zeta

Life in the fast lane: **5 ways banks win with speed**

Financial institutions have taken a lot of flack lately for their innovation track record, or lack thereof. But history suggests that banks haven't stopped innovating so much as the world around them is moving faster. This paper delves into why non-banks are driving the latest innovations and how banks can seize their full potential. We will cover the following:

Innovation in banking: Then and now

Barely a week goes by that some publication isn't proclaiming that banks need to learn to innovate, but that's not really fair. Banks have a long history of innovation. They were some of the first companies to utilize predictive models (such as credit risk, attrition and origination), they invented ATMs and credit cards, and introduced an array of product offerings - from rewards to balance transfers.

Banks haven't forgotten how to innovate, but the pace of change around them has accelerated tremendously. Fintechs and tech companies have launched most of the innovative financial products of the last decade. Looking at this chart, you'll see that many of the top fintech startups are focused on products traditionally owned by traditional financial institutions, like merchant acceptance, investing and PFM. Even BNPL is just layaway with sleeker customer experience. An overwhelming majority of those start-ups offer an improved experience, specifically in onboarding, and often target younger consumers, underserved segments and smaller businesses.

Fintechs thrive in underserved segments and effortless customer experiences

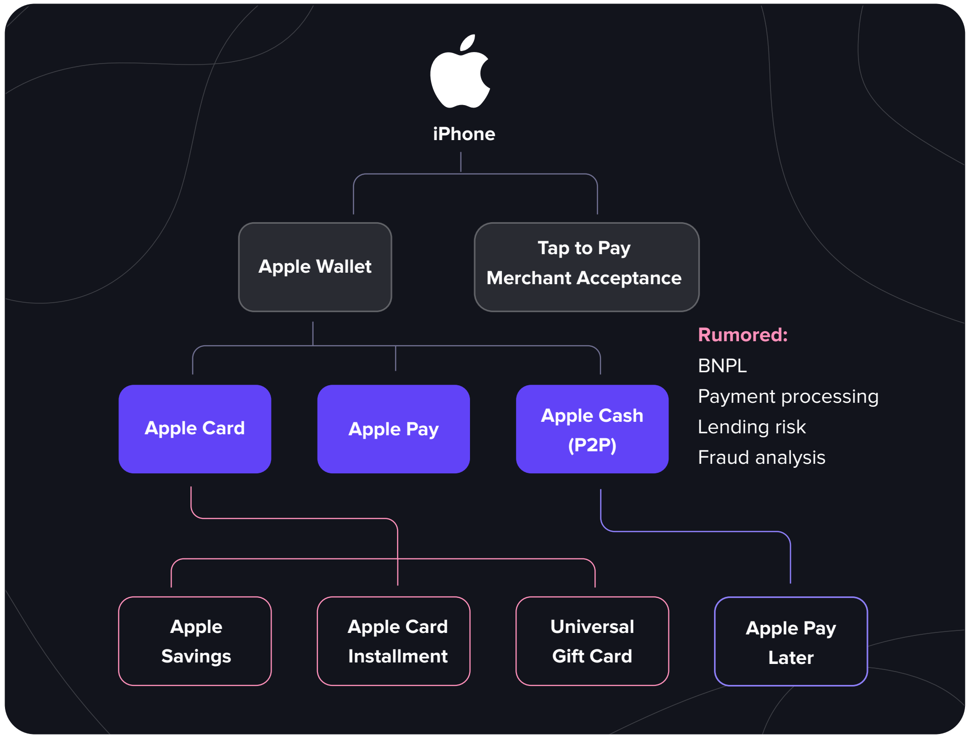
Merchant card acceptance	stripe, Square, toast, BOLT
BNPL	afterpay, Klarna.
Financial Management	INTUIT, monzo, Brex
Investing	Wealthfront, Robinhood, acorns
Digital Banking	chime, Revolut, Varo
Family Cards	GreenLiGHT, copper

What's at stake: Innovation is key to growth

Doomsayers often predict that banks will be entirely disintermediated by young people moving to non-banks and tech companies for their financial needs.[1] This is not hypothetical. Fintechs take up a much higher share of market capitalization in banking compared with five years ago. One can already see a glimpse of this future in China, where a significant percentage of day-to-day financial interactions happen on big social media apps.

That feels unrealistic in the US. The more likely scenario is more subtle, but still devastating for financial institutions: non-banks are simply going to snap up an increasing share of new customer segments, new products and new ways of interacting with our financial lives. And they'll use those footholds to expand their financial offerings among their customers. In other words, they'll take most of the growth.

Apple is a great example of this, as seen in the chart below. Apart from the enticing rewards, such as a 4.15% APY for the savings account, the real strength lies in how user-friendly, seamless, and interlinked the whole process is. The credit card application and savings account opening both take less than a minute to complete.



Apple is not trying to replace banks - it still goes through banking partners to offer its products - but they are unlikely to stop at savings accounts. Plenty of tech companies have shown repeated and persistent efforts to enter consumers' financial lives. Apple, Google, Amazon, Facebook and many others clearly want a piece of this pie and not all of them will have the same idea of when to stop encroaching.

1. Global banking annual review 2022 banking on a sustainable path | Mckinsey

The link between speed and innovation

So, why have most of the innovations of the last decade been launched by non-banks?

Financial institutions (FIs) are hesitant to invest years of time, capital and institutional focus in product development unless they are certain it will payoff.

Ultimately, innovation is a fancy word for trying new things. And in the last decade, banks simply don't try enough new things compared to competitors. A number of factors could influence that – culture, regulation, risk appetite – but by far the biggest contributing factor is simply the length of time and complexity it takes for financial institutions to complete innovation projects, an average of 21.4 months.[2]

Not all financial institutions take so long, but even nimble ones move too slowly. And most are hesitant to invest years of time, capital, and institutional focus in product development unless they are certain it will pay off. That means segments go unserved, products never get developed, and ideas die before they even get started.

Sometimes it can seem as if the biggest innovations happen from the brain of a singular genius who had it all figured out. But the truth is that most innovation happens from trying lots of new things and learning from those experiments.

Steve Jobs and Apple went through at least two attempts at creating a product similar to the iPhone, but it was only with the third attempt that they found success. The first two were dismal failures! And it's not just about having a groundbreaking idea. It's the little iterations, made over time, that perfect a product. Apple has released 91 iPhone models and iterations over the last 15 years.

Apple has launched
91 models in last 15 years!

Banks will never take the "move fast and break things" ethos of Silicon Valley, nor should they. But they cannot afford to lag behind on innovation and miss opportunities that they have a right to win.

2. Innovation Speed to Market Report | **Futurion**

What's different for financial institutions

Technical debt

Technical debt is the cost incurred when businesses do not fix problems that will affect them in the future. In the case of financial institutions, this debt manifests in the form of technology that's 40 or 50 years old.

To be fair, financial institutions have attempted to circumvent this problem by hollowing out the functionality from their cores to more modern systems, and focusing on better end-user experiences. With enough time, most user experiences and new products can be supported. But ultimately, changes to these systems have to be hard coded, and that means long lead times, complicated workarounds and systems that don't always talk to each other seamlessly.

> The high relative cost of changing complex and entrenched systems that have proven resilient has led many participants to limit investing to a long period of incremental improvements.
>
> **McKinsey 2022** [3]

Making matters worse is that financial institutions are often constrained by their technology provider's roadmap. This results in delayed prioritization, leading to frustrating wait times of months or even years to update back-end technology, if it changes at all.

3. 2022 Global Payments Report | McKinsey

This criticism of banking technology is hardly new. But after years of steadily improving digital experiences and moving service interactions from branches and call centers to devices, the limits of this approach are now becoming apparent. Consumers want more than just the call center experience on their phone. They want you to predict their needs before they ask, give them effortless visibility, remove friction from processes, provide instant resolution and personalize their interactions.

> *"Archaic back-end processes and rigid systems make it difficult to implement agile methodologies or use data to personalize experiences in real-time. The way older systems process information can slow the completion of tasks considerably."* [4]

Regulatory Compliance

While financial institutions may benefit from fewer entrants who don't want to deal with regulatory oversight, it also discourages innovation within those institutions.

The risk of getting it wrong is real. Just in the last year, we've seen banks and non-banks take creative new approaches to problems, only to face regulatory scrutiny. LendUp was shut down when it was unable to help consistently improve credit as it promised.[5] Hello Digit was fined when their savings product resulted in overdrafts.[6] Goldman Sachs ran afoul of the CFPB when it made disputes so easy on the Apple Card that they could not keep up with demand, causing unacceptably long delays and controversial dispute judgments.[7]

And banks were not immune either.

Compliance issues definitely make financial institutions carefully evaluate new initiatives, but sometimes they also can chill creative experimentation before it even reaches the upper management. We'll talk more in the recommendations section of the paper about what financial institutions can do to deal with this limitation.

4. What's Holding Fintech Back: Overcoming Legacy Barriers to Accelerate Innovation | Forbes

5. CFPB Shutters Lending by VC-Backed Fintech for Violating Agency Order | Consumer Financial Protection Bureau

6. CFPB Takes Action Against Hello Digit for Lying to Consumers About Its Automated Savings Algorithm | Consumer Financial Protection Bureau

7. Apple Card disputes the focus of Goldman regulatory probe | 9to5mac.com

Chase launches digital bank for international expansion

JP Morgan Chase is one of the largest banks in the world, largely based on the strength of its US operations and branch network. But in 2021, it went a different direction and launched a digital bank in the UK simply called Chase.

Taking on this challenge was not simple, even for the highly influential CEO Jamie Dimon. Shareholders were concerned with the bank's plans to increase spending on technology, particularly after the failure of JPMC's other digital bank, Finn, the prior year.

But they learned from that experience and focused on improvements, including a heavy focus on low overhead.

The new venture has been a success to date, with highly engaged customers and over $10 billion in deposits. Its success in the UK has many speculating that it has found a new model for international expansion.

Chase's Success With Its U.K. Digital Bank Could Become a Global Model | The Financial Brand

Greenlight attracts millions of users with family friendly debit card

Greenlight Kids Debit Card is revolutionizing the way parents manage their children's finances. It allows parents to easily transfer money, set spending limits and monitor where money is being spent in real time. They can also use parental control settings such as setting custom notifications when their children make purchases or transfer money from one account to another.

In a largely underserved segment, the result has been a resounding success, with over 6 million users and growing at a rate of 20% month over month.

Greenlight study shows why most bank financial literacy programs fail | Fintech Nexus

5 key benefits of moving faster in banking

01
Find new revenue streams

02
Reduce compliance overhead

03
Win digital-first customers

04
Capture more customer segments

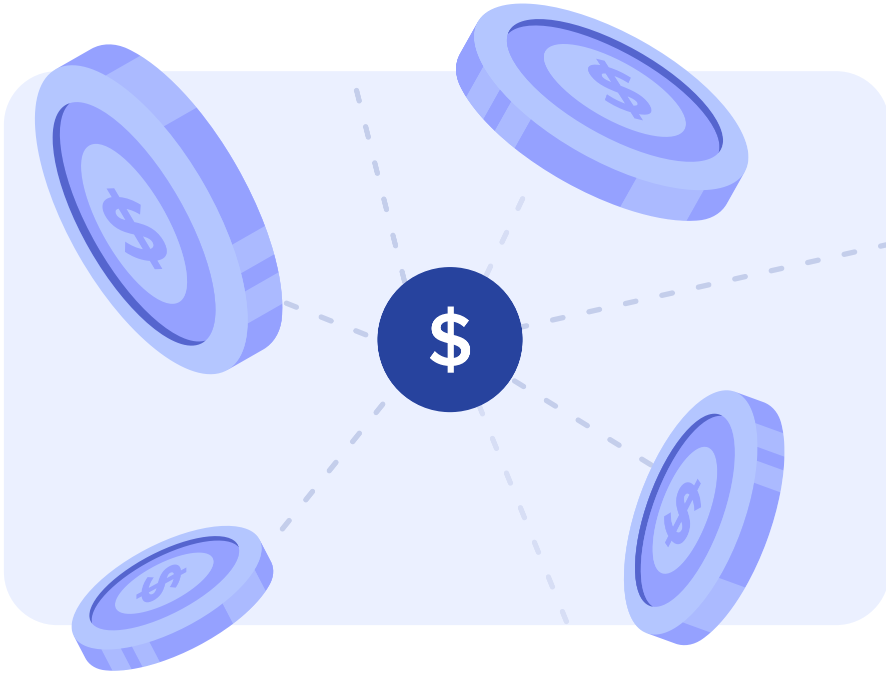
05
Improve loyalty and cross-sell

01 —

Find new revenue streams

With the pace of innovation accelerating, financial institutions have an opportunity to find new revenue streams. Fintechs have largely led the way on Buy Now Pay Later (BNPL), estimated to exceed half a trillion dollars by 2025.[8] While the long-term profitability for 0% Pay-In-Four plans remains to be seen, there is clearly demand for installment lending, particularly among younger consumers, who are keen to avoid long-term revolving debt, and are attracted to the seamless loan origination at the point of sale.

Without innovating in this area, "US issuers could by 2025 lose up to 15 percent of incremental profits to newer forms of borrowing, based on our simulation of the potential impact of buy now, pay later (BNPL)." [9]



Beyond BNPL, many banks don't launch new lines of business such as commercial, healthcare, or government cards because the difficulty of entering is prohibitive relative to the certainty of profit. And there are untapped new opportunities in virtual cards, push-to-card, and Just-In-Time funded cards as well.

8. Buy-Now-Pay-Later Is An Opportunity Credit Card Issuers Can't Afford to Pass Up | PhocusWire

9. Reinventing credit cards: Responses to new lending models in the US | McKinsey

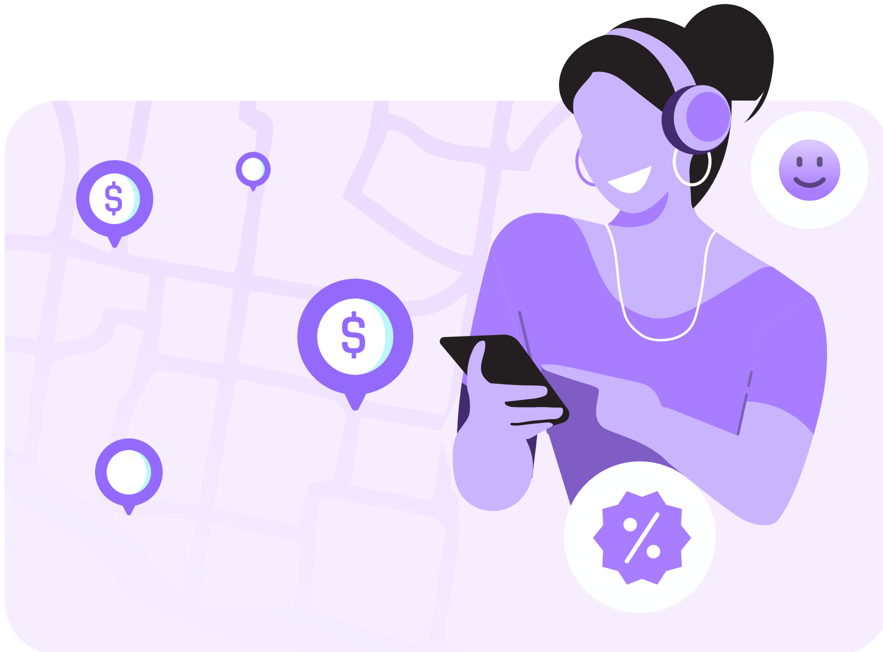
02 —

Reduce compliance overhead

Moving quickly to address new regulations is often a challenge for banks. The recent ruling on providing network choice for debit cards is a good example of how quickly regulators can change the playing field. Bank card issuers are "requesting a year-and-a half reprieve from complying with a recent debit card routing rule...requiring bank card issuers to make networks other than the two titans (Visa and Mastercard) available to merchants" both for in-store and online purchases.[10]

03 —

Win digital-first customers



More than 60% of Gen Z and Millennials would consider switching banks for better digital and mobile capabilities.[11] Furthermore, as a result of pandemic-driven digital adoption, "switching intent" nearly doubled for consumers and businesses.

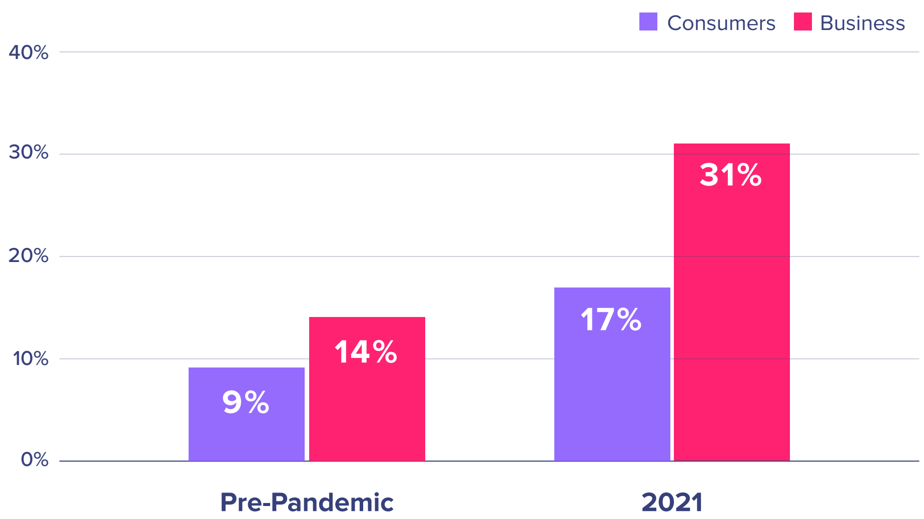
10. Debit routing rule tables turned on regulators | PaymentsDive

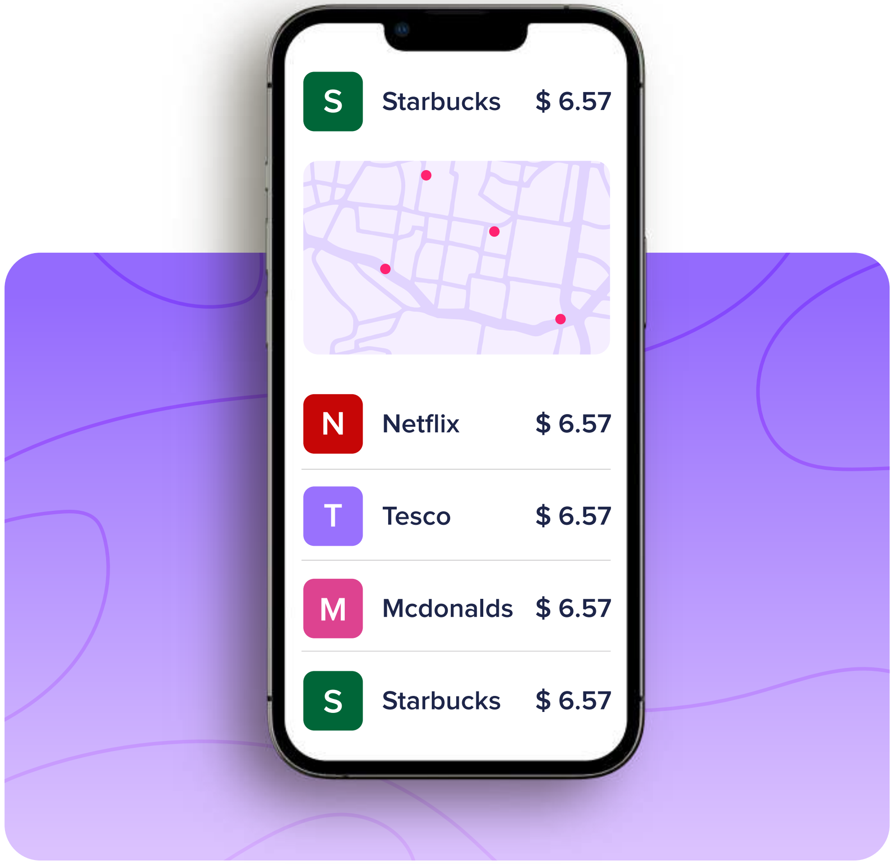
11. Millennials and Gen Z Are Banking Differently Than Their Parents Did | Moneywise

"I have never seen such a dramatic increase in switching behavior in the three decades I have been tracking this," notes one industry analyst. "Pre-pandemic, consumers actually planning to switch was usually under 10%. Now 15% are saying they're going to switch in the next six months." [12]

Today's consumers are looking for the same experiences from their bank that they can get elsewhere. When they use their Apple Card, they can see every purchase on a map. But when they see a bank statement, they often can't even tell which store they shopped at because the merchant name is cryptic. Tech companies are better at predicting customer needs, providing visibility into spending, giving flexible new ways to use rewards and personalizing the entire experience based on the individual customer. For banks, innovating enough to match these expectations can't be done on a 40 year old platform.

Switching intent within next six months[12]





12. Banks Have a Big Opportunity to Snag Frustrated Consumers | The Financial Brand

04 —

Capture more customer segments

Many fintechs are finding success by tailoring offerings to niche markets such as younger consumers, ethnic groups, pre-teens, and traditionally underserved or unbanked populations. For financial institutions, when it takes upwards of two years to launch a product, this takes a tremendous amount of institutional focus and capital.

Let's look at Gen Z as an example. Many card issuers have not yet developed a full product line to address this younger segment. Meeting the needs of this population is necessary for banks to be successful in the coming years:

> *As a fast-growing consumer group with massive spending power, Gen Z makes for valuable customers, but are being missed by current marketing strategies.*[13]

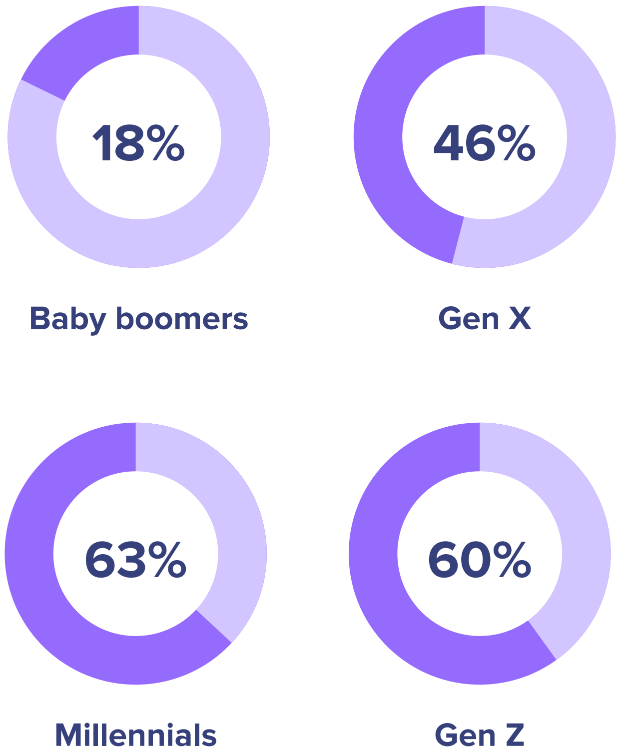
Capturing these segments is valuable in and of itself, but banks are positioned better than fintechs to create lifelong relationships with these customers. Small business acceptance can become business banking when the farmer's market baker opens a retail pie shop. Children and young adults can stay with their parents' bank if student accounts are nurtured and graduated. A decade ago, Millennials were a small opportunity of mostly low-income consumers. Now they are a key driver of account growth. Similarly, four million Gen Z customers per year will open new accounts, and they have unique needs, including a strong need for digital experiences.[14]

13. How to Build Lifetime Loyalty with Gen Z | Experian

14. Banks going after Gen Zers must prioritize digital and mobile | Insider Intelligence

Spend from younger consumers is growing 3x faster than other generations

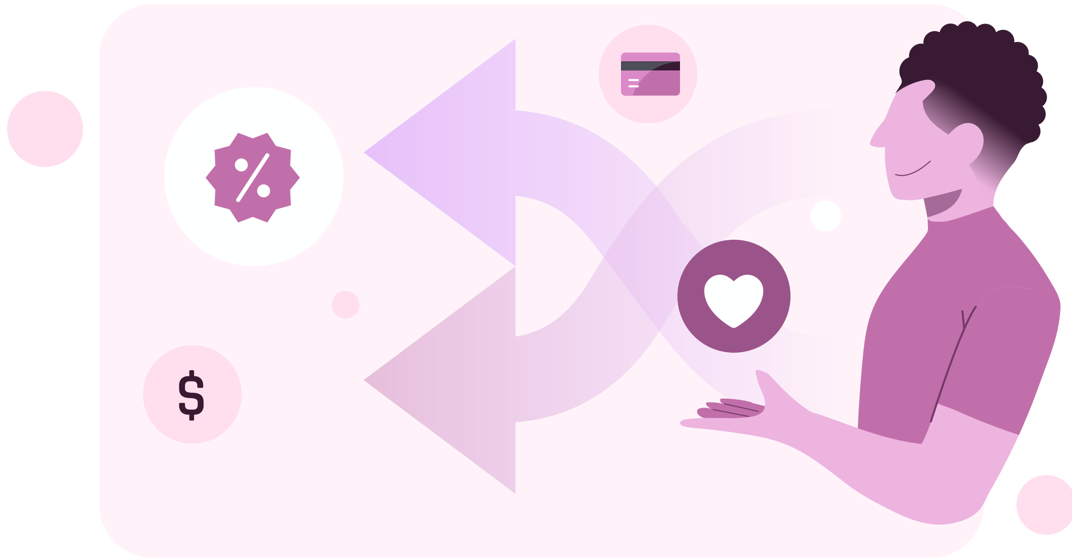
Percentage of shoppers who bought luxury in the past 12 months



DATA SOURCE: RAKUTEN AND VOGUE BUSINESS SURVEY OF VOGUE AND GQ READERS

05 —

Improve loyalty and cross-sell



Beyond digital experiences, consumers have come to expect that the companies they do business with will predict their needs, personalize their interactions, and give them more visibility than ever before. Whether in the hundreds of frictionless touchpoints you have with customers or a handful of key moments they'll remember, innovating to meet their needs pays off in loyalty, engagement and willingness to open additional products with the companies that serve them best.

3 foundational principles of innovating faster

While there are many ways to drive innovation, we believe there are three key ingredients that are needed in any organization

01 —

Leverage next-generation technology

Next generation technology is designed for the scale of modern data, the complexity of data relationships, and the interconnectivity necessary to deliver seamless experiences. While there are probably more than 15 or 20 key features that truly define such next-gen systems, some of the most obvious ones to look for include:

Flexible architecture

Most legacy systems support only very rigid product constructs. Modern systems tame this rigidity by breaking complex systems into foundational pieces that can be composed in various ways to build anything you want. It's similar to how car makers build cars. Decades ago, they used to design every component for every car. Now they use configurable platforms, such that passenger cars will even share the same platform with an SUV.

Native API capability

APIs are now ubiquitous throughout the technology world as a way to quickly allow developers to stitch together functionality and experiences across different platforms. Legacy payments technology providers often tack APIs onto old infrastructure, which provides some of this capability but does nothing to change the fact that the ‘core system’ cannot be really modified. Natively API-first systems empower banks to take more control over their technology roadmap, as changes can often be prioritized and implemented without the intervention of a third party provider such as a processor.

Microservices-based feature delivery

Microservice architectures have exploded in popularity in recent years by decomposing large and complex monoliths into discrete and independently running components. This provides numerous benefits including but not limited to: resiliency (i.e., when one service goes down the others are still functioning), simpler software upgrades (i.e., different parts of the system can be upgraded at different times vs. shutting down the entire monolith), scalability (i.e., more instances of a particular service can be created in response to load).

Truly Cloud Native vs. Cloud Applications

Gone are the days of the cloud being the new technology. It’s secure, efficient and reliable. And ramping up new products requires no build-out of servers or infrastructure. But being cloud native is not the same as being on the cloud. Truly cloud native systems are designed and built to exploit the scale, elasticity, security, resiliency, and flexibility the cloud provides. While outside the scope of this paper - it's important to understand the difference and ask your vendor some hard questions about this.

Out-of-the-Box Digital Experiences

Rich digital controls, AI-driven self-service options, instant issuance of one-time digital payment cards, enhanced payments security using FaceID or fingerprints, spend tracking categories, and immediately credited rewards points are a small set of examples of features that most customers expect with their card or financial products. Next-gen systems offer these digital capabilities not just out-of-the-box but also allow banks to build their own innovations by offering many capabilities that underlie these experiences as composable building blocks.

02

Foster a culture of innovation

> It's easy to come up with new ideas; the hard part is letting go of what worked for you two years ago but will soon be out of date.
>
> — Roger von Oech

Reward for success rather than punish for failure

Aligning incentives is not just about rewards for getting it right. If proper controls are in place, employees shouldn't be afraid that a failed product or experiment will be detrimental to their performance. Incentives – such as rewards when an idea is tested, a patent submitted or a product launched – are important to help people feel that they share in success. But a reward will not overcome the fear of negative consequences when a failure can derail a performance review or even a career. Few people will take that risk.

Processes to control risk

Risk can often be anticipated and controlled, and preparing for this should be part of the planning process. Banks have long led the way in detecting early credit risk by comparing performance curves by vintage. Similarly, new experiments should identify likely risks up front, monitor them, and have contingency plans if things go wrong. For example, if you're going to make disputes much easier to file, you need a plan to proactively track dispute metrics and have a plan for when things don't meet expectations.

Empowered to experiment

Financial institutions should ask themselves, "At what level are my employees empowered to champion a new product or service?". If innovation is only driven from the top, you won't get nearly as many good ideas. Institutions need to empower change from all levels.

Bring compliance in early

In a highly regulated industry, legal and compliance need a seat at the table, not just in product development, but from the start in the brainstorming process.

03 —

Invest in the right talent

Financial institutions may have to reskill to meet the needs of digital-first consumers. Many technology professionals deal with highly specialized systems, such as programming in antiquated languages like COBOL simply because that's what the legacy platforms use. Developing elegant experiences driven by next-generation platforms will require user experience experts, software developers and program managers.

Financial institutions with a strong focus on branch-driven customer service will have to focus on how to create a personal touch through digital channels.

That requires product managers, customer researchers and data analysts to help understand customers needs and how to meet them. And institutions that invest in analysts and data scientists will be at the forefront of utilizing the over 328 million terabytes of data generated...each day.[15]

Even operations talent will need to focus on finding ways to innovate, such as adapting to new acquisition channels, streamlining workflows, enhancing productivity and reducing costs, which ultimately leads to a better bottom line and greater success.

15. Data Generated Per Day | Exploding Topics

Putting it all together

> There is no innovation and creativity without failure. Period.
>
> **— Brené Brown**

Financial institutions have a long history of innovation, but the pace of innovation is so fast today that slower moving financial institutions risk being left behind. With fintechs and tech companies rapidly competing for the most profitable customers, products and interactions, innovating faster is critical to growth.

Ultimately, innovation means trying new things, and moving fast enough to keep up with competition. While fostering an innovative culture and talented team is crucial, ultimately none of that matters if the underlying platforms are too inflexible to transform at the speed of the market.

About Zeta

Zeta empowers issuers to launch next-gen credit card programs with its cloud-native and fully API-enabled stack that includes processing, issuing, lending, core banking, fraud, loyalty, and many other capabilities. Zeta has 1700+ employees & contractors with over 70% in technology roles across locations in the US, UK, Middle East, and Asia. Globally, 35+ customers have issued 15M+ cards on Zeta's platform.

Visit us at **www.zeta.tech**

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We'd love to hear from you!

How is your bank thinking about innovation and speed to market?
Reach out for a chat on your strategy and learn how Zeta can help.

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