How disposable technology will re-define the payments value chain?

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tribe the payments people

Executive Summary

While legacy players are slowly closing the gap on fintech innovators, their technology remains complex, often with services connected by a single body of code within one platform. This can result in recurring problems such as small updates causing service disruption and an inability to integrate the services of alternative providers that could offer improved functionality or efficiencies.

Technology cycles have accelerated rapidly in recent years and a new trend in servicing customers has emerged. For fintechs, this global trend could unlock a new source of innovation and competitive advantage over legacy players while re-defining the entire payments value chain.

Modular technology has special value to fintech as the industry seeks fresh opportunities to extend its legacy of innovation. Clients will be empowered to self-serve and choose supporting fintech services like apps that will be disposed of if they do not perform to the clients' expectations. Fintechs can expand their service offering to include new types of services under one roof, finally creating a real plug-and-play model for fintech innovation that has already gained huge traction in the consumer space.

While there will be a period where relationships and engagement models between fintechs evolve, it will increase choice, ensuring a better fit with the needs of the client and the nuances of their programmes. Modular technology is an opportunity to re-boot fintech innovation, driving down costs, encourage greater financial inclusion and speed to market for payment innovation.

Introduction

Legacy players in the financial services space are slowly closing the gap on fintech innovators. Digital transformation programmes are well underway. Consumers are beginning to see fintech innovations from two years ago finally going mainstream with legacy players.

But technology cycles have accelerated rapidly in recent years and a new approach to servicing customers has emerged. Evidence of this shift is all around us, spanning consumer and B2B markets. For fintechs, this global trend could unlock a new source of innovation and competitive advantage over legacy players while re-defining the entire payments value chain.

A brief history of fintech innovation

Over the past five years, fintech has become a case study for what technology and imagination can create in a changing regulatory environment.

Fintechs quickly targeted financial services where consumers were under-served and over-charged. Travel money and lending were early targets. As new core value propositions became established by challengers, the focus of innovation shifted to user experience. Vibrant new graphic designs, intuitive controls and process simplification are just a few ways fintechs and their apps have changed the way technology is delivered.

Legacy players began to catch up

However, in recent years, the incremental improvements in user experience delivered by fintechs have become less striking. Legacy players are slowly beginning to catch up, finally delivering services such as the ability to freeze cards nearly two years after their introduction by fintechs. Though digital transformation is a painfully slow process for legacy players, its progress will be relentless thanks to their scale, market share and deep pockets.

Fintechs must acknowledge that their window of opportunity for meaningful innovation may be closing. This coupled with the fact that legacy financial services players have still not yet lost significant share of the UK market. Recent 2019 statistics quoted by Wired indicate that the big four legacy banks still have a 70% share of the entire current account market. This puts more pressure on fintechs to find significant new ways to innovate in order to sustain their existence. Failing to expose new opportunities for innovation is likely to prove that fintech was simply just a sticking plaster that would eventually fall away to expose new and more customer-centric faces of legacy players.

Current technology

Today, legacy players are using technology that is complex with a highly integrated back-end infrastructure.

This can mean that services are connected by a single body of code within one platform. This can result in a number of recurring problems such as:

- small platform updates can result in cardholders being subject to service disruption for specified periods of time
- inability to integrate the services of alternative providers in the payments value chain that could offer improved functionality or efficiencies
- difficulty in updating functionality quickly in response to market trends or opportunities due to the level of analysis and lead time that is required to schedule changes

The new opportunity

To remain relevant, fintechs must maintain an IT capability that creates meaningful competitive advantage and opportunity for innovation beyond what is possible for larger and less agile legacy players.

Over the past few years, technology cycles have begun to change faster than ever before. This acceleration is evident across all industries, but it presents a timely opportunity for new fintechs who are designing their platforms for the next generation of payment innovators.

The clues to how things are changing are already visible.

- Smartphone apps are essentially self-contained tools that perform specific tasks that deliver value to the end user in an interchangeable, modular way. Tools such as our mail, diary, TV and more are integrated into a single platform. Multiple developers create new, more powerful versions of these and a plethora of other tools from which we can choose the ones that best suit our business and personal preferences and dispose of those that become superseded.
- Consumers are increasingly confident in moving away from the financial services provided by their banks to a more mix and match, modular approach.
- The ubiquity of APIs which facilitate greater interoperability and design that enables technologies to integrate with other providers more readily
- The emergence of B2C and B2B digital marketplaces is proving the appeal of the agnostic, modular model where end-users assemble and configure services and products for optimal performance to meet their own requirements.

Modular delivery is re-defining the value chain

Challenger banks have taken the lead in embracing the trend towards the delivery of modular, interchangeable services by launching their own digital marketplaces.

Starling Bank is giving its retail and business customers access to competing and interchangeable modular services through its market place that all work within the bank's own platform. In February 2018, Starling inducted the first wave of financial service providers into its retail marketplace giving its consumers in-app access to a range of additional services from third-party insurers, pension providers, investment platforms and mortgage brokers.

Starling's chief platform officer said at the time, 'We are building a banking experience fit for the 21st Century, where the best financial products are available securely in one place.'

By the end of 2018, Starling had extended its marketplace approach to its 20,000 small businesses customers which includes products across loyalty and receipts, mortgages, savings, investments and insurance.

Monzo is also offering services of third-party financial services players to its customers. On April 24, 2019, the FT online published a report regarding Monzo's agreement with OakNorth. The FT stated that "this marketplace model is the only way challenger banks that aren't doing substantial amounts of their own lending, like regular banks (and like OakNorth) can in fact make money."

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Modular benefits

Modular technology offers a number of benefits across sectors. Some corporates are already using modular technology e.g. IBM and Google to enable them to do upgrades more easily.

Modular technology has special value to fintech as the industry seeks fresh opportunities to extend its legacy of innovation.

Modular technology means that payment innovators should be able to:

- Update code without impacting performance elsewhere and achieve greater platform resilience as code sits across discreet areas and APIs
- Access new functionality such as chatbots, automated submission of chargebacks, AI and machine learning as there are easier to deliver via modular architecture
- Achieve optimal user experience through multiple technology providers
- Consolidate suppliers into one contractual agreement to avoid paying multiple suppliers
- Each with monthly minimums
  flex and scale from start-up to mature corporate

The modular design also means that when functionality reaches the end of its life-cycle, it can be disposed of. Applying this principle across the entire service offering means that fintechs with platforms based on modular technology may effectively be able to break the cycle of obsolescence.

An article published by PwC technology principals Leon Cooper and Milan Vyas states, ‘The life cycle of information technology is becoming shorter every year. The technology systems of the past competed on functionality. They were designed to do one or two things very well, and the organization adapted to focus on those one or two activities. When the enterprise needed to change its focus, the structures and processes of the system held it back. Today’s more modular systems can be much more flexible.

They can rapidly accommodate a range of possibilities for connection and configuration. So seek out modular platforms that can accommodate a wide range of plug-and-play functions for your business — including those that haven’t been designed or even imagined yet.’

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> *Cooper & Vyas, PwC*

Implications for legacy players

While new fintechs and innovators stand to gain from the rise of modular technology, forward-thinking legacy players could also leverage it as part of their digital transformation strategy. Modular technology could be used by a legacy player as an overlay or patch for aging functionality.

Longer-term, legacy players are likely to have two possible courses of action. The most immediately disruptive and expensive would be to build a new platform in a modular structure. For an approach that is less disruptive in the short-term, a legacy player could opt for a multi-platform model to retain existing clients, but this is likely to cause long-term problems of inefficiency in maintenance, interoperability and security.

A new payments value chain emerges

Historically, the payments value chain has evolved with fintechs performing singular, discreet roles based on their specialist knowledge or capabilities. Issuers, issuer processors, acquirers, BIN sponsors, KYC services and many others have been assembled by players such as issuer processors on behalf of their clients to deliver payments innovation.

With modular technology, clients will be empowered to self-serve and choose the supporting fintech services like apps that will be disposed of if they do not perform to the clients' expectations. It will enable fintechs to expand their service offering to include new types of services under one roof, finally creating a real plug-and-play model for fintech innovation that has already gained huge traction in the consumer space.

The concept of 'preferred partner' is likely to become redundant. This is often short-hand to describe a good, trusted all-round partner with whom the fintech is already integrated. The preferred partner may however not provide the functionality that will optimise the performance of the new payment programme. The modular approach will reduce fintech's reliance on preferred partners and instead enable them to implement functionality that best suits the clients' needs by removing the friction of integration.

The move towards modular technology will be out of scope in the immediate future for legacy players due to the scale of the task, investment required and risk. However, modular technology could present some opportunities to support legacy players as short-term patches to support digital transformation projects particularly in the areas of mobile banking where legacy players tend to struggle most.

Modular benefits

The advancement of modular technology is undeniable with compelling evidence of its value proposition in serving the needs of consumers and it is now clearly emerging in B2B markets.

This trend should be causing concern amongst legacy players in financial services as it is likely be the single greatest threat to their resurgence; reopening the chasm between themselves and fintech. Forward-thinking legacy players could leverage modular technology as part of their ongoing digital transformation activities as a short-term functionality patch which could be especially valuable in areas such as mobile banking where they often face significant challenges.

In the near future, modular technology will offer greatest opportunity for fintech and payment innovators who want to compete in new ways with legacy players and create a new value chain where services and functionality are more accessible and tailored to the needs of innovators.

While there will be a period where relationships and engagement models between fintechs evolve, it will increase choice, ensuring a better fit with the needs of the client and the nuances of their programmes. Modular technology is an opportunity to re-boot fintech innovation for a new generation, driving down costs and increase speed to market for payment innovation.

"Introducing modular technology as part of a fintech offering should increase the viability of different business models and create new opportunities in important areas such as financial inclusion."

Syed Kamall MEP (London)

"Fintech can help lower barriers to entry and make it easier to bring innovative payment ideas to market. Hopefully, this can reduce our dependency on large financial institutions that have not always sought to serve all sections of society. Modular technology is emerging across many industries and could help to reduce costs and barriers to market entry still further. Introducing modular technology as part of a fintech offering should increase the viability of different business models and create new opportunities in important areas such as financial inclusion."

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