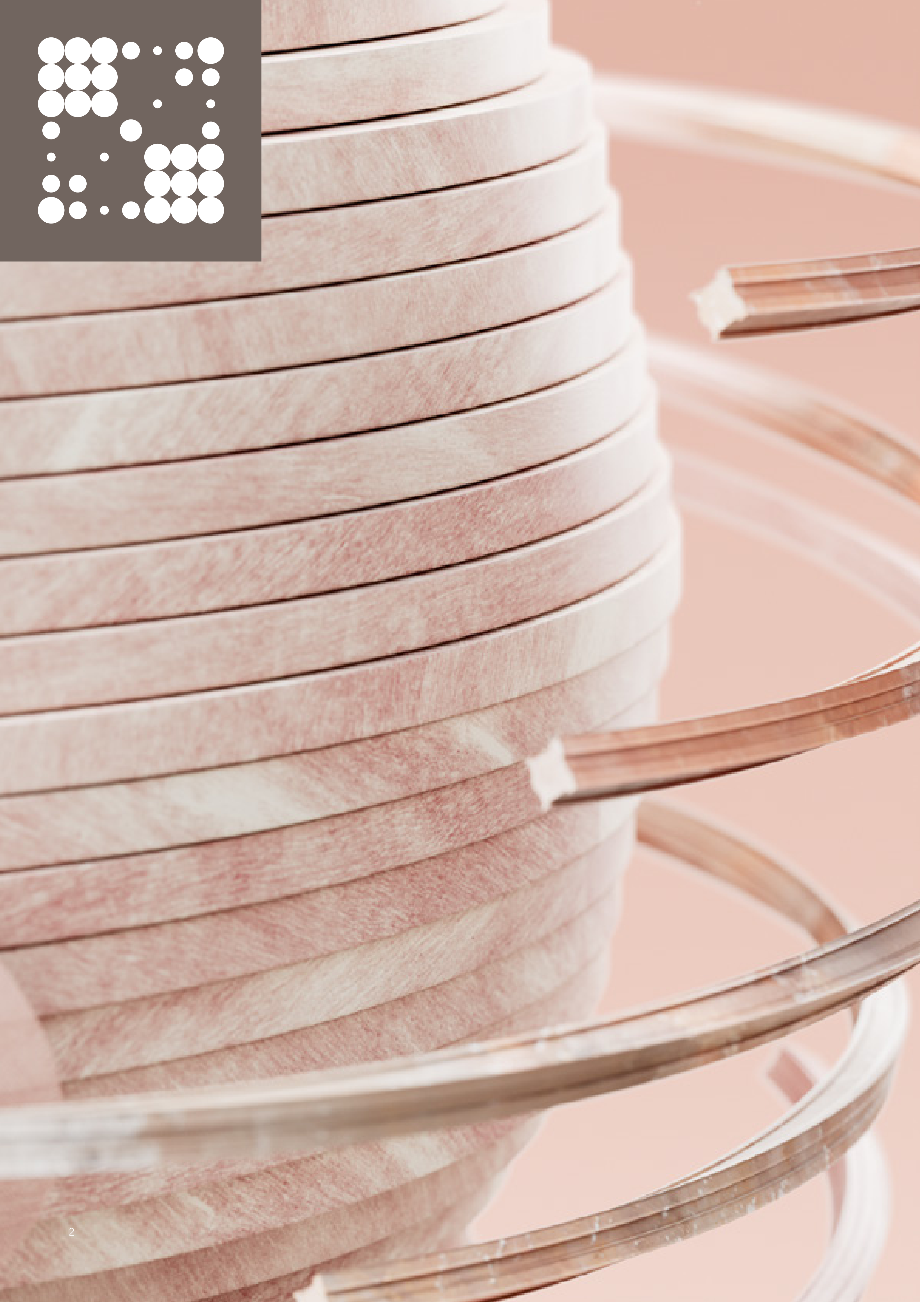
SaaS: the future of payments outsourcing

tietoevry

Developers of Digital Futures



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Executive Summary

As the European banking landscape transforms to digital payments and services, banks are under pressure to deliver higher margins and better customer service, pushed by new competitors including non-bank financial institutions (NBFIs), fintechs, Big Tech players and digital start-up banks.

In response to these challenges, banks are now looking to outsource parts of their payments business, with processing, fraud management, account management and card management all popular choices. Almost three-quarters of banks in this survey intend to use SaaS or another outsourcing model for some part of their card functions in the next three to five years.

At present, banks marginally favour a Software as a Service (SaaS) approach over full business process outsourcing (BPO). While BPO holds some advantages, especially for smaller banks looking to pool some of their requirements, our survey reveals banks are increasingly considering SaaS for their outsourcing needs thanks to the combination of flexibility, control and cost reduction that it offers.

The need to deliver greater operational efficiency is a key driver for outsourcing, followed by better platform functionality and flexibility and the capacity to reduce cost. Banks have a realistic and practical attitude to how much cost can be shifted from capital expenditure (CapEx) to operational expenditure (OpEx). However, banks recognise they lack practical experience in managing service level agreements (SLAs) and believe that it could take several years before their internal processes are optimised to enable efficient outsourcing.

When it comes to hosting arrangements, banks have a good working knowledge of the relative benefits and risks of delivering services via public and private cloud At present, many banks are considering third-party delivery models using SaaS for their outsourcing needs ; however, we anticipate that private and public cloud hosting arrangements will coexist alongside each other for the next 5-10 years as banks grow more confident and comfortable with public cloud systems – and software companies become more adept at using public cloud providers to serve the specific needs of payments companies and financial institutions.

These results underline the need for banks to work with trusted, knowledgeable partners as they develop their approaches to outsourcing and migrate more of their card and payments businesses to outsourced platform and service providers. We provide further conclusions and recommendations at the end of this report.

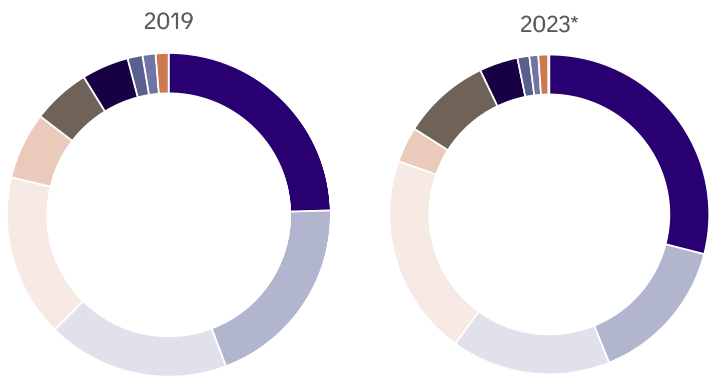
Introduction

SaaS – outsourcing and bank digitalisation

The European banking landscape has transformed in the last 15 years. The switch from branch to digital banking is the most obvious sign of this transformation: according to Eurostat[1], almost two-thirds of Europeans now use digital banking, compared to less than one in four fifteen years ago. With specific regard to payments, cash use has continued to decline, and is being replaced not just by cards, but by a diverse range of payment options including digital wallets, account-to-account payments and more recent options such as crypto and "request to pay" technologies.

Data from Worldpay demonstrates this diversity in action. Worldpay's Global Payments Report 2021[2] predicts the use of digital wallets will rise to almost one in three transactions by the end of 2023, with card payments experiencing a corresponding decrease in usage. Meanwhile, PCM's Digital and Card Payment Yearbooks 2021-2022[3] show cash is now used in just one in five transactions in the UK and Netherlands, with cash use below five percent in Norway and Sweden.

Digital wallets predicted to account for 1 in 3 online transactions by 2023"



	2019	2023*
Digital/Mobile Wallet	24.6%	29.0%
Credit Card	19.7%	14.9%
Debit Card	18.2%	16.1%
Bank Transfer	16.3%	20.4%
Charge & Deferred Debit Card	6.7%	3.6%
Buy Now Pay Later	5.8%	8.9%
Cash on Delivery	4.7%	3.9%
Other	1.5%	1.2%
Pre-Paid Card	1.3%	0.9%
PrePay	1.3%	1.0%
PostPay	0.0%	0.1%

CREDIT = Worldpay

While grappling with this transformation in the way consumers pay and get paid, banks are also having to contend with a sharp rise in competition, whether from non-bank financial institutions (NBFIs), big tech players or licensed digital-first banks, the so-called "neobanks" which have attracted so much media attention in recent years. To take just one of these competitors, the global market for digital-only banks is predicted[4] to grow at just under 50% each year through to 2028, reaching a value of more than $700 billion at the end of this period. Across Europe, the second payment services directive (PSD2) has, since 2018, ushered in yet more competition, with players from telecoms, utilities and other sectors now able to offer their customers banking services subject to licensing and approvals.

[1] See Eurostat, August 2021, "Digital Society Statistics Explained – internet activities": https://ec.europa.eu/eurostat/statistics-explained/

[2] See Payments Cards and Mobile, "EMEA Payments Trends": https://www.paymentscardsandmobile.com/global-payments-report-emea-payment-trends/

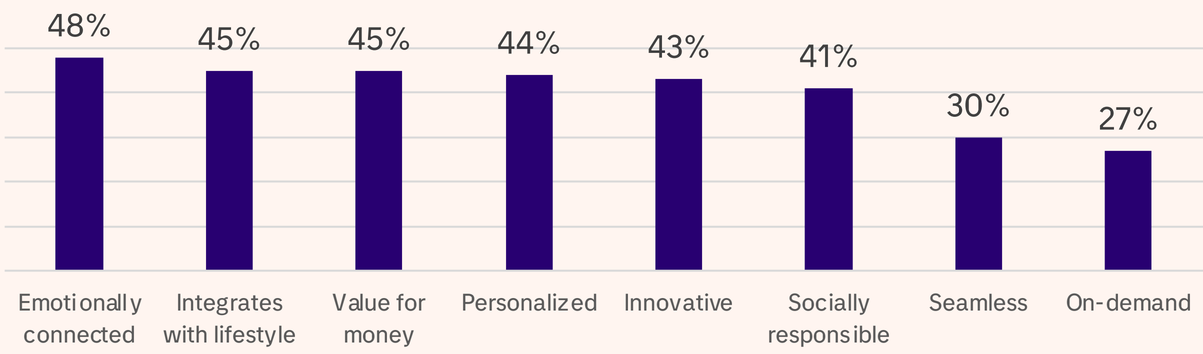
[3] See The Digital and Card Payments Yearbooks 2021-2022 at www.paymentyearbooks.com

[4] See Grandview Research, February 2022: "The Neobanking Market 2022-2030" https://www.grandviewresearch.com/industry-analysis/neobanking-market

Outsourced SaaS: the answer to customers' great expectations

The combination of increased competition, a wider range of payment methods and greater regulatory flexibility has led to a huge increase in customer expectations of great service and innovative products. A 2021 survey from CapGemini details the gap between what consumers expect and the services banks provide. Although almost half of consumers are looking for lower-cost products and services, fewer than one in four banks have a strategic focus in this area. Likewise, although just 12% of banks are looking to provide better customer support, around one-third of consumers are looking for improvements in customer service.

Customers expect more – can banks provide?



Sources: Capgemini Research Institute for Financial Services Analysis, 2022; Capgemini Voice of Customer survey N=8051.
Question to customers: Do you agree or disagree with the following statements about your primary bank? (customers rating 3 and below, where 1: customer strong disagreement; 5: strong agreement)
For example: 52% customers disagreed that "banking is fun."

CREDIT = CapGemini Consulting

When it comes to payments, outsourcing enables banks to improve efficiency and rationalise the way they provide card and other payments services by – for example – reducing the number of card platforms operated in their organisation, or modernising their systems. Outsourcing also helps banks to keep pace with fast-changing regulatory demands and focus on innovating for the benefit of their customers and partners.

Working in partnership with PCM, we have surveyed the views of senior bankers from across Europe with regards to outsourcing. This report examines executive views from more than 65 European banks on their plans to outsource card and digital payments services over the next five years via SaaS or other outsourcing models. Specific areas of interest covered by this study include business areas they intend to outsource, as well as their intended approach to outsourcing – such as the use of Software as a Service (SaaS) approaches, and the use of public and private cloud networks for data storage.

With this publication, we aim to generate debate about the future of card and payment outsourcing in European banking, and highlight relevant factors to consider when deploying payment systems in the cloud. We welcome any comments and questions, and look forward to discussing your institution's outsourcing strategies with you.

Valdis Janovs

Head of Instant, Retail Payments, and Cards at Tietoevry Banking

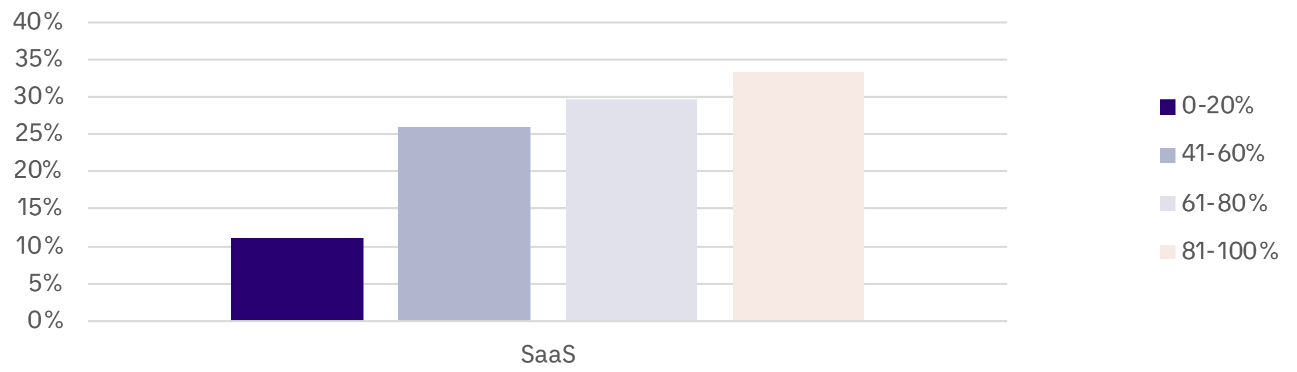
Toms Jansons

Senior Strategic Product Manager at Tietoevry Banking

Why outsource?

European banks' outsourcing plans

Most European banks plan to outsource some parts of the card value chain in next five years.



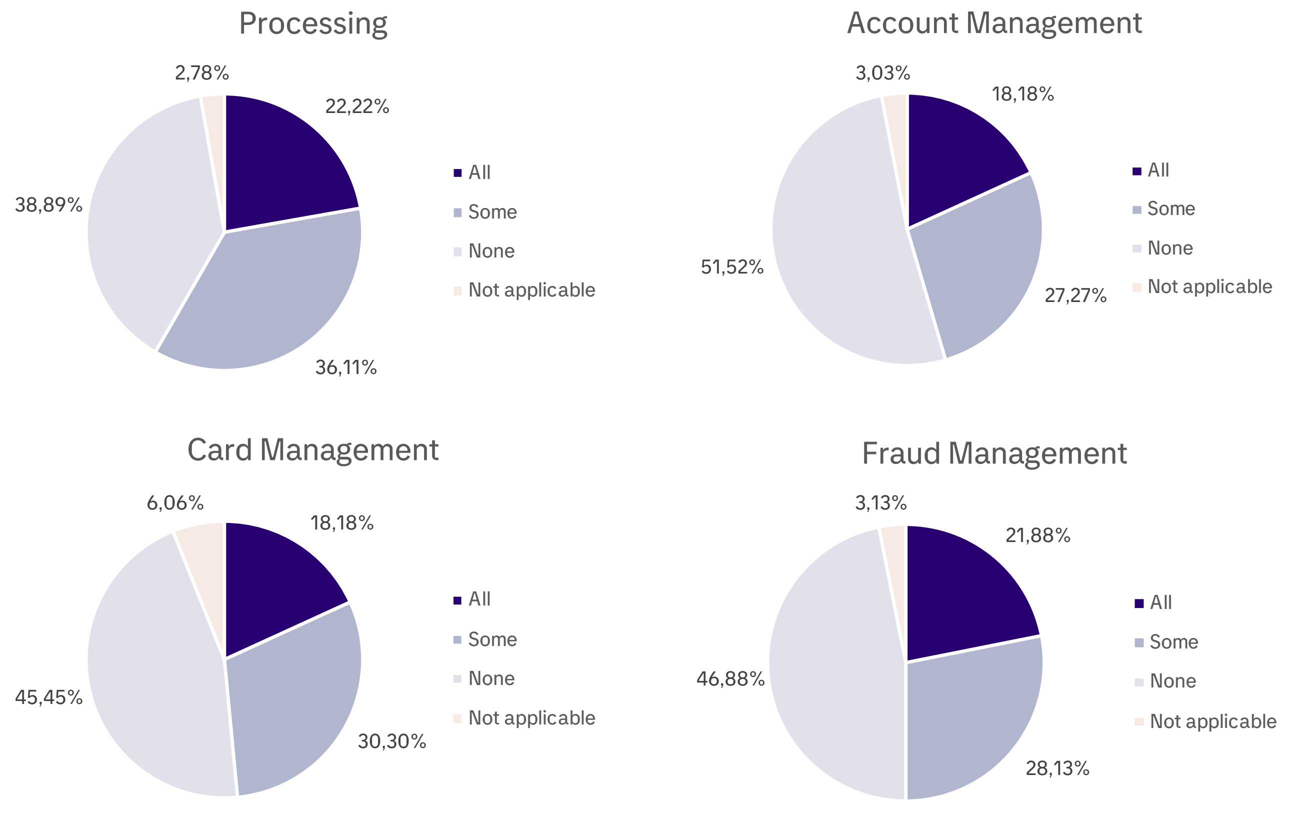
CREDIT = Tietoevry/PCM

Our survey shows that almost half of participants (48.8%) are looking to outsource at least part of their card operations in the next two years. Looking out over a three-to-five year time frame, a further 24.4% of respondents say they will be outsourcing some card operations, meaning that almost three-quarters (73.2%) of those answering say they intend to outsource, with a little over one in ten (11.1%) saying outsourcing is not a priority for their institution.

> “Almost three-quarters of European banks intend to outsource some card operations in the next five years.

Key target areas for outsourcing

The most popular areas for outsourcing.



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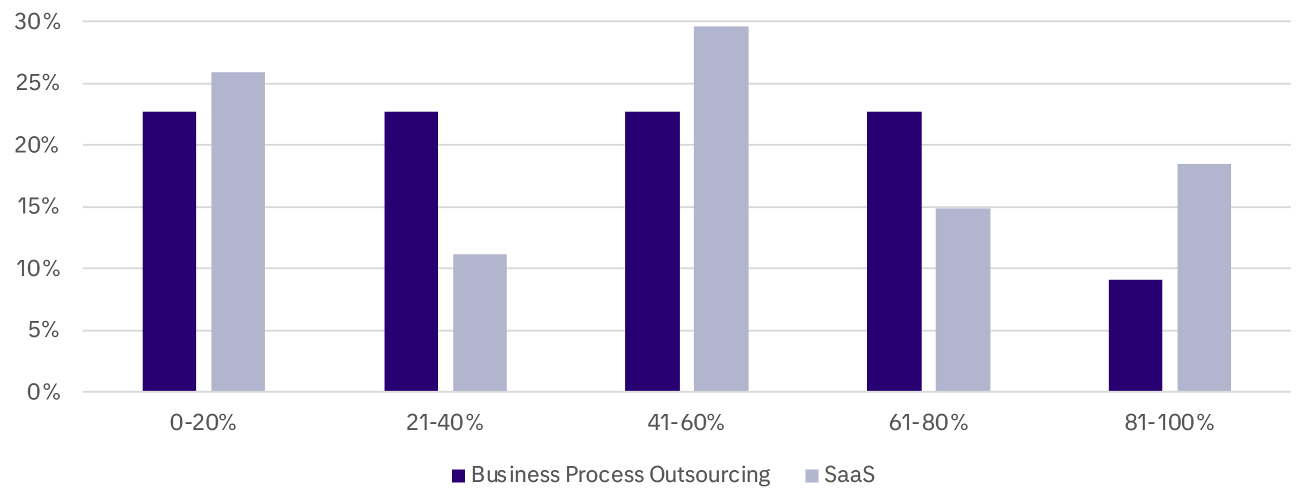
Transaction processing is the most popular area for outsourcing in our survey, with 60% of banks either outsourcing all (22.5%) or some (37.5%) of their processing requirements. Toms Jansons, Senior Strategic Product Manager at Tietoevry Banking, says this is to be expected: “Banks see processing as a commodity, and a function that's easy to outsource. What's more, banks can expect to see benefits relatively quickly if they can consolidate their processing under one outsourced provider.”

With just over half (51.4%) of banks choosing to outsource fraud management, this is the second most widely-outsourced card process. Slightly more banks (22.9%) choose to outsource all of their fraud management compared to processing or other functions, though fraud is also an area in which many banks choose to retain some degree of control. All of the other processes listed are more frequently partially outsourced than fraud management. Valdis Janovs, Head of Instant, Retail Payments and Cards at Tietoevry Banking, says: “Banks' decision to trust fraud management to outsourced partners is rational given the high number of players that specialise in this area. Especially for smaller banks, pooling fraud management requirements and outsourcing them can yield benefits in terms of cost and effectiveness. This is more likely driven by bank's internal competences and resources availability rather then software capabilities.”

Card Management (51.3%) and Account Management (48.6%) were also outsourced by many banks, though it's noteworthy that in these areas – especially in Account Management – banks were less willing to outsource all of their requirements. Account Management ranks lowest when it comes to functions that are fully outsourced, with just 18.9% of respondents saying they fully outsource their account management function compared to 21.6% of banks fully outsourcing card management and somewhat higher proportions for Processing (22.5%) and Fraud (22.9%). The lower proportion of banks willing to fully outsource these functions may be explained by the fact that they are seen as being more “branded”, or customer-facing, than processing or fraud management. Here we can see that the SaaS model is more likely to gain popularity compared to BPO as it provides more control for the bank over business processes while still enabling them to benefit from outsourcing their network requirements.

Outsourcing approaches: today and tomorrow

Marginally more banks favour SaaS as an outsourcing model today...



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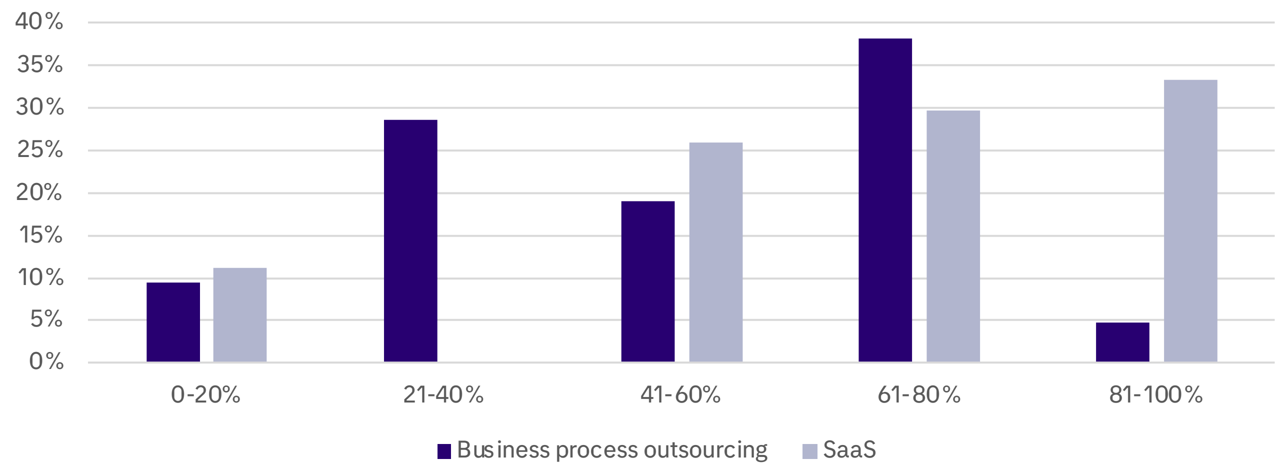
...but SaaS wins longer term for major projects.



CREDIT = Tietoevry/PCM

There are two main outsourcing routes banks can choose for their card functions. The first, Software-as-a-Service or SaaS, is a means of delivering services via licensed software which is accessed online following payment of a subscription, rather than software being purchased and installed on a bank's servers. The second main method, Business Process Outsourcing (BPO), involves the full delegation of a business function (such as fraud management) to an external provider that then managed that process based on measurable performance criteria defined through a Service Level Agreement, or SLA.

When asked about their preferred options for outsourcing over the course of the next year, respondents to our survey favoured the option of outsourcing via a Software-as-a-Service arrangement by a narrow margin (28.3% vs. 27.6%). The remaining 44.1% of respondents said that they had no plans for further outsourcing in the next twelve months.

> "Whether it's via SaaS or BPO, banks should seek a reliable and trustworthy partner for their outsourcing needs. – Valdis Janovs, Tietoevry Banking

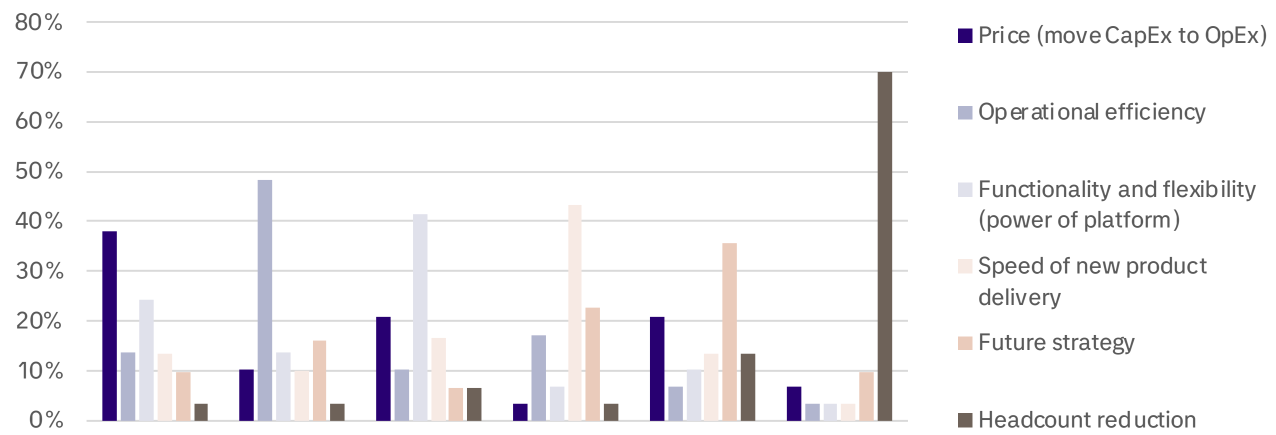
Valdis Janovs explains BPO can be a logical choice, especially for smaller banks – but that caution may be required in some cases: "In the near term, the slight preference for SaaS is understandable. Banks need experience to manage BPO arrangements effectively, including the creation of a proper model to define and govern Service Level Agreements (SLAs). Whether it's via SaaS or BPO, banks should seek a reliable and trustworthy partner for their outsourcing needs."

As our second graphic above shows, in the longer term banks are more likely to favour SaaS for their outsourcing needs – especially for projects that involve more of their card business. A clear majority of respondents favoured SaaS as an outsourcing tool for projects that involved more than 40% of a business function such as Account Management or Fraud Management. Tietoevry's Toms Jansons says: "Most institutions are looking to outsource via SaaS because this offers them more control over the outsourcing process and how functions are deployed. It's also easier for banks to control a vendor's platform via SaaS than if they completely outsource the function via BPO. While BPO can make sense for some smaller banks, most larger banks only want to outsource parts of their function – as this survey shows – so that they can retain control while managing operational costs."

While a smaller bank might be more driven by cost and efficiency, a larger bank will pick the best solution for each function. Typically, larger banks can manage business processes themselves and achieve differentiation from their competitors in this way. However, outsourcing via SaaS allows larger banks to outsource their technical functions and retain business processes as a differentiator.

Improving platform efficiency and performance

Re-platforming: Efficiency, Price and Flexibility Rule.



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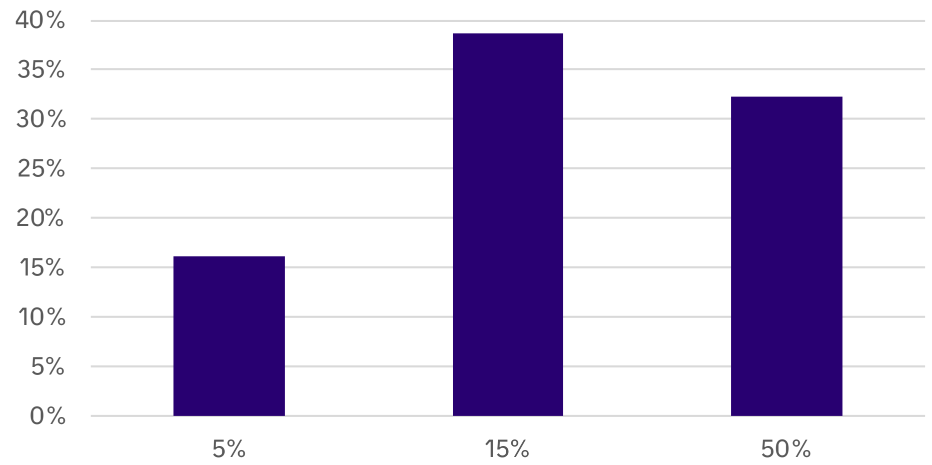
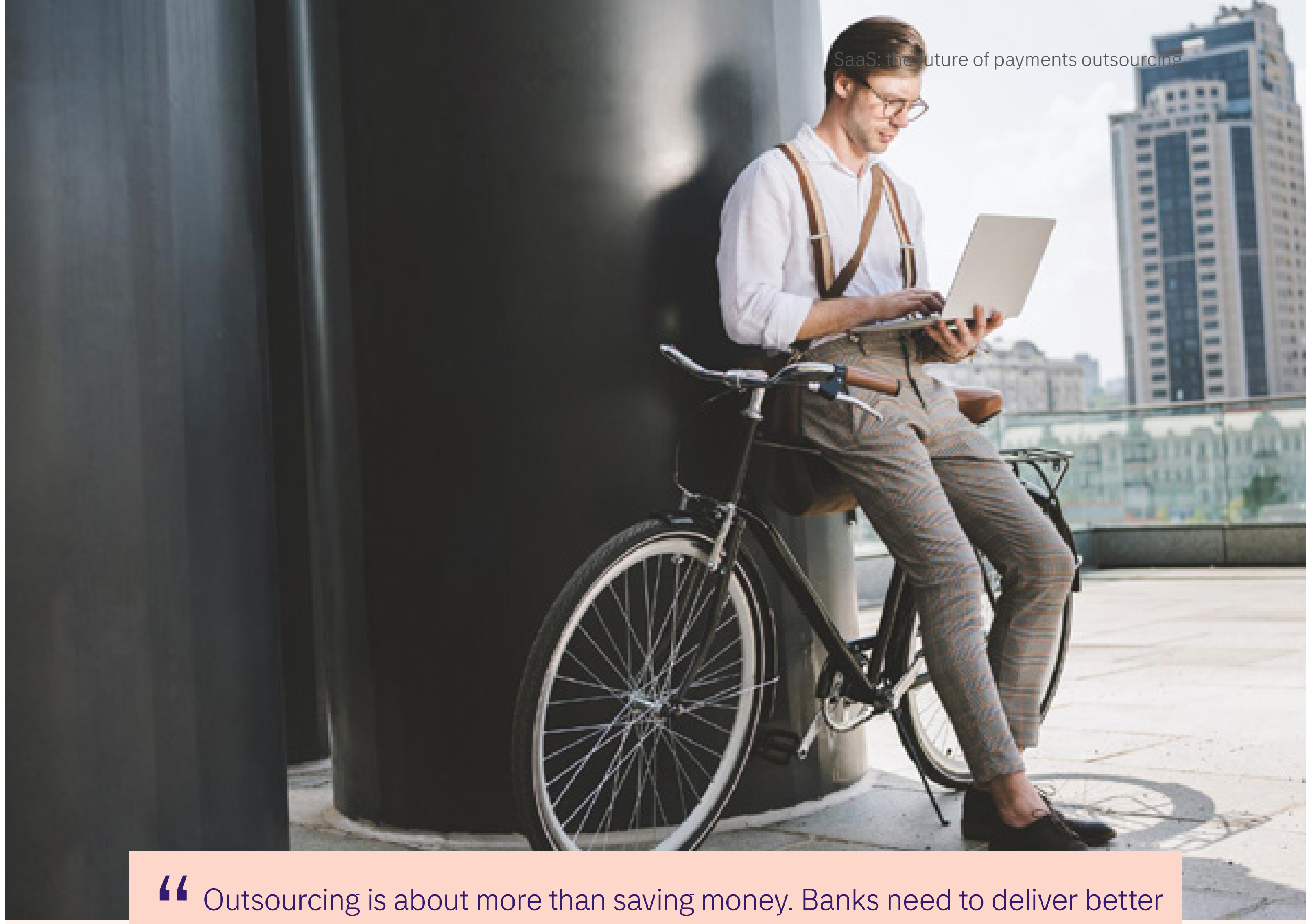
Banks have realistic views of shifting cost from CapEx to OpEx



More than one-third of banks expect to shift around 15% of cost from CapEx to OpEx

CREDIT = Tietoevry/PCM

Respondents ranked the need to deliver greater operational efficiency as the key driver for switching their card platform, followed by better platform functionality and flexibility and the capacity to reduce cost. For Toms Jansons, these requirements help to explain why SaaS is the preferred model for outsourcing: "Banks need to deliver better performance and higher margins while compliance costs are increasing year over year. It's not just about saving money. Outsourcing via SaaS offers a great blend of control with access to innovative services that enables banks to focus on the customer experience."



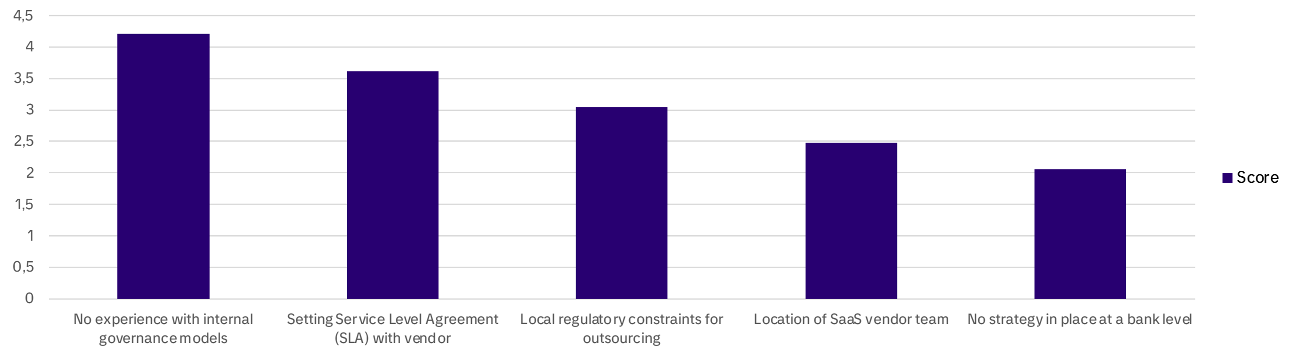
> "Outsourcing is about more than saving money. Banks need to deliver better performance and higher margins. – Toms Jansons, Tietoevry Banking

Many banks are seeking to shift the cost of card programmes from capital expenditure (longer term, fixed costs) to operational expenditures, which are more flexible and open to revision based on business volumes. Our survey reveals that most banks have a realistic view of what can be achieved, with 38.2% of banks hoping to achieve a shift of 15% between CapEx and OpEx through outsourcing. Valdis Janovs says, that banks are right to be conservative in their estimates: "Not all costs can be shifted from CapEx to OpEx, such as hardware costs. However, licensing costs and some employee expenses can be shifted, and in any case the bulk of costs in the card business are usually middleware and operations costs, rather than infrastructure. Banks should also bear in mind that some cost reductions may fluctuate. That said, the capacity to manage an SaaS arrangement with a team of ten compares favourably to managing a process in-house with 100 staff, especially given that SaaS deals allow for strong control of the outsourced function."

Bank concerns with outsourcing

Ready for risk?

Internal concerns dominate the bank mindset for SaaS.



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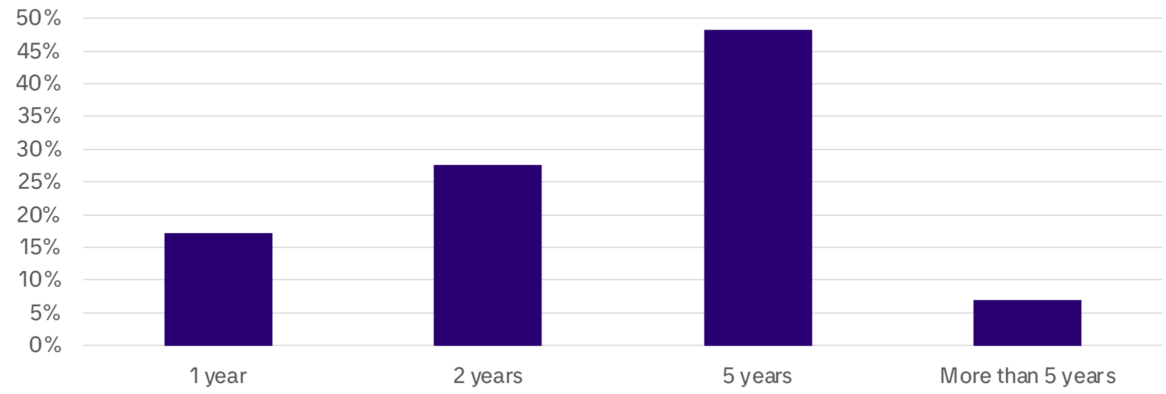
Banks think SaaS adaptation could take five years.



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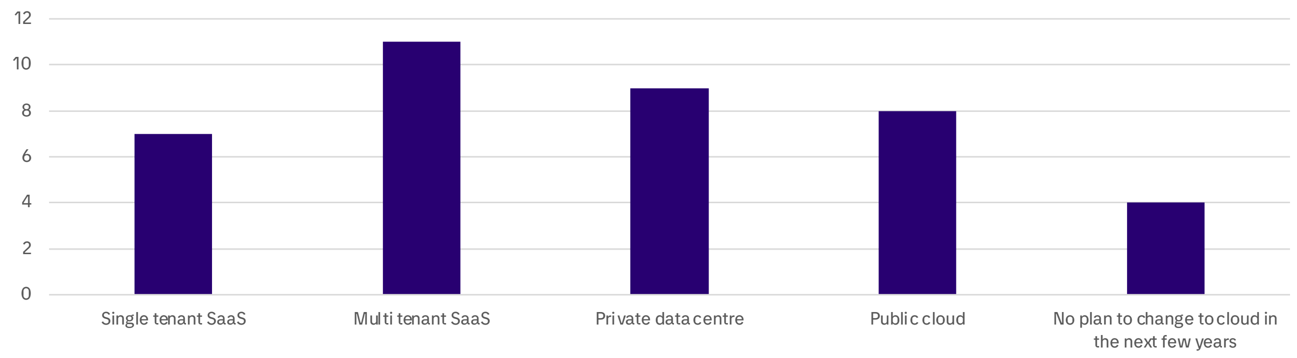
So far, banks have been conservative in their approaches to outsourcing – something that makes sense, given their desire to retain strategic control and relative lack of experience when it comes to managing outsourced services. Our survey reflects this approach, showing that banks rank concerns about their capacity to set and manage SLAs, as well as their limited internal experience of setting and managing governance models, as among their greatest challenges when outsourcing. These concerns are reflected in the fact that half of those responding to this question believe adapting their internal models for SaaS could take up to five years.

Banks also concerned about security, privacy and data residency when it comes to outsourcing, especially when outsourcing services to the public cloud. Finally, they are also concerned about their capacity to manage local regulatory restraints regarding the outsourcing of certain functions and processes. Tietoevry's Toms Jansons comments, "While these concerns are understandable, banks should see outsourcing as a staged learning process, rather than an either/or option. One successful strategy is to start with their biggest challenges, select reliable partner for SaaS or other outsourcing models, and learn from the process."

Outsourcing to the cloud

Public or private? A debate about clouds

Multi- and single-tenant SaaS preferred.



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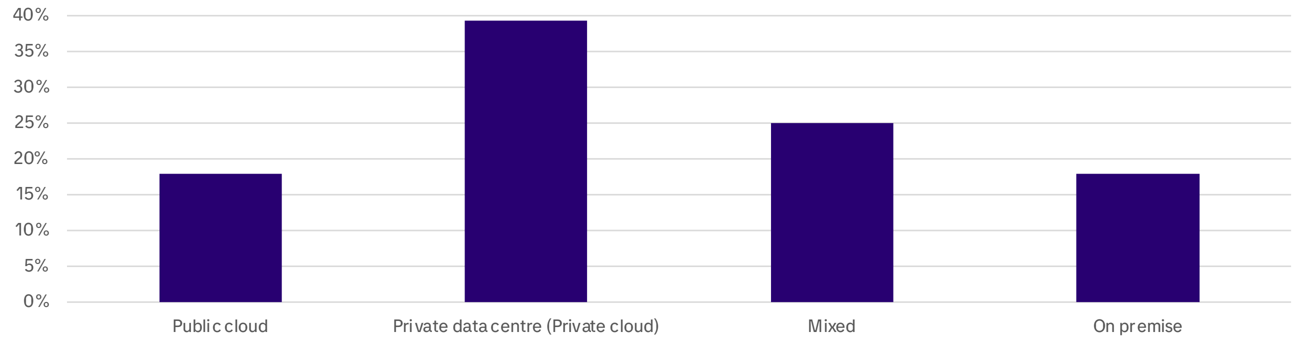
Private or public hosting? Where banks see their future in the cloud.



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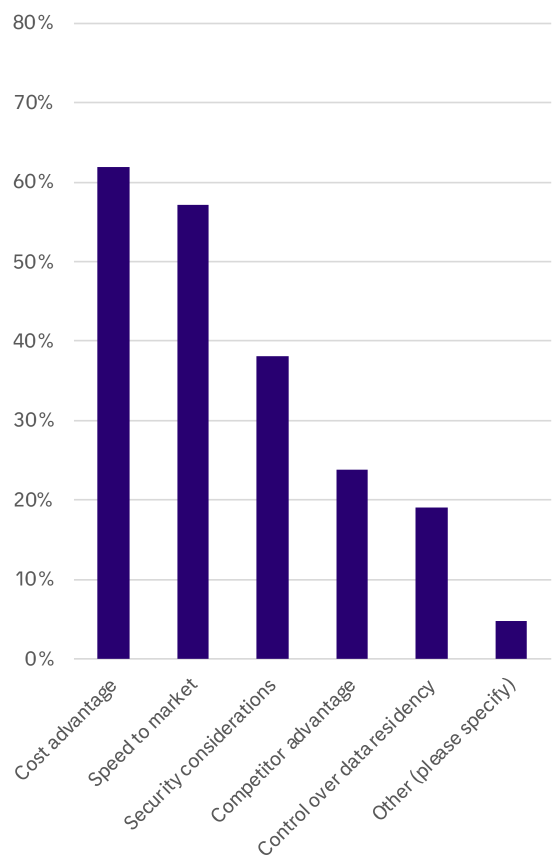
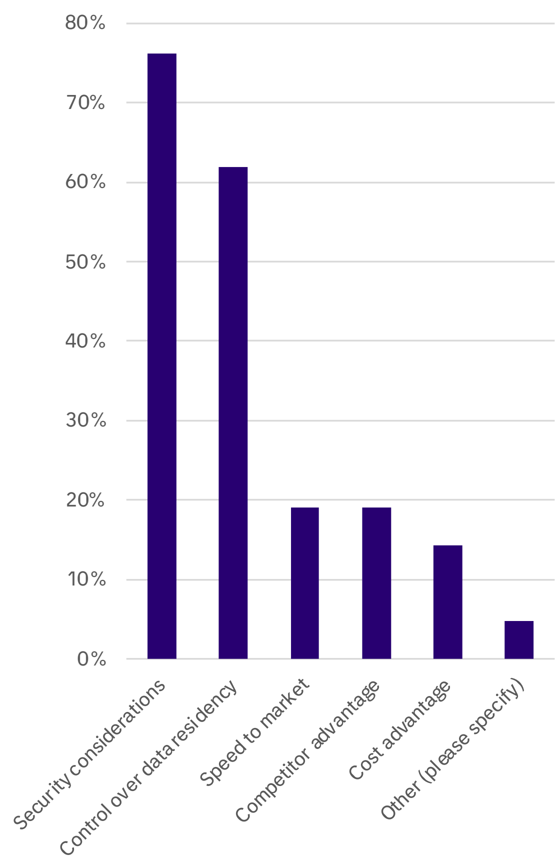
Having selected an outsourcing method, banks then need to make a choice of IT infrastructure to enable that outsourcing. When asked which kind of outsourced infrastructure they prefer, 38.7% of our respondents say they intend to opt for a multi-tenant solution to meet their SaaS outsourcing needs over the next year. Single-tenant solutions are the next most popular option at 29%. Meanwhile, public cloud hosting holds a very slight edge over private cloud arrangements.

Such choices reflect banks' need to be cautious in their approaches and manage risk. Likewise, almost 42% of those surveyed prefer the tailored, but more secure, option of private cloud hosting, with mixed hosting the next most popular choice. "There's no one-size-fits-all solution", says Valdis Janovs. "Clearly, clients are evaluating the different options and making choices based on the strategic needs of their business."

Top ranked benefits of public cloud



Top ranked benefits of private cloud



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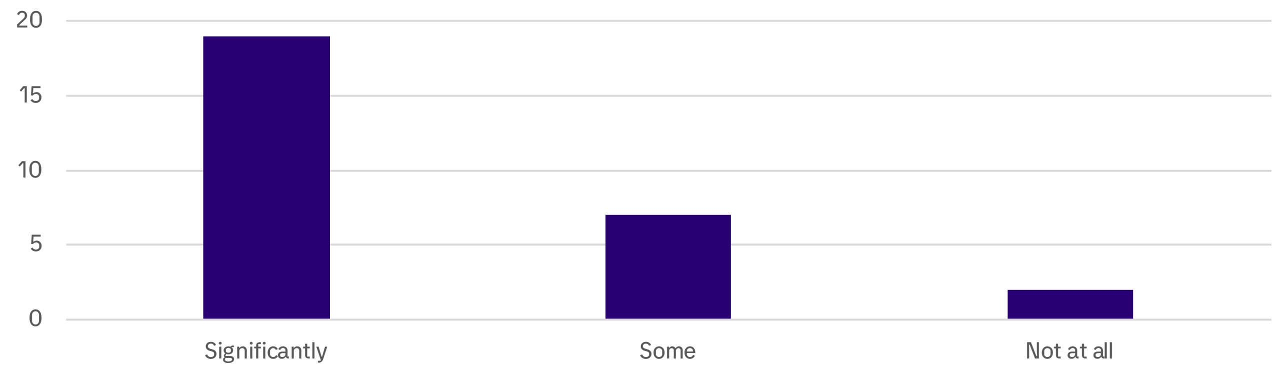
Data from our survey suggests that banks know and understand the benefits and potential pitfalls of public v. private cloud. Our respondents recognise that public cloud systems are more automatised and flexible for expansion, including features such as an on-demand data center which removes the need for planning data hosting requirements. At the same time, banks continue to have concerns over security (60%) and data control (70%) when it comes to public cloud arrangements, especially taking into account PCI DSS requirements for card infrastructure and operations. Amplifying these concerns, banks also worry about the impact of future regulation, with two-thirds of banks saying that regulation had a "significant" impact on their outsourcing plans, and a further 23.3% saying regulation had somewhat affected their outsourcing strategy.

Regulatory concerns are affecting bank outsourcing approaches.



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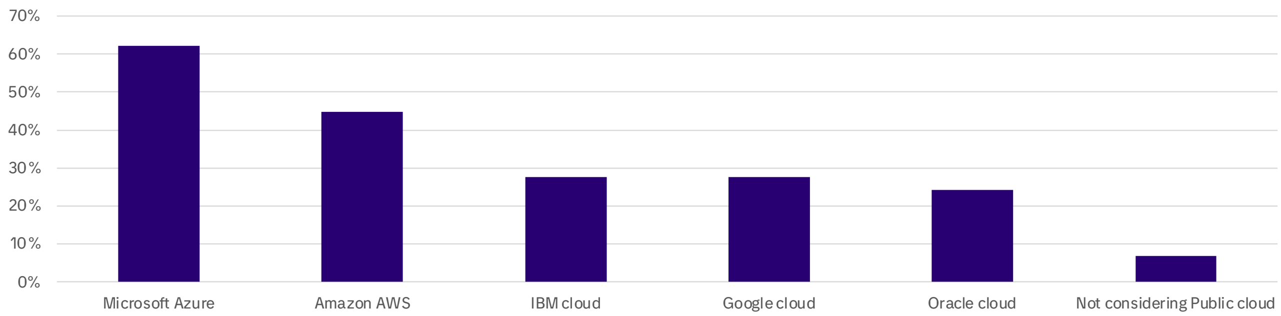
Commenting on these findings, Tietoevry's Valdis Janovs notes that, "while banks should be applauded for recognising the risks, it may be that there's still some gaps in their appreciation of how to get the best out of public and private cloud hosting. For instance, banks could allay their security concerns by moving to a private-label, single-tenant SaaS cloud in the first instance, followed by a faster and less expensive public cloud arrangement subsequently. Approaches like these are great for delivering results while managing risk."

> "Banks should be aware of the higher cost of private cloud arrangements, and their comparatively lower flexibility. We can expect to see private and public cloud networks co-existing for the next decade at least.

Respondents see private cloud hosting as more complicated to set up than public clouds, and more expensive. Toms Jansons explains: "Private clouds are more specific, personalized solutions and can be a great choice in certain circumstances. However, banks should be aware of the higher cost of private cloud arrangements, and their comparatively lower flexibility. We can expect to see private and public cloud networks co-existing for the next decade at least."

Top clouds with clout

Top Cloud Providers



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Overwhelmingly, those engaging in our survey said they would select either Microsoft Azure (58%) or Amazon AWS (49.4%) as their public cloud provider, with IBM, Google and Oracle as other favoured options. To some extent, this is because the cloud is still seen as a general-purpose platform. "There's a degree of uncertainty about how to deploy payment systems in the cloud", says Valdis Janovs. "Cloud environments can actually be more secure than hosting on premises. As we move through the next five years, things will get easier with banks gaining more understanding of how cloud hosting works and which parts of their business they want to host on the cloud."

Part of the challenge for banks when moving to cloud hosting is that there are a number of workloads or processes which are specific to financial services and payments. While Azure and Amazon AWS are the absolute leaders, there are other options for financial services cloud solutions such as IBM and others. "Banks can see the benefits in terms of speed and flexibility of hosting on public cloud networks", says Valdis Janovs. "Over the next few years, we'll see hosting in cloud environments gather pace as banks become more comfortable with the concept. To be successful, however, they will need to work with knowledgeable partners whom they trust."

Conclusions and recommendations

Conclusions

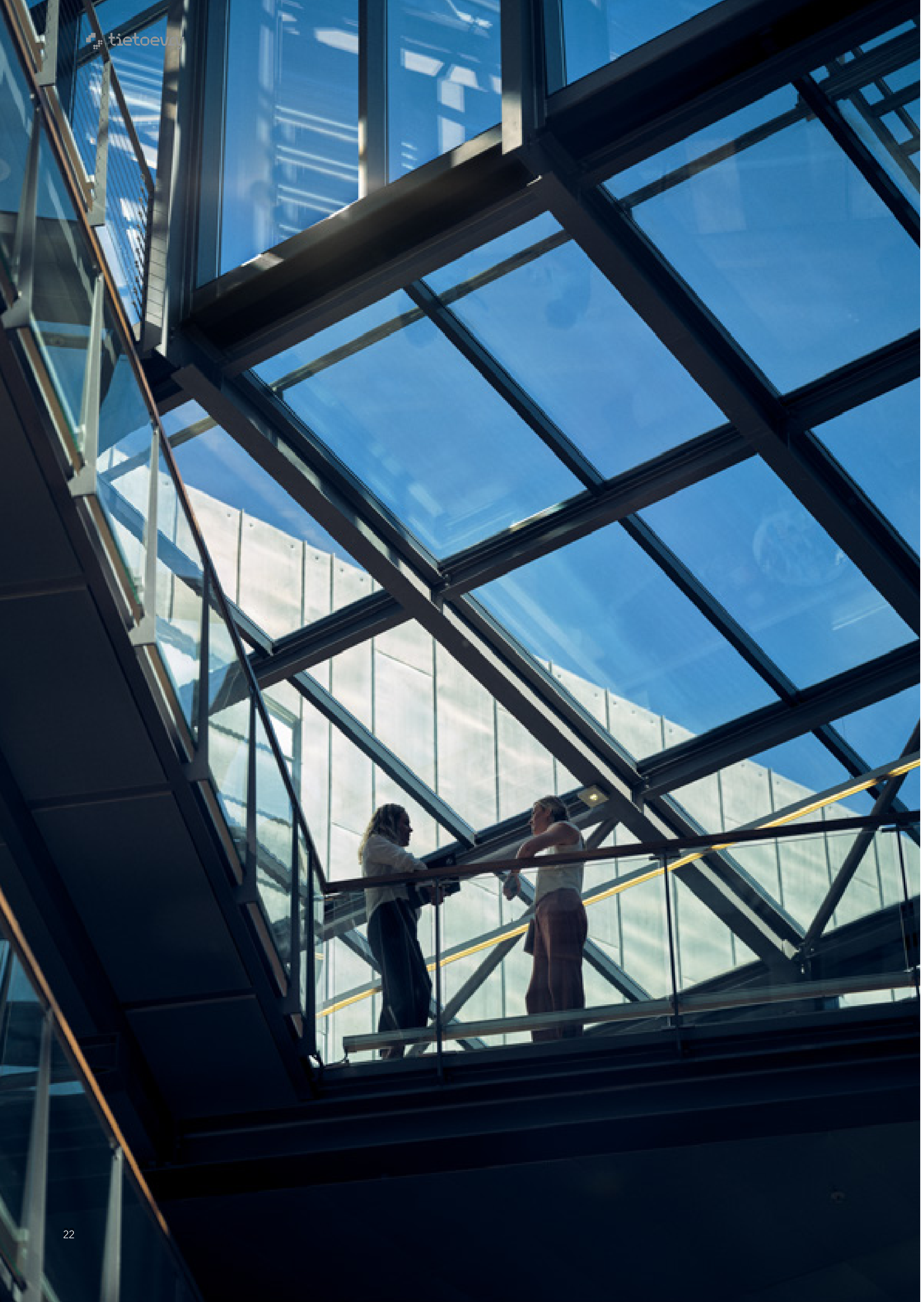
Outsourcing is going to become increasingly important to banks of all sizes as they hunt for higher margins and improved customer services to fend off competition from fintechs, big tech and digital start-up banks.

As our survey shows, almost three-quarters of banks are seeking to outsource some part of their payments business in the next 3-5 years, including processing, fraud management, account management and card management.

> “Banks’ growing preference for SaaS outsourcing reflects the combination of flexibility, control and cost reduction that it offers

The need to deliver greater operational efficiency is driving the move to further outsourcing, alongside the opportunity to reduce costs and improve platform functionality and flexibility.

While there is a slight preference for SaaS outsourcing at present, banks intend to ramp up their use of SaaS as an outsourcing approach over the next five years. This growing preference for SaaS outsourcing reflects the combination of flexibility, control and cost reduction that it offers.



Recommendations

> “Banks should be working with partners that have deep experience of adapting to the specific requirements of their internal systems and processes, as well as a range of outsourced requirements.
> Their partner should also offer a wide range of flexible solutions.

While we expect public and private cloud models to exist alongside each other for the next 5-10 years, ultimately we believe public cloud systems will prevail for their flexibility and power. Banks should prepare for this future, and work with third-party outsourcing vendors that have a good knowledge of interfacing with public cloud systems to serve banks' needs.

Given the growing importance of outsourcing to success and banks' relative inexperience as expressed in this survey when it comes to reshaping their internal processes and managing service level agreements (SLAs), banks should be working with trusted, knowledgeable partners on their outsourcing needs.

Concretely, this means working with partners that have deep experience of how to interface with existing bank systems and processes; a partner with experience of both private and public cloud systems, and, above all, a partner with the flexibility to adapt to the specific requirements of any size of bank.

About this survey:

In May and June 2022, Payments Cards and Mobile (www.paymentscardsandmobile.com) surveyed more than 65 senior leaders from European banks, over half of whom hold C-suite positions or have primary responsibility for payments in their institution. The banks in this survey came from all tiers of capitalisation, with concentrations in the large international (more than €30 billion capitalisation) and smaller national (less than €1 billion capitalisation) segments. 43% of respondents came from the UK or Western Europe, 25% from the Nordics and Central and Eastern Europe, with the balance coming from the EEA and other territories. Almost three-quarters of respondents (72%) came from banks whose primary interest lies in issuing payment products.

About Tietoevry Banking:

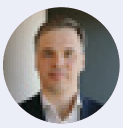
Tietoevry creates purposeful technology that reinvents the world for good. We are a leading technology company with a strong Nordic heritage and global capabilities. Based on our core values of openness, trust and diversity, we work with our customers to develop digital futures where businesses, societies, and humanity thrive.

Our 24 000 experts globally specialize in cloud, data, and software, serving thousands of enterprise and public-sector customers in more than 90 countries. Tietoevry's annual turnover is approximately EUR 3 billion and the company's shares are listed on the NASDAQ exchange in Helsinki and Stockholm, as well as the Oslo Børs.
www.tietoevry.com

About Payments Cards and Mobile (PCM):

Payments Cards & Mobile cuts through the noise to create stories that make headlines. We deliver valuable research and practical debate on the industry topics that matter most. PCM's high calibre writers and researchers have years of hands-on experience across the payments, banking, FinTech and retail industries. This skilled team provides the perfect combination of expert journalism and industry analysis, getting to the heart of issues that will shape the future of payments. Leveraging 15 years of data across 43 markets, our resources, expertise and approach make us the go-to market intelligence hub for senior payments professionals across the global payments ecosystem.
www.paymentscardsandmobile.com

For further information, please contact



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