

White Paper

Optimising Payment Platforms For Profitability & Commercial Success

Enabling
customisation to
boost performance,
accommodate
change, and retain
competitive
advantage

Executive Summary

Obvious fiscal and operational pressures aside, the underlying challenge facing financial institutions (FIs) is serving today's mobile, socially oriented, security conscious and loyalty reluctant customers in a marketplace which is increasingly dynamic, regulated and unpredictable.

In addition, players from outside the traditional financial services space are disrupting existing business models and offering customers new and compelling ways to manage their money.

This paper examines the integral role that payments will play in this new landscape; discussing its pivotal function in building trust and loyalty to differentiate and gain a competitive advantage. It also explores how payment systems are uniquely placed to drive new revenue based services: and how their reengineering and customisation can unlock new profitability through improved efficiency, increased performance and optimisation of resources.

However, many financial institutions are currently trapped by legacy systems and 'islands' of in-house development. How can organisations, restricted by inherently siloed systems and proprietary software, take payments to this new level? How can FIs customise their platforms quickly, easily and cost-effectively to unlock the potential opportunities that new market dynamics offer?

In this paper, Compass Plus considers these challenges and looks at the delivery models available to forward thinking financial institutions - including in-house, proprietary and Open Payment Development Platforms - examining their merits as a means of successfully customising existing payment platforms.

The paper proposes that it is not simply a question of 'build or buy' but how best to harness both internal and external resources; making them agile and more flexible to ensure they can deliver the creative yet solid commercial environment that goes beyond customisation.

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Market Overview

As financial institutions recover from the late-2000s financial crisis, whose shock waves still reverberate throughout the economic world, they are being challenged on all fronts by an increasingly dynamic and unpredictable market.

Many factors are combining to create a highly pressurised and volatile landscape that makes the 21st century market dramatically different from anything that has come before. There are now many new complex and interconnected factors outside a financial organisation's control which significantly impact its day to day operations, commercial viability and competitive success. These include:

Recession & Fiscal Pressures

Reduced margins, loss of profit and shrinking revenue - across retail and wholesale banking, card issuing and acquiring, and merchant business - is driving the need to rationalise, improve performance and consolidate operations while creating new revenue streams and achieving better profitability.

Increased Security Requirements

Greater legislation and regulation from local and international bodies - SEPA, PCI, and card issuer mandates - combine to create an environment of constant change which requires FI's to make significant investment just to stay compliant.

Competition & Disruptive Forces

New players continue to carve up the market as peer-to-peer payment providers, mobile operators, retail institutions and global digital and social media companies all fight to get a slice of consumers' bricks and mortar and virtual payments.

Consumer Demands

From smart phones and touch screens to social media and digital content, technology is changing customer behaviour, perception and expectation. With loyalty harder to maintain, FIs are experiencing an increase in churn that can not be countered by 'security and trust' alone - it requires greater customer contact; demonstration of relevance to customers and their lifestyles; and value rich offerings to safeguard revenue and remain competitive.

Figures from a recent survey by Gartner*, see Figure 1, show how these factors are translating into operational change.

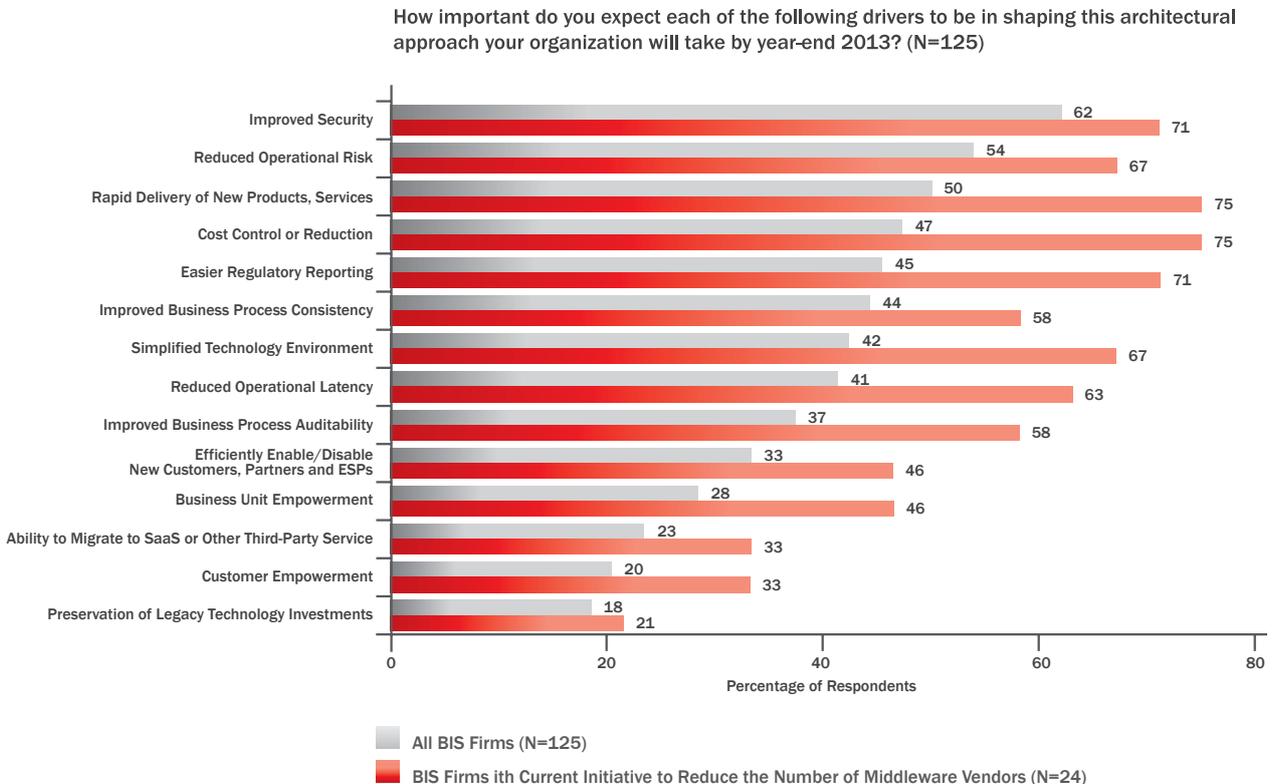


Figure 1

*Gartner, Inc., Survey Shows That Financial Firms Targeting Agility & Efficiency Are Consolidating Middleware, Knox-Thompson, February 11, 2011.

TowerGroup's* study regarding the 2011 Top 10 Technology Initiatives in Bank Cards reinforces this view. The research, highlights that although "payment card-based transactions will grow 8% globally through 2020. The business model will face disruptive, often unwelcome change in every major market." The research also points out that "technology will be essential to the success of industry operators seeking profitability after three years of high credit losses, hyperactive regulators, and general economic stress."

It comes as no surprise then that, according to research from Ovum**, global IT spending on retail banks will reach \$132bn by 2015. With IT spending set to increase by an average of 24% over the next five years.

Undoubtedly the time is right to explore the best way to optimise this investment to help FIs achieve the new levels of commercial agility, backed by nimble operations that will allow them to respond to changing customer and market requirements. How businesses shape their processes and architecture now, will play a crucial role in their transformation for long term success.

*Tower Group. Bank Cards: Top 10 Technology Initiatives for 2011, Moroney and Riley, January 24, 2011

**Ovum, Retail Banking Business Update, January 2011

The Role of Payments

Payments is the most basic and pervasive financial service. It is central to all businesses - cards, retail and corporate - and across all FI product and service offerings. By 2020, it is estimated that the global payments market will be worth \$782 trillion in noncash transaction value and \$492 billion in transaction revenues according to the Boston Consulting Group's* (BCG) report, Global Payments 2011: Winning After the Storm.

On this basis alone, payments represent a significant prize to those who own them. And the owners are changing. Take the growing prevalence of telecoms operators as the mobile payment market increases in size. According to a new study from Juniper Research**, Mobile Payments Markets: Strategies & Forecasts 2010-2014, the value of mobile payments for digital and physical goods, money transfers and NFC transactions will reach almost \$630 billion by 2014.

But the power of payments lies not just in its income potential; trends show that payments is fast becoming a strategic factor in controlling cost, reducing risk and meeting customers' evolving needs.

In a highly competitive market with many new entrants, establishing and maintaining trust is central to building loyalty and securing customer relationships. Consumers are more likely to trust those FIs who do the basics well - that means secure, reliable and consistently available payments and processes.

As they move towards more customer-focused service delivery, payments will also be vital for FIs seeking to understand the consumer and identify their needs through the use of modern analytics. With the aid of intelligent tools, payments can provide the customer data and contact points to fuel value added service delivery and boost revenue.

Many of today's current payment platforms are built on old legacy systems, leaving them ripe for reengineering to reduce costs and improve performance. Effective payments can impact on commercial performance, competitiveness and future success.

Payment platforms need to tie 'products' with modern lifestyle and commercial requirements to ensure FIs stay 'relevant'. Ultimately, FIs need to get payments right to survive as the market continues to evolve and competition grows.

*Boston Consulting Group, Global Payments 2011: Winning After the Storm, Grealish et al, February 2011

**Juniper Research, Mobile Payments Markets: Strategies & Forecasts 2010-2014, Wilcox, May 2010

Payment Platform Evolution

Today's software and systems architecture has progressed rapidly since the 1970's, see Figure 2. However, to deliver to this new market brief, payment platforms must continue to evolve further.

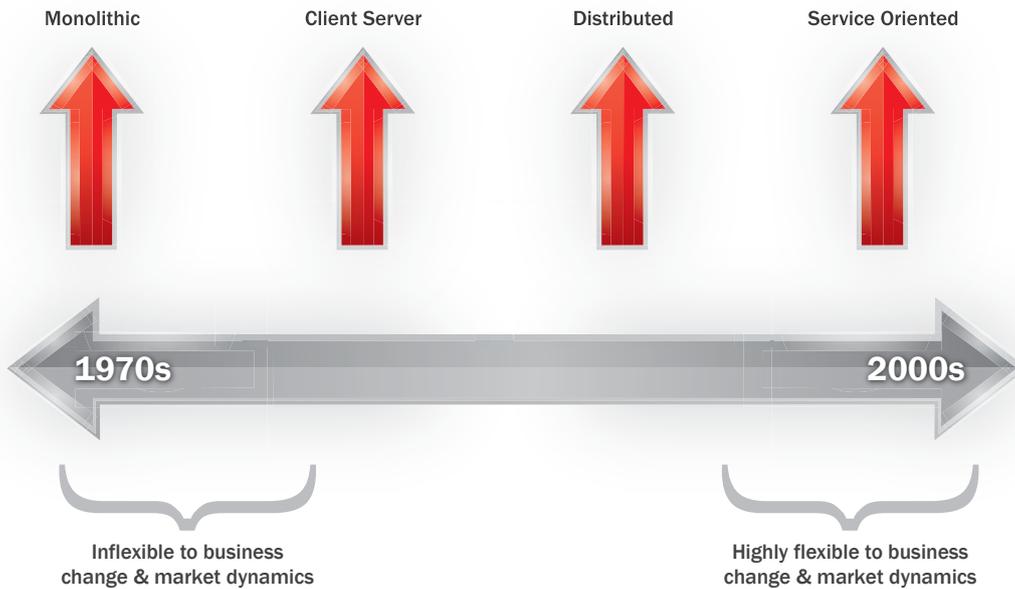


Figure 2

Current development is often hindered by in-house 'piece-meal' legacy systems and a siloed operational approach.

There is a real need to reengineer payment platforms for profitability by reducing current IT complexity and data process redundancy; simplifying workflow and avoiding duplication; and speeding the creation and delivery of new market facing services.

According to industry experts, major banks must adapt to sweeping changes in the payments industry in order to reverse revenue and profit declines and chart a course to sustainable growth.

This requires increasingly agile and robust centralised payment functions that can respond and deliver to market and regulatory demands in short time frames.

To achieve this, payment platforms must offer a high degree of flexibility to accommodate rapid change, whether it comes from legislation, the business or the market. Customisation, the ability to modify and create new payment parameters quickly and easily, is the key to payments evolution.

By adopting highly-customisable payment platforms FIs can:

- continue to deliver a centralised system across product and service lines aiding transparency, reducing risk and encouraging single customer view.
- drive operational and service improvements and instigate customer rather than product level pricing and profitability.
- use payments strategically to boost competitiveness, deliver better profitability and help business transformation.
- build new services with third parties more easily; providing payment services to digital content developers, online game providers and social network providers, all of which have business models demanding more-flexible payment arrangements.

Development Options

Customisation of the payment platform requires technical resource, software and development tools as well as codes that can be readily programmed. It also necessitates integration with core processes and other front and back end services.

This creates a number of issues in terms of delivery and ownership which is made more complex by the disparate nature of many FI's own internal systems; their understandable reluctance to systemic change; and their over reliance on legacy investments.

There are four main development options for payments - in-house development, external integration providers, proprietary software and open platforms. Examined closely, they all offer both positive and negative contexts for customisation.

In-house Development

Pros: The model is able to accommodate FIs' often complex internal processes to deliver solutions independently for different parts of the business. It provides the resource and opportunity for very specific ongoing development.

Cons: In house teams are often restricted by the latent inflexibility of its in-house or proprietary legacy systems and toolsets. There is much duplication of effort across the organisation which reduces efficiency and effectiveness. Customisation can be costly and difficult to maintain, particularly in environments with frequently changing interface and messaging transformation requirements. This may threaten the Banks' and FIs' agility and efficiency. It does not take advantage of readymade re-usable and vast libraries that existing solution vendors offer, which will match at least most of the requirements as a rule.

Integration Providers

Pros: Typically these are 'best of breed' solutions designed to meet the needs of multiple internal and external transactional flows and are suitable for supporting service oriented architecture environments. They can be easier to maintain than supporting in-house developed solutions. Integrators often update libraries of common industry connectors and messaging transformations which can positively affect agility.

Cons: Customisation can be costly and presents greater implementation challenges than software solutions delivered as part of an application suite due to the need to integrate them into the legacy environment.

Proprietary Application Suites

Pros: Payments application suites often contain their own underlying development layers, which is integrated with the application functionality and contains specialized B2B connectivity functionality. This can reduce cost as well as maintain and speed up implementations.

Cons: Customised application suites can sometimes be highly specific and it may be difficult to extend their support to other applications.

Open Payment Development Platforms

Open Payment Development Platforms (OPDPs) are APIs that enable the functionality of an underlying payment platform to be understood and leveraged by banks or FIs. An OPDP may involve a payment application or a series of separately provided service components as the source of functionality and services (for example, a payment services hub). A payment framework may also be included to guide users in the use of the platform and the orchestration of components.

Pros: The benefits of OPDPs for banks and FIs are faster time to market with new payment services and the ability to provide more flexible payment services. Payment and data services created through OPDPs can be integrated with other data and services to create new applications by composing capabilities from existing systems or components of those systems. OPDPs accelerate the pace of innovation and ensure that services are compliant with industry regulations and standards.

Cons: The challenges of OPDPs are licensing and support, intellectual property, and security. OPDPs will result in the availability of more payment applications for the banking industry. However, the internal development support for these applications is usually challenging, given that the developers building them are often small entities. Therefore, there will need to be extensive resources available for typical software post implementation support situations.

Fraud and security are also concerns. Using OPDPs from vendors who provide an environment and appropriate rules and procedures to maintain security is the only sensible approach. In addition, more public access to these underlying payment platforms will breed innovation, but they will also likely attract a new set of fraudsters that will attempt to compromise the system and the payments that run through it. Banks and developers need to work closely with a vendor who has knowledge and the right OPDP tools.

Accelerating Customisation

Utilising SOA

To provide 24/7/365 availability and the faster introduction of more flexible and innovative new services, many FIs are turning to Service Oriented Architecture (SOA) to free capacity, maximise resources and streamline payment complexity.

In fact, Forrester's* Q3 2010 Global Financial Services Architecture Online Survey revealed that SOA has definitely taken off in financial services: The vast majority of those it surveyed were using SOA today; almost three-quarters were using SOA in a significant number of business applications in a production environment; and many had plans to extend the SOA footprint into their organisations.

SOA developed solutions will provide enhanced configuration flexibility allowing companies to decouple services and build a component repository that can be 'mixed and matched' depending on client requirements, or brought together to solve ever complex business needs such as high-volume, stand alone payment hubs.

SOA platforms can deliver agility, flexibility, easy integration and faster service development and deployment as well as easier access to report and status information. As a result, SOA platforms can protect investment while providing retailers, banks, card issuers and merchant acquirers with clear, lower cost pathways for future service evolution.

A Flexible Approach

When designing a payment platform, the first decision to make is determining where to leverage standard components throughout the system.

Traditionally, in-house service development can take much longer than when using pre-designed software components as significant R&D time and effort goes into designing the platform before revenue generating services can be introduced. Cost and effort can be saved if such a platform is acquired from the vendor ecosystem, with internal resources applied fully to the development of applications and services.

Well positioned vendor libraries with extensive readily available software can help in-house teams create a vibrant ecosystem that embraces standards-based hardware and high-availability middleware.

This maintains the ability to create bespoke solutions but in a 'plug and play' context. The result is faster time-to-market, reduced resource costs and increased revenue potential, for even the most complex financial applications.

A side benefit of such an approach is that since the platform has already been put together with pre-tested and pre-integrated components, the overall testing and quality assurance effort is also reduced.

Conclusion

It is clear that government regulation, tighter competition, and shifting customer demands are all taking a toll on revenues and profits.

All around is change. FIs will have to follow suit - or suffer relegation. Payments and services must evolve in order for FIs to stay secure, relevant and profitable.

Holding on to legacy systems and unyielding, ineffective and inflexible development models will hold the industry back. Confining IT development exclusively to in-house teams is detrimental to technological and, ultimately, business performance.

By restricting access to external software, FIs risk wasting their own IT resources 'reinventing the wheel' to introduce new services quickly and efficiently according to industry standards. Working autonomously slows time to market and limits competitiveness.

This paper concludes that it is time to shake off the old 'in-house OR proprietary' approach that has long dampened innovation within Europe's financial institutions. With open development frameworks the two can, and should, work in close harmony.

Using SOA platforms, in-house teams can choose to exploit well designed, pre-tested software and toolkits from proven payment experts. The cost associated with external software licenses can be offset against productivity savings, reduced time to market and faster revenue generation. Third party software components are also designed to comply with the latest mandates and standards, shifting the responsibility for ongoing updates away from the FI to the vendor.

All of this frees in-house IT functions to be more effective and creative; removing the burden of maintaining the payment platform so they can concentrate on evolving better cross-business solutions and market-winning services.

As many legacy systems reach end of life, there is now ample opportunity to reengineer payments for greater profitability.

The ability to build richer, deeper relationships with payments solution providers, will become key attributes of successful 21st Century banks and payment processors.

With dedicated IT resource, intrinsic system flexibility and commitment to customise the payment platform, the new collective goal for FIs, and their IT partners, will be: "Encourage innovation today, to safeguard tomorrow."

Compass Plus provides comprehensive, integrated and flexible software and services that help financial institutions meet rapidly changing market demands. Our diverse customer base spans over 100 retail banks, processing centres, national switches and personalisation centres in 28 countries across Europe, Asia, Africa, the Middle East, North and South America. With more than fifteen years experience, Compass Plus helps build and manage electronic payment systems that generate new revenues and improve profits for its customers.

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