Toward Customer-centric Payments Operating Models

Growing competition and cost pressure are forcing Dutch banks to reconsider the traditional payments business model.

Executive Summary

In the past few years, payments has emerged as an area of strategic importance for corporate and commercial banking institutions. Payments and fee-based transaction products have recorded continuous growth and have proven to be stable sources of revenue even during periods of volatility and low interest rates.

However, the past few years have also witnessed a number of challenges impacting banks' payments business. Regulations such as SEPA, PSD and FATCA have led to increased competition and greater cost pressure. At the same time, the demand for innovative and value-added payment services has led to the emergence of a number of non-bank third-party players such as peer-to-peer (P2P) payments providers, e-wallets, etc. that are disrupting the payments business and eating into banks' revenues. Therefore, banks' traditional operating model for the payments business is ripe for an overhaul.

To understand how Dutch banks have been weathering these challenges, we conducted a series of interviews with senior business and IT subject matter experts from the top four banks (in terms of market share) in the Netherlands. We present our findings in this paper. Our survey indicated that Dutch banks today see a need to optimize and realign elements of their payments operating models. We believe banks must adopt a customer-centric approach in such an endeavor. This approach will enable banks to deliver a superior client experience at optimized costs.

Challenges in the Payments Business

Our interviews highlighted some key challenges for banks today:

Regulations

Around 86% of the Dutch banking executives we spoke to indicated that dealing with regulatory requirements was the biggest challenge affecting payments processing (see Figure 1).

Regulatory Pressure

Banks' rating of regulatory pressure as a challenge on a scale of 1 to 5 (5 being the most challenging)

Figure 1
More than 80% of respondents believed that the introduction of SEPA in Europe required an overhaul of existing technology landscapes and business processes, thereby affecting their operating model. SEPA made it mandatory for all the banks in the region to migrate to a SEPA-compliant framework, ensuring uniformity in payments offerings and increasing straight-through processing (STP) capabilities.

**Emerging Players and Technology**
The payments business is witnessing increasing competition from new entrants, some of which are non-bank players specializing in niche value-added services in the payments processing chain. They are challenging the status quo for Dutch commercial and corporate banks.

**A Rethink of the Payments Operating Model**
In the face of changing customer needs, evolving regulations, the changing face of technology and the emerging threat from non-bank players, banks are beginning to consider whether their current payment operating models are sustainable and future-proof.

Most of the respondents believed that their current payments operating models are quickly becoming outdated, expensive to maintain and in need of improvement.

In this section, we examine how Dutch banks have been assessing their payments operating models in light of the recent trends. We focus on three key elements of a bank’s operating model:

- **Sourcing**
- **Technology**
- **Processes**

**Sourcing**
Increasing competition and cost pressures are forcing Dutch banks to rethink their payments sourcing strategy. Banks have been under pressure to lower costs, focus on their core business competencies and address the lack of qualified resources in payments processing.

The respondents are apprehensive about outsourcing all aspects of the payments process. While an overwhelming 72% of respondents advocate managing payments in-house, 80% of them believe that payments should be overhauled and that costs need to be rationalized in the current operating model. Loss of control has been cited as a reason for not wanting to outsource payment processes.

Around 86% of Dutch financial institutions either already outsource or are open to the idea of outsourcing noncore payment processing activities (see Figure 2). Noncore payment processing activities include payments reconciliations, format standardizations, payment validations and payments investigations.
Only 14% of the respondents advocate keeping noncore payment process activities in-house and would like to continue building internal capabilities around payments.

Dutch banks have little appetite for handing over complete control of their payment processing services to third-party vendors. When asked to rank the various sourcing models on a scale of 1 to 5 (1 being the highest), 43% of the respondents ranked “Shared Service Model” and “Selective Outsourcing” as the most preferred future sourcing strategies. None of the respondents ranked “Managed Service Model” as their first preference (see Figure 2).

When asked about diversified vendor sourcing strategy, almost 96% of the banks interviewed vouched for a multi-vendor diversified model. Approximately 43% respondents believed that adopting a multi-vendor strategy led to lower risks. Another 43% were of the opinion that having multiple vendors gave their banks access to the latest market insights and the latest technology since every vendor had something new to offer (see Figure 4).

Approximately 17% of respondents felt that a diversified sourcing strategy led to cost inefficiencies since it was very difficult to manage multiple vendors. Also, 14% of the respondents believed that having too many vendors led to a complicated technological landscape that is cumbersome to manage.
Technology
Technology continues to be a key focus area for Dutch banks. More than 90% of the banks we spoke to are hobbled by aging IT applications in payments processing. Of the respondents, 43% believed that the technological challenges of inflexibility, non-adaptability and non-scalability were the biggest hurdles to achieving stability in payments processing and greater client satisfaction.

Benefits of IT Modernization Programs for Payments

Around 80% of the banks interviewed indicated they have been exploring programs to modernize and rationalize their payment IT applications. The timing is appropriate given that many Dutch banks are under regulatory pressure to increase straight-through processing capabilities, standardize payment offerings and achieve scalability in payments processing. Approximately 15% of respondents stated that regulatory pressures forced them to procure ad hoc off-the-shelf payments processing platforms.
Around 57% of respondents believed that 30-40% cost reduction could be achieved through overhauling and modernizing their payment processing IT landscapes. While 29% of respondents thought that the most pressing need is to prioritize such modernization programs and implement them quickly, around 43% of respondents believed that such programs, if effectively implemented, lead to long-term business benefits and competitive differentiation.

When asked about the main barriers to modernization, 71% of respondents noted that such programs led to lower returns given the initial investments. While 14% of executives felt that the increased time-to-market to implement such programs was a major barrier to adoption, another 14% felt the lack of knowledgeable people on board often led to delays and in some cases the failure of such programs.

Processes

When asked about current operational challenges in payments processing, more than 43% of respondents cited fragmented technological landscapes and long governance change windows. Such challenges often had to be tackled with more manual (non-straight-through) payments processing activities, leading to inefficiencies. Approximately 30% of respondents believed the lack of visibility in the payments value chain often leads to operational challenges in day-to-day business activities. Most respondents admitted to not having invested much in developing internal capabilities and solutions to track payments and related traffic information. Interestingly, most of the respondents believe they are sufficiently staffed in terms of knowledge around payments (especially international, cross-border payments), while 14% think that having a decentralized operational model to perform payments processing activities (with distributed knowledge centers) does not lead to any inefficiencies.

On STP, 43% of the respondents cited enhanced processing capabilities of current operating models as the biggest contributor to higher STP rates. Client awareness was regarded by 29% of respondents as a contributing factor, as clients are now better informed on how to initiate error-free payments.

On the tools needed by operations and internal customer service teams to improve customer experience, 57% of respondents felt the need for an internal dashboard providing real-time visibility into the lifecycle of a payment, which would help solve customer queries faster.

A Customer-centric Payments Operating Model

To offer a consistent customer experience across all payment offerings and channels, we believe Dutch banks must reassess their priorities and restructure their operating models. One way banks could achieve this is by taking a more customer-centric approach. Customer-centricity involves understanding customer needs holisti-
cally and matching them with market offerings while consistently providing a superior customer experience. This is in contrast to the siloed, product-based approach traditionally followed by most banks. In our view, customer-centricity will be the main driver for differentiation in the banking industry, and banks must apply this thinking to their payments businesses as well.

We believe there are five key enablers that banks must consider (see Figure 7), which we will examine in the following sections.

Sourcing Models
As we have seen above, most Dutch banks recognize the advantages of pursuing a selective outsourcing strategy for payments. In order to future-proof themselves against the rapid commoditization of payments, however, banks should explore a shared services sourcing model in the short term and transition to a complete managed service model in the longer term.

Payments are increasingly becoming a utility offering and global banks are beginning to consider completely outsourcing payments processing to a third-party solution provider while maintaining a solid governance model to drive customer-centricity. Such sourcing models will help banks cut costs and focus on core business priorities.

Right Governance Models
Good governance instills confidence in the market about a financial institution. It is central to a sound and efficient payments system.

Banks must look at governance from three perspectives:

- Achieving a coherent governance model for “business-as-usual” day-to-day activities in payments processing.
- Ensuring the right governance models for management control and oversight for key investments decisions and higher-level decision-making.
- Choosing the right governance model to ensure management control and accountability for the various bank payment sourcing models.

An effective governance model will establish ownership for decision-making.

Payment Hubs and Platforms
Our analysis indicates that most Dutch banks have siloed systems and operations for their payments processes, which results in a lack of end-to-end visibility in the payments processing value chain. This can be resolved by deploying a payments hub solution. Payments hubs provide a centralized platform and can process any type of payment irrespective of the payment mechanism.
The benefits include improved efficiency and capacity, reduced risks, improved time-to-market and stronger cross-channel collaboration. It also leads to cost efficiencies for the bank. Banks can use the integrated solution to deploy a common set of utilities underpinning a range of payments applications.

**Process Optimization**

Banks should streamline processes such that customer-centricity is at the core. Innovative approaches such as business process management (BPM) can streamline and automate processes through the use of workflow management tools and integration software packages.

Tools such as internal dashboards also enable process streamlining. By allowing access to payments performance information, banks will be able to quickly identify performance issues and problem areas.

**Talent Management**

Payment processing services are becoming commoditized and the quality of the service provided is gradually becoming the only differentiator. Managing talent is therefore an important driver. Establishing knowledge centers of excellence (COEs) can provide banks with an opportunity to nurture and retain talent. Such COEs provide employees with learning opportunities in the form of training, certification and skill assessment. Banks must also strengthen and develop their talent management practices to prevent attrition of top talent.

**Looking Ahead**

Although there are several challenges that banks face in their payments and transaction business lines, our research indicates that Dutch banks will continue to consider payments a strategic business area in the medium term. Our research also highlights the fact that most Dutch banks realize the need to prioritize transformations and changes to their payments operating models.

It is our view that such a transformation journey is best started by adopting a customer-centric approach. Given the growing focus on client-centricity and superior customer experience, a clearly defined payments sourcing strategy, future-proof payments platforms, robust governance models and proactive efforts to manage and retain talent will be key success imperatives for a bank to differentiate and gain competitive advantage.

**References**

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