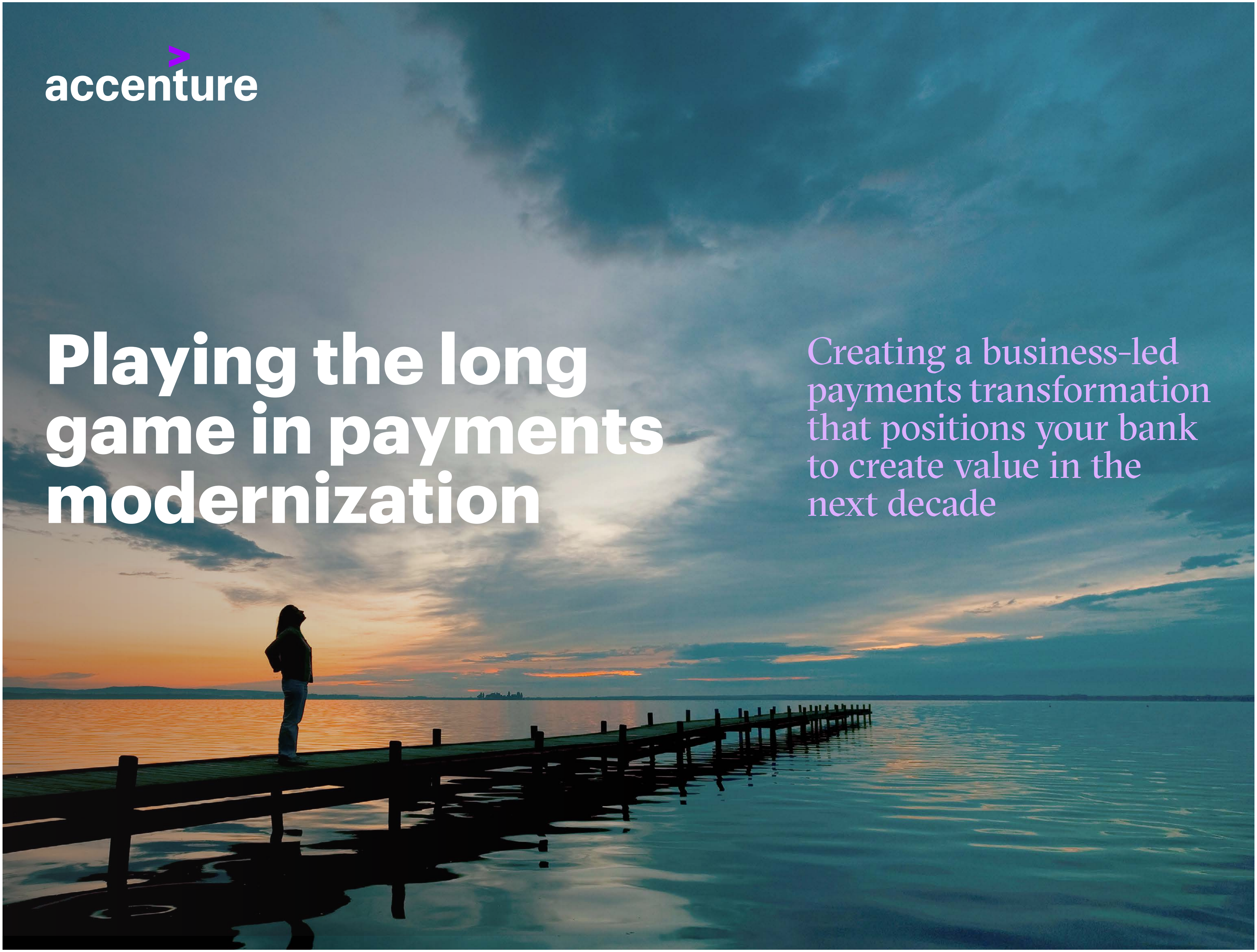


Playing the long game in payments modernization

Creating a business-led payments transformation that positions your bank to create value in the next decade

Banks are not getting optimal returns from their investment in payments modernization. The reason for the disappointing performance? Often a reactive, compliance-driven, and piecemeal approach that leads to inefficient adoption of new capabilities.

Understanding the drivers of payments modernization is key to creating long-run value

The imperative for payments modernization has never been more urgent for incumbent banks. In the next decade, a total of 2.7 trillion transactions, worth US$48 trillion, are expected to shift from cash to cards, interbank payments, and alternative payments instruments, representing a US$300 billion opportunity for payments providers*. In some regions like Western Europe this will take the form of incremental change in already mature e-payments markets, while in others like Southeast Asia and Latin America we could see a radical shift away from cash as these economies become e-payment enabled.

To gauge how well-prepared banks are to take advantage and ward off disruptive threats in a competitive payments market, we surveyed 120 payments executives at banks in Europe, North America, Asia-Pacific, Brazil, and the United Arab Emirates (UAE) about the progress and results of their payments modernization programs. We also interviewed senior bank executives to get their perspectives on the best strategies and approaches to unlocking value from payments modernization.

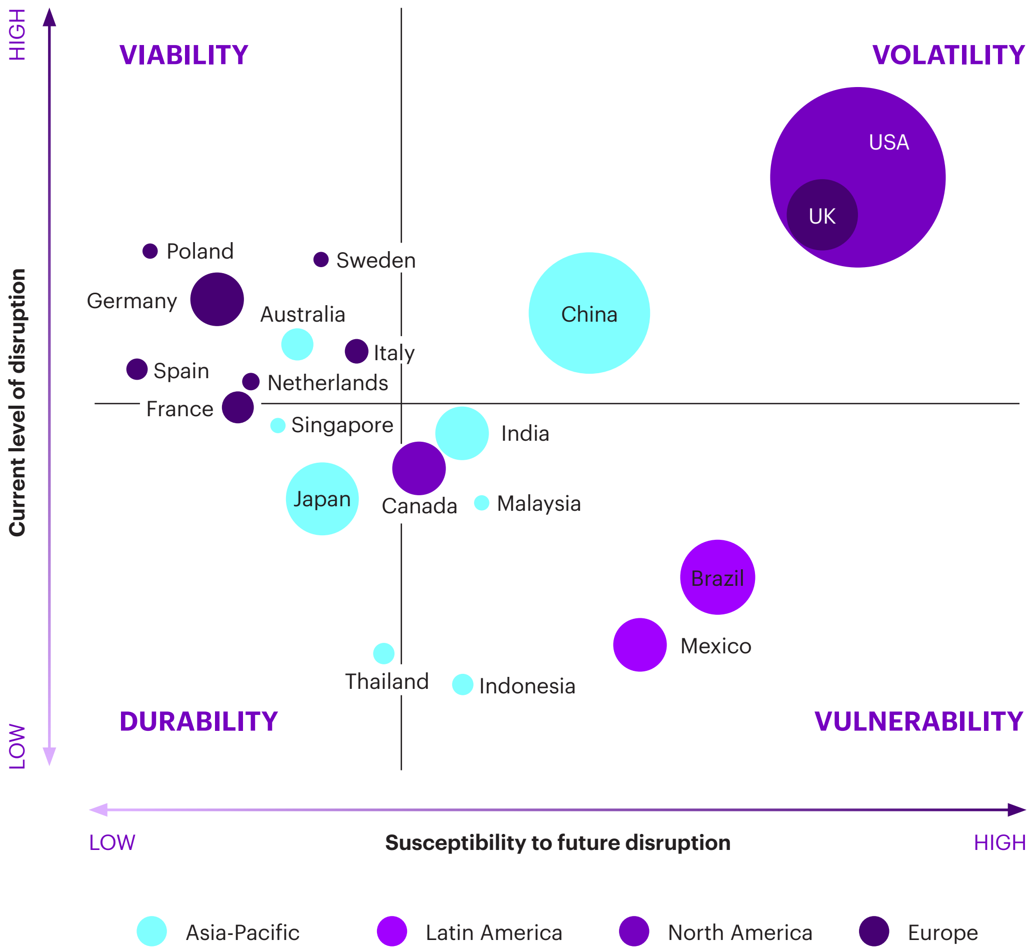
Market dynamics certainly vary across countries, but no incumbent bank is immune to disruption (Fig.1). COVID-19 has made consumers more digital than before and increased the likelihood that new alternative payments systems will get traction and take share. Competition is growing, whether the threat comes from fintech companies, large tech giants adding payments capabilities, payment internalization by major retailers or aggressive domestic banks embracing new payments technologies to increase their market share.

* Calculations based on GlobalData.

While COVID-19 has depressed payments revenue in the short run, three-quarters of banks in the survey agreed that the pandemic has led to greater urgency to execute on payments modernization programs and 73 percent said the pandemic has made the emergence of central bank digital currencies more likely as a result of the acceleration of digital payments.

Figure 1: Payments Disruptability Index by Market

Note: the size of the circles indicates the relative value of transactions in each country.



Source: Payments Disruptability Index, Accenture

VIABILITY

Already disrupted by well-established disruptors

Traditional market with strong incumbent presence. A few innovative solutions emerging, with regulators supportive of innovation and the advent of new payments systems.

VOLATILITY

Highly disrupted market with high level of anticipated future disruption

The market is disrupted and thus both innovative and competitive.Demographic, regulatory and market factors are expected to drive disruption to the next level.

DURABILITY

Traditional market with little disruption

Very traditional market with strong incumbent players, low level of innovation and weak competition.

Traditional consumer base as well as lack of structural, regulatory and infrastructure incentives, impeding major change.

VULNERABILITY

Expected acceleration in disruption

Conservative market with strong incumbent players and a lack of disruption so far. Young customer base as well as supportive regulatory and infrastructure environment should drive disruption in the future.

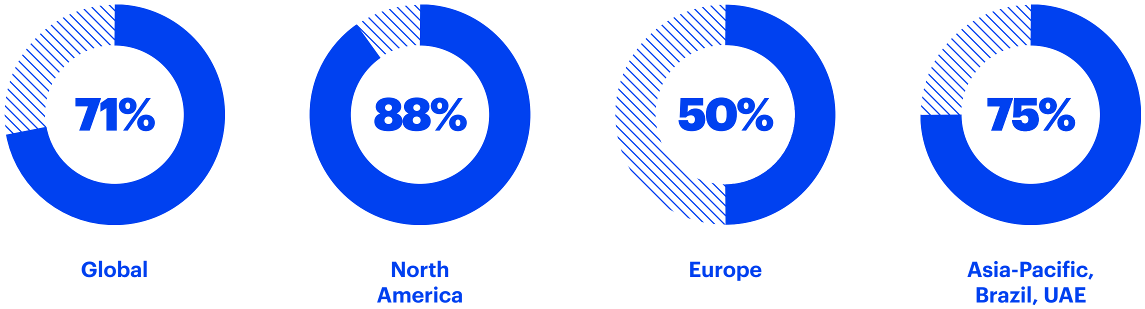
Few banks are unlocking the value of payments modernization

The survey confirms that many banks have invested in multi-year payments modernization programs to drive technology simplification, meet the demand for real-time payments, and reduce operational costs. However, the survey also shows that these investments are often driven less by customer needs than by changes in regulation and national payments infrastructure mandated from outside the bank.

In other words, payments modernization is mainly considered a technology- and compliance-led transformation instead of a business-led transformation. This results in a lackluster return on investment. In-depth interviews with senior executives at leading banks suggest better results are achieved when banks treat payments modernization as a strategic business initiative with robust governance, rather than simply as a regulatory or technology program.

Most of the banks in our survey acknowledged the importance of investing in payments modernization, with seven out of 10 agreeing that transforming the payments business is a core pillar of their broader digital transformation program. Among the different regions, North American banks appear to be placing the highest emphasis on payments modernization. European banks are at the other end of the spectrum, possibly because payments is already more commoditized in many European markets with less revenue upside (Fig. 2).

Figure 2: Banks' Prioritization of Payments Transformation
Question: To what extent do you agree that transforming the payments business is a critical aspect of your broader digital transformation program?
Percentages below represent respondents who selected "Agree" + "Strongly agree".



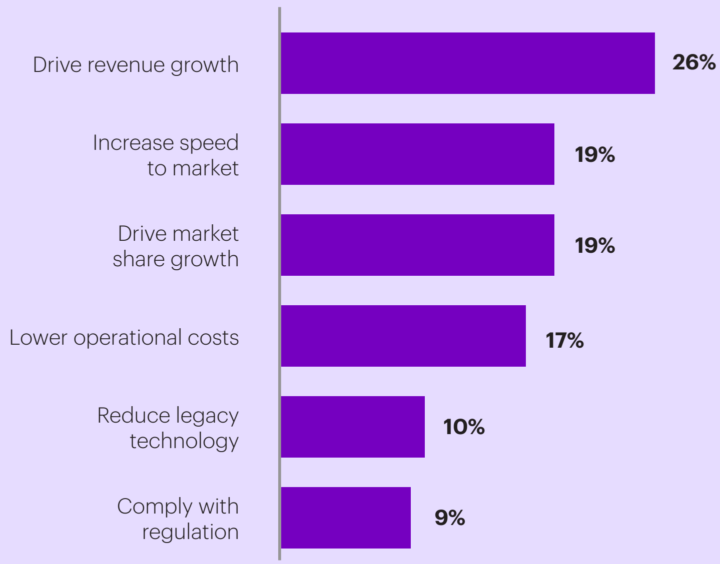
Source: Accenture Payments Modernization Survey, 2020

Yet only a handful of banks have unlocked material business value from their payments modernization programs.

Although the executives in our survey indicated that revenue growth was a key objective for their payments modernization programs (Fig. 3), only 13 percent reported that their institution had increased payments revenue in the last three years by more than the average market growth of 6 percent.

The outlook for the next three years is not much better, with just 16 percent expecting to grow revenues at a rate above the forecast market growth of 5 percent (compounded annually between 2020 and 2023).

Figure 3: Objectives of Payments Transformation
Question: What is the main desired outcome for your payments modernization program?



Source: Accenture Payments Modernization Survey, 2020

So, why are incumbent banks struggling to capture the expected returns from their investments in payments modernization?

Compliance or technology first, rather than business first

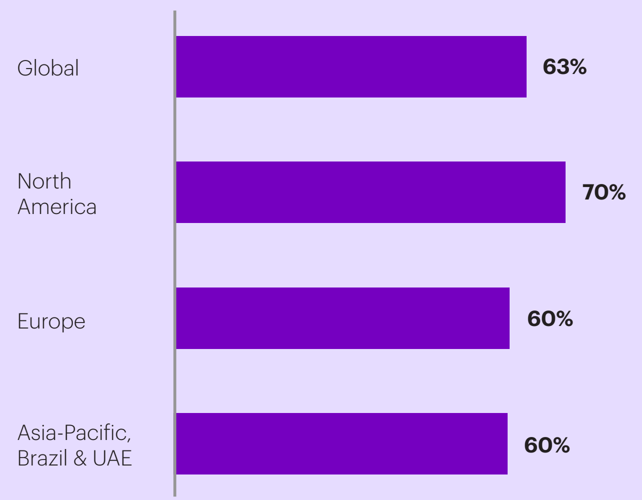
Unlike the more successful payments fintechs, banks are generally reacting to change rather than driving disruption. Among the survey respondents, 75 percent agreed that payments modernization is driven by changes in regulations and the national payments infrastructure.

In line with this reactive posture, three quarters of the banks in our survey embarked on payments modernization via the implementation of point solutions rather than by revamping their entire payments architectures through a holistic and coordinated program. Nearly two-thirds (65 percent) agreed that the costs of maintaining legacy technology are crowding out investments in new payments ecosystems and innovative customer solutions.

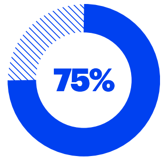
Fragmented governance and payments underperformance

The survey indicates that the governance structure at most incumbents does not provide effective direction to the payments business or align it with a strategic approach to growing revenues. For instance, 63 percent of banks agreed that they treat payments as a cost center (Fig. 4), even though many are trying to generate revenue growth from their payments modernization program.

Figure 4: Payments a Cost Center or a Growth Generator?
Question: To what extent do you agree or disagree that your bank treats its payments business as a cost center?
Percentages below represent respondents who selected "Agree" + "Strongly agree".



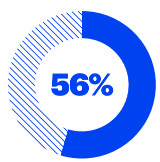
Source: Accenture Payments Modernization Survey, 2020



Most (75 percent) are looking towards technology investments to solve the pressure on the payments business, suggesting they are not grasping the importance of governance in improving performance. While 51 percent of banks are making changes to their technology infrastructure as part of their payments modernization program, only 35 percent are also implementing changes to their operating model in parallel.

It is not unusual for technology and the business to move out of lockstep during a multiyear payments modernization program. Only 38 percent of payments technology executives said their modernization program is a coordinated bank-wide effort and 55 percent said it is primarily a technology/operations effort.

Fragmented governance means that many are making uncoordinated payments investments that are compounding rather than resolving inefficiencies and complexity in their payments architecture. They are responding to challenges piecemeal—department by department, business line by business line, and technology by technology.



More than half (56 percent) achieved compounded annual revenue growth of less than 3 percent in the last three years and 76 percent cut operating costs by less than 3 percent a year in the same time frame.

A compliance-driven mindset might explain why most banks (92 percent) are satisfied with the progress of their payments modernization programs, despite a mediocre return on investments that often run into hundreds of millions or even billions of dollars.

Four steps to unlocking long-term value from business-led payments modernization

Given the regulatory and disruptive pressures they face—with COVID-19 adding more volatility to the mix—it is not surprising that many banks are addressing payments modernization through ad hoc technology investments. However, those that chart a long-term roadmap will unlock significantly more value from their efforts.

All banks need to embrace emerging industry standards such as real-time payments systems or architectures enabled by application programming interfaces (APIs). Each bank does have the choice, however, about how it uses the transition to new standards and technologies to offer better customer experiences, enhance architectural flexibility, and increase revenues.

The optimal route involves taking a bank-wide, business-led approach to payments modernization rather than treating it as a technology and operations effort.

One of the experts we interviewed noted that there is often good alignment of business and technology at the outset of a payments modernization project. But after six months have passed, the business side becomes impatient as it needs to deliver on its targets. Before long, the program becomes a pure technology initiative decoupled from business priorities.

The right vision, governance structures, realistic budgets, and deadlines are essential if a bank is to avoid this outcome. Although the journey and destination will differ between institutions, four key steps will help banks get the most out of their payments modernization program.

Step 1: Define the vision for payments

A high-impact, bank-wide vision for payments modernization will drive revenue growth from payments and lead change rather than just respond to it. This vision will look beyond cost and compliance towards ways to generate income from new services and products.

Define what the bank wants to achieve

Leading banks will ask how they can monetize the investments they need to make in each new and emerging standard, technology, or regulation. A successful bank will identify key performance indicators at the outset of each initiative to ensure it can measure those outcomes.

A bank in Asia-Pacific has monetized around two-thirds of regulation-driven investments. The bank considered ways to generate a return on its investment in real-time payments in the planning stage. It was able to drive revenues through value-added solutions like real-time payrolls and real-time products for merchants.

Align the payments vision with the bank's priorities

A payments vision that is aligned with the bank's broader digital transformation strategy is more likely to succeed. Forming a dedicated payments strategy team that reports into the group strategy team is one way to facilitate closer alignment between payments and the rest of the business. Payments modernization programs should be driven by multidisciplinary teams that include representation from the back- and front-end of the payments business—for example, people from technology, treasury, lending, and merchant acquiring.

A dedicated payments strategy team at a European bank keeps tabs on market developments and competitor activity and reports these insights to a group strategy team. This ensures direct communication between payments and the group at a strategic level.

Step 2: Create time and space to invest

To unlock the true potential value of payments modernization, successful banks take an agile approach to budgeting that ensures there is adequate funding for each program yet does not allow costs to spiral out of control. They also look at return on investment with a horizon of up to 10 years to ensure they are making the right bets for the longer term.

Start with a bottom-up cost estimate

Banks frequently underestimate how much time, resources, and funding it takes to implement a payments modernization program. These inaccurate budget estimates are often the result of a payments executive being reluctant to propose a big number to the board, or of the board setting an unrealistic top-down budget for payments modernization.

In a traditional waterfall development model, the first year will be spent gathering specifications. Once implementation commences, challenges such as unexpected dependencies, lack of resources, divergent priorities or conflicting standards start to crop up and the budget proves to be inadequate.

One European bank we interviewed budgeted €1 billion over four years for its payments modernization program; at the end of this period, it had actually spent €2 billion and achieved only 30 percent of its aims. This bank started with a top-down estimate for budget and timeframe for the program.

Because it used a waterfall approach and left the implementation stage until last, it only discovered some thorny systems integration problems towards the end of the project. The result was that it added another payments system to its infrastructure and could not decommission its legacy platform.

A bottom-up, agile approach to budgeting works better for many payments modernization programs. The bank starts with a particular customer journey or a small piece of functionality and modernizes it across different layers of the architecture and value chain. This agile methodology highlights issues such as integration headaches at an early stage of development, enabling the bank to budget more realistically for the broader payments modernization program.

A European bank embarked on a payments re-platforming project with the goal of completing it in three years. The project took five years to complete after teething issues were detected in testing. The bank needed to spend the extra time to iron out unanticipated security concerns and other technology challenges.

Widen the time horizon for the ROI calculation

Payments modernization programs balance a range of initiatives and projects unfolding over different timelines—a reality that needs to be considered in return-on-investment (ROI) calculations.

Regulatory compliance and the shift to digital payments are urgent priorities; adoption of robust messaging, open banking or real-time payments could be short-term or medium-term concerns depending on the country; and central banks' digital currencies might be longer-term initiatives.

For many banks, the focus on meeting immediate compliance needs through short-term programs has drained their resources. They have taken tactical actions that have left them with less control over how their payments ecosystem evolves. To drive better results, leading banks will look beyond the usual three- to five-year horizon for return on investment.

These banks need to take a page from the book of venture capital firms, which invest in payments startups with a longer-term view than a three-year return on investment. These investors are looking to create disruptions that generate value and market dominance over the longer term.

A ROI window of up to 10 years might thus be more appropriate, given that payments modernization is a long-term play with a great deal at stake. Without clear direction on investment horizons and funding priorities, different departments may fund and prioritize projects in a manner that is sub-optimal for the payments architecture over the next decade.

Step 3: Align the operating model

Our survey highlights two major challenges for banks: a lack of governance due to multiple stakeholders and a misalignment of costs and revenues. Addressing the weaknesses in the bank's operating model is key to driving a better return on investment from payments modernization.

Streamline governance

Payments leaders empower decision-makers in their organizations with the resources and authority they need to make the right investments, as well as create organizational structures that align stakeholders with their payments vision. A payments lead or a payments council comprised of leaders from the payments business are the options favored by the most successful payments players.

It is important to document responsibilities, so that people can be held accountable for driving results from payments modernization efforts. Reporting lines should be aligned with responsibilities and configured in a way that avoids functional silos and duplicative work.

One bank in Asia-Pacific merged its technology and operations divisions into a joint DevOps team that is responsible for the payments architecture. Creating this single DevOps team enabled the bank to reduce the number of different applications as well as promote standardization across countries—thereby increasing speed to market.

Secure human resources

Human resources are often overlooked in payments modernization programs, but a lack of internal skills can be a major bottleneck. Many payments-related technology skills are scarce and difficult to hire at short notice. Even if the bank can hire people with the right competencies, it will generally take them some time to become familiar with the organization and its technology environment.

An agile approach can enable a bank to kick-start payments modernization, even when the payments team is not yet fully staffed. It can deploy the resources it already has to work on the most urgent elements of the payments modernization project, and address its goals across a phased roll-out.

A business-led payments modernization program at a European bank failed to deliver the anticipated results, partly because most of the people working on the initiative were new hires, recruited due to a shortage of in-house capacity. Their lack of familiarity with the business resulted in friction between the team running the day-to-day payments business and the payments modernization team.

Step 4: Develop a flexible architecture

Many banks are still weighed down by an architecture consisting of a collection of point solutions that are not designed for continuous change and interoperability. The problem is amplified in international banks working across geographies, where each country may have developed its own payments architecture and approach. Payments leaders look to overhaul their payments architecture and replace legacy systems with more flexible, modern platforms that can also be more consistently deployed on a global basis with customization limited to that which is strictly necessary for each market.

Migrate to the cloud

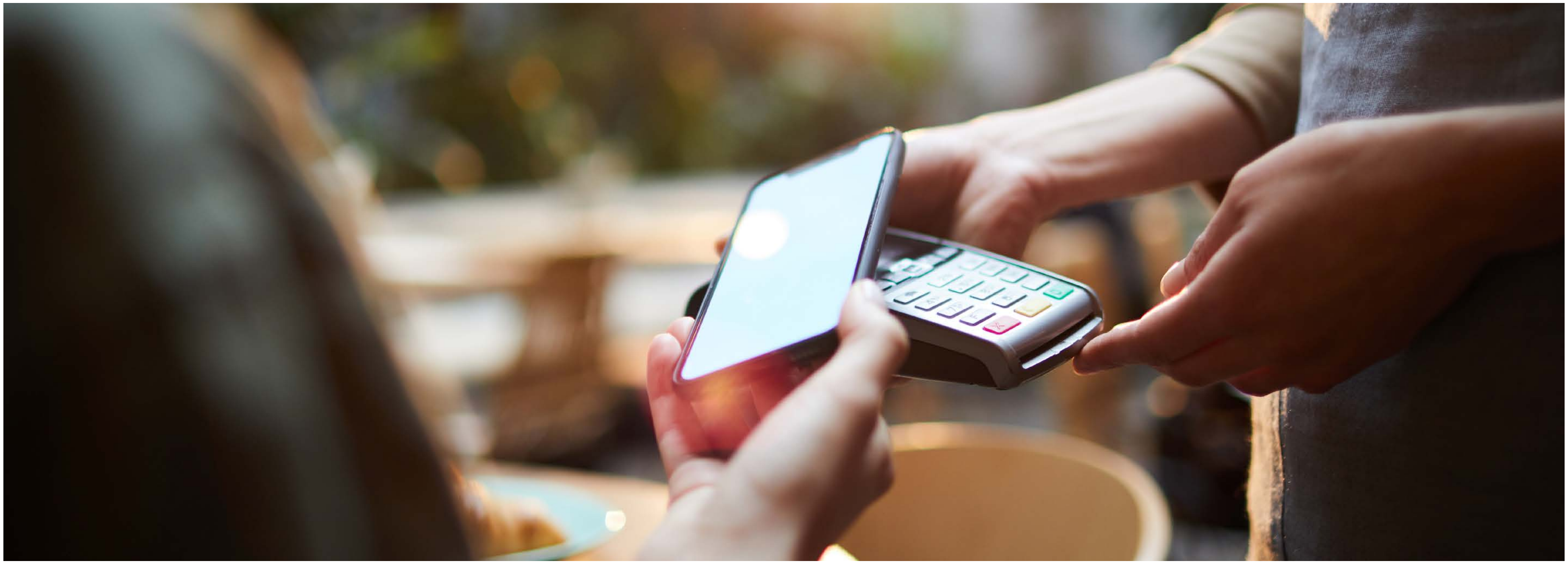
Banks may be able to enhance agility, reduce cost of ownership, and improve flexibility and resilience in their payments architecture by migrating to the cloud. Even though they have adopted cloud systems in other parts of the business, only 38 percent are investing in cloud systems as part of their payments modernization journey.

Moving towards the cloud offers some complex choices. Banks will choose, for example, which options to use in their target-state architecture: payments on cloud infrastructure, payments as a service, payments on cloud platform, or fully outsourced payments operations. They also have the choice between three cloud deployment models: private, public or hybrid.

Banks may face a choice between better or cheaper payments processing and a trade-off between differentiation and cost. Larger institutions that want to differentiate their digital experience or compete with value-added payments services tend to seek more configurability.

But those that customize too extensively risk becoming locked in with one cloud provider, unable to shift to a competitor if they are not achieving the cost benefits they anticipated. Smaller banks may choose standardized, self-service solutions to reduce costs, but will potentially sacrifice differentiation of products and services.

A major bank in the UK is working with a payments fintech to investigate a cloud payments infrastructure as it continues to modernize its IT infrastructure. The strategic partnership will enable the bank to develop a cloud-native platform-as-a-service, which has the potential to reduce costs and streamline processes.



Aim for an API-enabled architecture

Seventy-one percent of payments executives agree that moving to an API-enabled platform is a necessary component of any payments modernization program. Opting for an API-enabled architecture enables banks to insource and outsource work seamlessly with a range of technology and business partners.

An institution in the Asia-Pacific region sees APIs and the partnerships they enable as critical to differentiating itself at the service level, in turn helping it to win new clients.

Positioning for the long-term win with business-led transformation

Change in payments has hardly let up over the past decade, and it is likely to go into overdrive in the decade to come. Finding themselves squeezed from all directions—rapid regulatory changes, new customer expectations, and evolving national payments systems—many banks have responded to the payments modernization imperative through tactical, technology-driven programs focused mostly on cost and compliance.

However, banks that will build the most successful long-term position in payments will be those that take a step back to look at the big, strategic picture. Not only will they invest in technology; they will also focus closely on the business-led transformation of their operating models and overall payments architecture. The focus should not be only on today's urgent regulatory mandates, but also on driving long-term value.

How Accenture can help

Accenture Payment Services offers a unique combination of deep payments industry expertise, robust technology capabilities, innovative thinking and unsurpassed global outsourcing delivery experience. In addition to our payments consulting expertise, we have access to specialist teams in technology, finance and risk, and workforce and talent management.

The 5,000+ specialists in our Payments practice are engaged in business and IT consulting, systems integration and business process outsourcing for more than 150 clients. These include banks, card processors, payment schemes, merchant acquirers, central market infrastructures, retailers, marketplace platforms, telecom companies and government departments.

Our consulting services span:

Card issuing

Helping issuers and partners across strategy and product development, channel and value chain optimization, risk management, fraud mitigation and digitization.

Payment acceptance

Supporting the product, operational, strategic and technical initiatives that allow payments acceptance clients to compete effectively.

Retail payments

Helping organizations, networks and other stakeholders rethink payments and delivery models in a world of real-time payments, mobile-first applications and open banking / open APIs.

Corporate payments and transaction banking

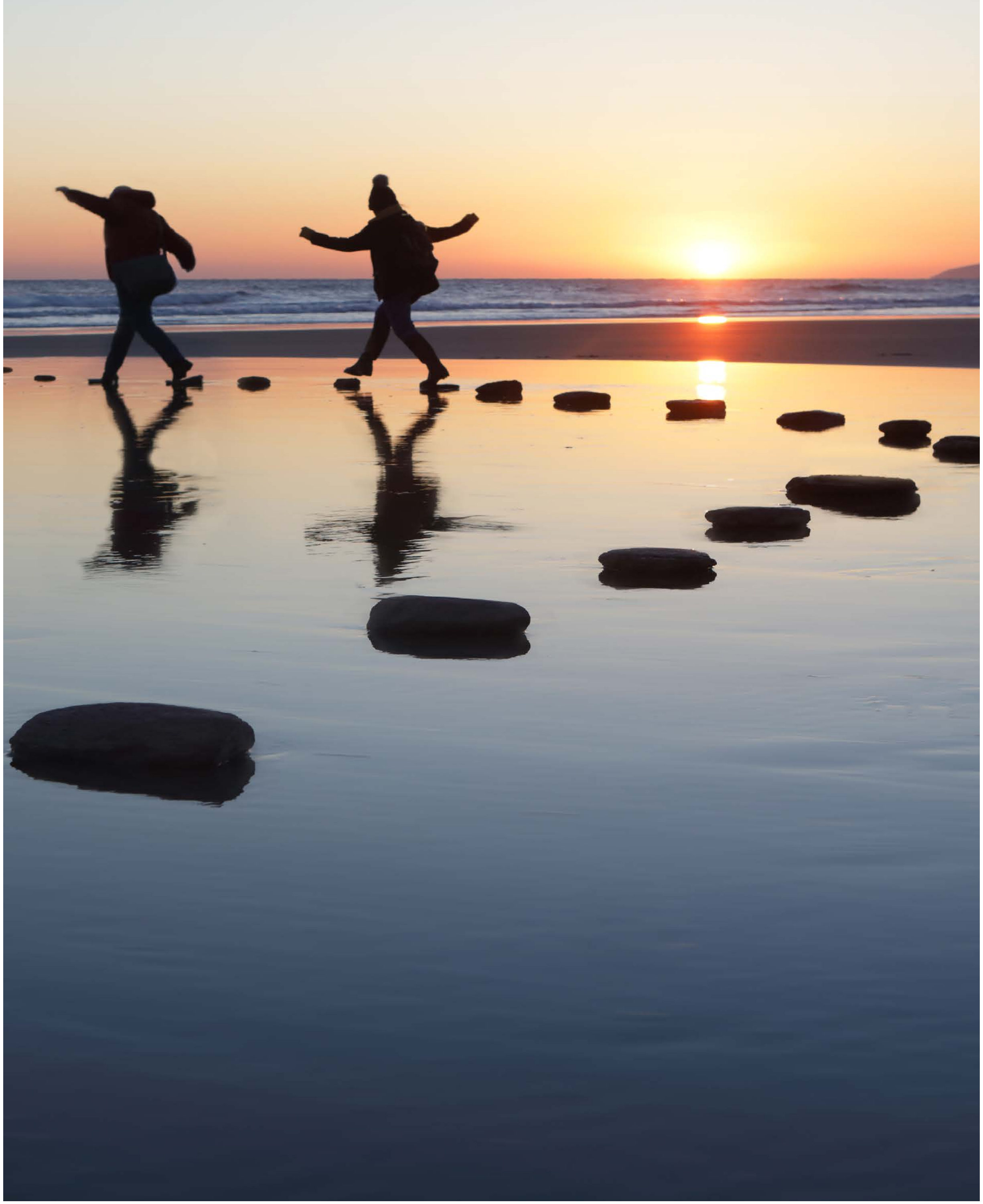
Delivering strategic automation, standardization and global solution optimization to financial institutions and corporate payments clients.

Infrastructure renewal

Assisting with payments infrastructure strategy and design, infrastructure transformation, payments hubs, payments platforms as a service, ACH / RTGS renewal, instant payments and API infrastructure.

Strategy and innovation

Creating digital and mobile payments solutions that facilitate commerce, enhance the customer experience and protect customer data.



About the survey

Between July 31 and August 24, 2020, Accenture conducted an online survey of 120 payments executives in 20 countries: US, Canada, UK, Germany, the Netherlands, France, Spain, Italy, Sweden, Finland, Denmark, Norway, Australia, Japan, India, China, Singapore, Thailand, UAE and Brazil.

The respondents were evenly split between retail payments executives, corporate payments executives and payments technology executives. The overall margin of error is ± 1.55 percentage points at the midpoint of the 95 percent confidence level.

About the Payments Disruptability Index

To help banks better understand disruption in payments, Accenture has created an index that reveals the level of disruption currently affecting 20 payments products and 20 countries, as well as their susceptibility to future disruption. To measure disruption we examined 42 metrics within two dimensions:

- The current level of disruption, measured as the presence and penetration of disruptors and traditional players' performance.
- The susceptibility to future disruption, as indicated by customer readiness, the strength of the innovation ecosystem, and the market structure as it relates to payments regulation and infrastructure.

Accenture's Payments Disruptability Index positions 20 countries and 20 payment products against those two axes. The median scores are then used as dividing points to highlight four states of disruption: Durability, Vulnerability, Volatility and Viability.

Contact the authors

Alan McIntyre
Senior Managing Director – Banking
alan.mcintyre@accenture.com

Sulabh Agarwal
Managing Director – Global Payments
sulabh.agarwal@accenture.com

Luca Gagliardi
Director - Accenture Research, Payments Lead
luca.gagliardi@accenture.com

Contributors

Edlayne Burr
Managing Director – Growth Markets Payments
edlayne.a.burr@accenture.com

Nanna Svahn
Manager – Accenture Research, Banking
nanna.svahn@accenture.com

Margaret Weichert
Managing Director – North America Payments
margaret.m.weichert@accenture.com

Dominika Bosek
Specialist - Accenture Research
dominika.bosek@accenture.com

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Accenture Research shapes trends and creates data driven insights about the most pressing issues global organizations face. Combining the power of innovative research techniques with a deep understanding of our clients' industries, our team of 300 researchers and analysts spans 20 countries and publishes hundreds of reports, articles and points of view every year. Our thought-provoking research—supported by proprietary data and partnerships with leading organizations, such as MIT and Harvard— guides our innovations and allows us to transform theories and fresh ideas into real-world solutions for our clients.
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