DON'T BE LOCKED-DOWN, LOCKED-IN OR LOCKED-OUT:

Three red flags to look out for when selecting a modern payments platform

As digitisation continues apace, many prominent financial institutions (FIs) are choosing to carry on running their core business on outdated payments technologies that can't sustain the ever-increasing pace of progress nor maintain and grow the vital partnerships, needed to compete in today's payments landscape. This failure to address systemic weaknesses is leaving FIs at risk of limited customisation, with an inability to integrate with modern payments applications, and they are finding themselves tied-in and restricted by their vendors.

For some years now, leading consulting firms such as accenture have identified re-tooling FIs' payments systems for the digital era as a major challenge. Back in 2018, Gartner Research predicted[1] up to 80% of banks would be irrelevant by 2030 owing to their inability to adapt platforms and systems for the new era of digital payments. On the upside, Bain and Company argue[2] that those banks which choose the right strategy for digital payments platforms could generate up to 50% more customer loyalty and enjoy 9% higher revenue growth when compared to their peers.

In seeking to address the challenge of how to re-tool or replace systems for the digital era, a number of banks have attempted to find shortcuts, whether by replacing only those parts of their tech stack that are not mission critical, installing plug-ins and wraparounds or implementing orchestration systems which sync their legacy systems with "bolt-on" new technologies.

> "Many banks have sought to implement shortcut solutions to their systemic challenges, leaving themselves vulnerable to significant risks."

However, none of these approaches solve the underlying problem. On the contrary, banks can find themselves forced into the role of systems integrator, "fire-fighting" incompatibility issues and attempting to untangle complex webs of patched up legacy systems, to say nothing of the complexities of integrating of new features. What's more, such approaches leave financial institutions vulnerable to significant risks that can hamper a bank's ability to innovate and adequately serve its customer base in the medium to long-term.

1. See Finextra, "Most Banks will be irrelevant by 2030 – Gartner", https://www.finextra.com/newsarticle/32860/most-banks-will-be-made-irrelevant-by-2030---gartner
2. See Bain & Co: "As banks pursue digital transformation, they struggle for profitability", https://www.bain.com/insights/as-banks-pursue-digital-transformation-many-struggle-to-profit-from-it/

Locked-down, locked-in, locked-out

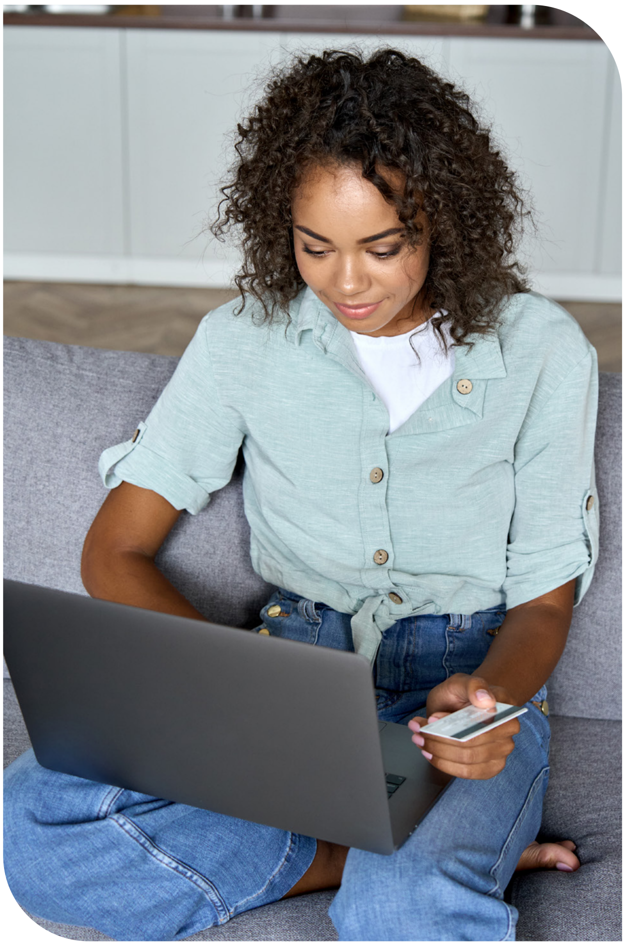
In what follows, we review the key issues FIs face if they choose to continue with outdated payment platforms that underpin their technology stack. When thinking about these issues, it's important to remember that whilst problems with legacy systems have been recognised for a long time, today's industry disruptors are accelerating the pace of change like never before. The COVID pandemic has only elevated the need for modern, dynamic and responsive systems in order to navigate #accelerating digitisation, in an industry that has seen a 30%[3] increase in e-commerce transactions, and 39% growth in the use of digital-first "neobanks" by consumers[4] over the last few years. In such a turbulent environment, the risk to FIs of not modernising their payment systems grows more acute – failure to adopt the right approach could see FIs left behind. The key considerations for FIs looking to truly future-proof their payments business for the long-term are explored in more depth below, paying close attention to the red flags to look out for when selecting "modern" payments technology platforms on which to build the foundation of their business.

VENDOR LOCK-DOWN: The ability for an FI to differentiate is key for survival – it is the way they attract and retain customers, build their business and make their money. However, many FIs still run on software built in the 80s, which, whilst still adequate for performing commodity functions such as switching, offer little to no customisation capabilities. There is such limited ability for FIs to innovate on their underlying platform that they have to resort to either innovating on the fringes using integration layers, by integrating with fintech software, or by acquiring the fintech themselves in order to provide them with modern, differentiating, revenue-earning products and services. This means that to take advantage of industry advancements, such as Open Banking, faster payments, Buy Now Pay Later, Request to Pay, crypto, AI, xPays and the like, FIs with legacy systems have no choice but to achieve this via partnerships. However, by having to manage such a large set of fintech partners, FIs have no single view of their system overall; true omni-channel is unachievable, the system has ever-increasing points of failure, maintenance costs grow exponentially, and the attention of an FI's technical team is taken away from their core business.

> "COVID-19 has accelerated digitisation, accentuating the risks to those FIs that fail to modernise their payments software platforms."

3. See The Digital and Card Payment Yearbooks 2021-2022 at www.paymentyearbooks.com
4. SIA Partners, "Disruptive Fintech During COVID", https://www.sia-partners.com/en/news-and-publications/from-our-experts/disruptive-fintech-during-covid-19-pandemic

Of course, not all FIs run on 80s software - a large proportion have migrated all or significant parts of their technology stacks to card management and payment platforms built in the 90s or early 2000s. These platforms offer an improved level of customisation through advanced parameterisation capabilities and comprehensive SDKs. Whilst they offer a reprieve from older legacy systems, they are still inherently card-based, are not built for the complexities of the modern payments world and come with their own set of challenges. The often unnoticed red flag is that with these card-based systems FIs still end up having to use wraparounds to trick the system into thinking it is dealing with cards in place of tokens and alternative payment methods, so from day one this "modern" system is already outdated and no where near future-proof.



These systems, their plug-ins and modern-day technological crutches are packaged so that they appear more than able to cope with today's payments landscape. Vendor lock-down really becomes apparent when FIs want to make more significant changes aligned to their specific vision. The end result is that FIs find themselves with a product that doesn't meet their exact requirements, launched later than they needed it and at much higher cost; ultimately leaving them unable to react intuitively to industry trends. Many FIs are aware of this and therefore, unfortunately, decide to customise cautiously, instead choosing "off the shelf" options in order to avoid significant vendor lock-down.

Issues don't just concern those with platforms from the 80s. The propensity for FIs utilising 90s systems to miss these red flags and be dazzled by yet another 90s system in "sheep's clothing" is astonishing. Whole system replacements are complex, costly, time and resource heavy, not to mention involve navigating internal company politics. Inadvertently replacing like-for-like does not equate to a comprehensive, future-proof strategy.

When taking the plunge and modernising the foundation of their core issuing and acquiring systems, in order to avoid vendor lock-down, FIs should look for token-based systems that are built on modern engineering principles with customisation in their very DNA. Particularly good systems have multiple user exits that allow customers to apply their own logic to adjust standard system settings and processes, enabling customisations on the fly, independent of the vendor. Next level systems provide customers with access to the same tools that the vendors use whilst preserving the system integrity.

Customisation is no longer an add on or "nice to have" or something you have bullied a system into offering, but an integral feature of any payments platform developed to go the distance.

VENDOR LOCK-IN: FIs are not static organisations – they have strategies to grow and develop their business, move into new sectors or geographies, scale their business, etc. And whilst there are a lot of software options available to FIs, the vendor and technology they choose can often lead to challenges further down the line. When choosing an underlying enterprise-level issuing and acquiring system, FIs aren’t just investing money into technology, they are investing into a long-term partnership with a vendor that will directly influence the success of the core business and the scope of their evolution. An inconceivable number of FIs can’t see past the now and issue RFPs to solve their current problems with very few focussing on the near-future, let alone long-term, completely forgetting that they will be locked-in to these enterprise level systems for an average ROI of 7-10 years. The red flag here is that FIs partner with vendors that, whilst fit-for-purpose now, do not offer a range of deployment options, shooting themselves in the foot from the get-go.

The relevance of deployment options here, that is often missed, is the flexibility that a vendor can offer. This goes beyond the technological capabilities of the platform, resource availability and lead times, which is why vendor lock-in is rife.

There may come a point where an FI wants to take their system, or part of their system, such as their core revenue-generating business lines, out of the multi-tenanted SaaS environment they first launched their business on and move to a PaaS model or even skip a step and move in-house with a license. Yet, very few processors offer multiple deployment processing options, let alone bridge the gap between processing and license models. And even if they do, it may not be easy for the FI to move between the them because of the tendency for these to be run on different technological platforms and operated by different teams.

When it comes to choosing such enterprise-level systems, FIs must employ a long-term view and cannot afford to overlook deployment flexibility at any cost. FIs should look for forward-thinking vendors that can not only offer deployment progression from processing to license, but can also offer the option to reverse this flow, where having purchased a license, they can make the move to outsourcing, PaaS or SaaS, depending on real-world challenges or as a strategic play.

Visionary vendors, capable of lasting partnerships, will be able to offer a multitude of deployment models on the ground and in the cloud, including the ability for an FI to take advantage of a hybrid approach, whereby they can hand-pick the mix of deployment options that best suit their business lines at any specific time.

VENDOR LOCK-OUT: In today's world of interconnectivity, it is universally agreed that APIs are reshaping the future of payments. Most vendors these days will claim to have fully flexible and "open" Application Programming Interfaces that allow for easy integrations and dialogue. However, not all APIs are created equal. APIs can either add significant value or be a major liability. The danger of investing in pre-2000 systems is that they were built code-first and became API-rich at a later stage. Adding APIs adhoc, rather than developing API-first, creates redundancies, lack of consistency, poor maintenance practices, and limited transparency with longer development cycles, unplanned rework and a higher defect rate, cancelling out many of the potential benefits. Ultimately, if you are not API-first, you are not customer-first.

For everything to work as it should, it becomes critical to have fully-functional, extensive, intuitive, well-structured and documented APIs that are built to last and support modern standards and technologies for integration. Simply having APIs is not sufficient. Good APIs are not something you bolt-on, they need to be embedded into the DNA of any system. Unfortunately, a red flag often missed is that whilst anything built pre-2000 has APIs, they may not always be fit-for-purpose and this can lead to vendor lock-out. API-rich is not the same as API-first and it is important to make this distinction.

The issuing and acquiring platform that underpins an FI's technology stack is the fundamental base that many auxiliary, front-end, value-adding systems will integrate into. These are the systems that drive multiple and interchangeable partnerships with fintechs and API-first platforms will enable an FI to lift and shift freely between service providers, so they can innovate faster, better, and at lower cost, independent of the core system vendor.

Modernity matters

Payment analysts across the world have clearly articulated time and time again that change is no longer optional. This message has been received, and FIs are keen to modernise their payments systems. From the masses of RFPs issued by FIs, however, almost half decide to remain with their incumbent vendor, choosing instead to navigate the increasing complexities of partnership management, growing integration challenges, spiralling operational costs, innovation at the fringes, and static deployment models. Partnering with fintechs are an integral part of a payments business, but an FI's payments modernisation strategy cannot solely be tied to third-parties. Whilst changing the underlying issuing and acquiring platform is no mean feat, it is not impossible so any FI looking to truly take ownership of their future needs to take action now.

When making the critical decision of modernising the underlying core platform, FIs need to dig deeper, look further, and investigate the market properly to ensure they don't inadvertently replace legacy with legacy.

In a mid-2021 paper on banking technology[5], McKinsey & Co advise banks to modernise so that they can integrate everything from blockchain and crypto payments through to tokenised transactions and the use of AI to fight fraud and serve customers better.

5. McKinsey & Co, "Technology-led shifts in payments", https://www.mckinsey.com/industries/financial-services/our-insights/banking-matters/technology-led-shifts-and-opportunities-in-card-based-payments

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