

INNOVATION READINESS PLAYBOOK





THE TOP PAYMENTS PERFORMER
EDITION

The PYMNTS **Innovation Readiness** series, in partnership with payments and commerce solutions provider i2c Inc., gauges where banks are on the road to becoming innovators. We surveyed executives at 214 FIs in the U.S. (excluding the largest 25 banks) and scored the institutions from zero to 100 in terms of innovation readiness. The banks in our sample fell into four size groups: assets below \$500 million, \$500 million to \$1 billion, \$1 billion to \$25 billion and more than \$25 billion. We divided the banks into three groups: Top 15 Performers, Middle Performers and Bottom 15 Performers. We then analyzed the data to understand what, exactly, Top Performers are doing so well, and the lessons everyone else can learn from them.

JANUARY 2018

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The Innovation Readiness Index: Innovation Playbook was done in collaboration with i2c and PYMNTS is grateful for the company's support and insight. [PYMNTS.com](https://pymnts.com) retains full editorial control over the findings presented as well as the methodology and data analysis.

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INNOVATION



The internet has transformed banking and financial services. Today, customers can deposit checks, transfer money to their peers and check their account balances — all from their smartphones. Meanwhile, apps like Venmo and Square allow customers to complete person-to-person (P2P) transfers. The onslaught of new features means the pressure is on banks to keep up with the pace of innovation or risk losing customers to the sharpest innovators.

The scramble to add new products and services is no surprise. A staggering 88 percent of financial institutions (FIs) say they are losing revenue to FinTech innovation.¹ Meanwhile, 82 percent report they expect to increase partnerships with FinTech firms within the next few years, and 77 percent note they plan to step up their innovation game.² Knowing you need to improve your innovation level is one thing, but what are banks actually supposed to do to achieve this? What works and, more importantly, what doesn't?

Our [Bank Innovation Readiness Index™](#) gauges where banks are on the road to becoming innovators. This month, we've developed the first Innovation Playbook in the series, and we're diving into specific data areas from the Index.

The Innovation Playbook examines the elements that separate the best innovators from the ones in the middle of the pack. We zero in on the top banks that are nailing innovation, then take a dive deep into why they outperform others and which attributes enable them to succeed — including industry best practices and emerging technology. Finally, we examine how they do what they do, distilling their strategies into actionable steps to help banks understand how to transform into top innovators themselves.

¹ Kulkarni, Tatjana. Traditional financial institutions still consider FinTechs as major threat. Bank Innovation. Nov. 23, 2017. <https://bankinnovation.net/2017/11/traditional-financial-institutions-still-consider-fintechs-as-major-threat/>. Accessed November 2017.

² Kulkarni, Tatjana. Traditional financial institutions still consider FinTechs as major threat. Bank Innovation. Nov. 23, 2017. <https://bankinnovation.net/2017/11/traditional-financial-institutions-still-consider-fintechs-as-major-threat/>. Accessed November 2017.

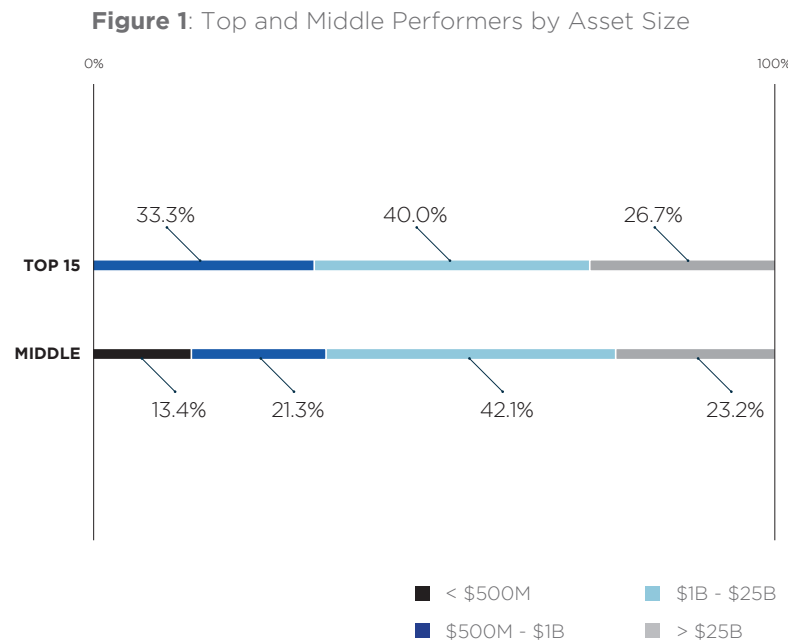


THE MAKINGS OF
A TOP
PAYMENTS
PERFORMER

The good news for banks is that almost anyone can be a top performer. For context, 85 percent of all FIs in the U.S. hold fewer than \$500 million in assets. However, those FIs manage less than 10 percent of assets held by all U.S. FIs.

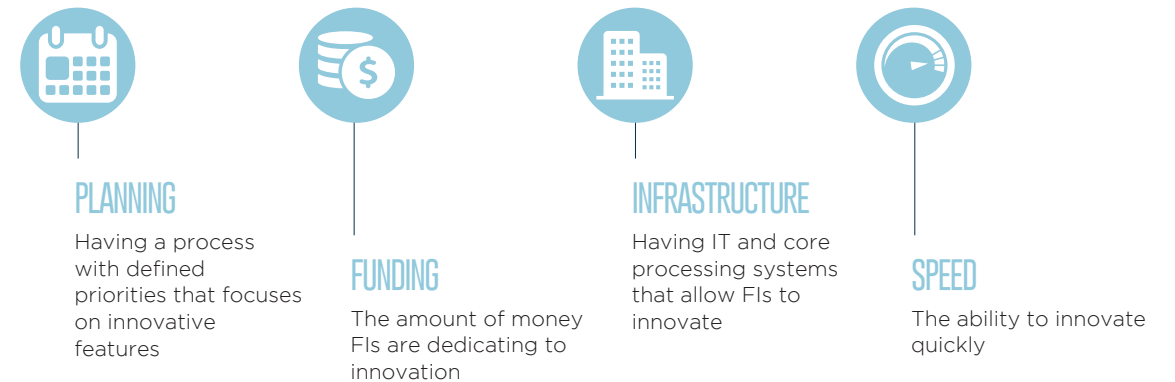
As seen in Figure 1, our Top Performers do not include any banks with fewer than \$500 million in assets, but are otherwise equally distributed across all other sizes. Meanwhile, Middle Performers are distributed across all FI sizes. The only difference is that they include banks with fewer than \$500 million in assets, too.

Top Performers reported feeling most threatened by large national banks, credit unions (CUs) and digital debit cards/banking alternatives. Middle Performers and Top Performers competed with large national banks and CUs. To a lesser extent, they also compete with regional banks.



“Almost anyone can be a top performer.”

In our analysis, we found there were four key attributes that distinguished Top Performers from Middle Performers:



Overwhelmingly, the Top Performers possessed these attributes in spades compared to Middle or Bottom Performers. At least 70 percent of Top Performers had each of these attributes. Top performers did much better than Middle Performers in terms of infrastructure, though — 47 percent scored well compared to just 12 percent of Middle Performers.

Table 1: Attributes of Top Innovating Financial Institutions

CATEGORY	DESCRIPTION	PERFORMERS	
		TOP	MIDDLE
 PLANNING	Focus on innovating features over the next three years	80%	38%
	Defined priorities for the next three years	100%	96%
 FUNDING	At least 50 percent of budget allocated to innovation	73%	12%
	More funding for payments innovation than innovation in other areas	87%	54%
 INFRASTRUCTURE	Existing IT infrastructure that makes innovation easy	60%	12%
	Current core systems are well-suited for innovation	73%	61%
 SPEED	Development in six months or less	80%	54%
	Completed early or on time	86%	81%

■ BEST ■ WORST

PLANNING



It may seem obvious, but planning is a key attribute for innovation readiness. It's difficult to create changes without a plan — particularly without one that includes defined priorities. All Top Performers had defined their innovation strategies for the next three years, but one-third of Bottom Performers had not defined their own. In addition, Top Performers focused on innovating new features rather than new products.

“ 86% of Top Performers plan to focus on payment technology innovations over the next three years. ”

Overall, Top Performers have **three or four** areas on which they are focusing, giving significantly more attention to these areas than Middle Performers do. Top Performers are steering focus from mobile/digital to consumer engagement and digital analytics. Middle Performers are directing their efforts toward improving user experience and mobile/digital. Eighty-six percent of Top Performers have made payment technology a priority, compared to 58 percent of Middle Performers.

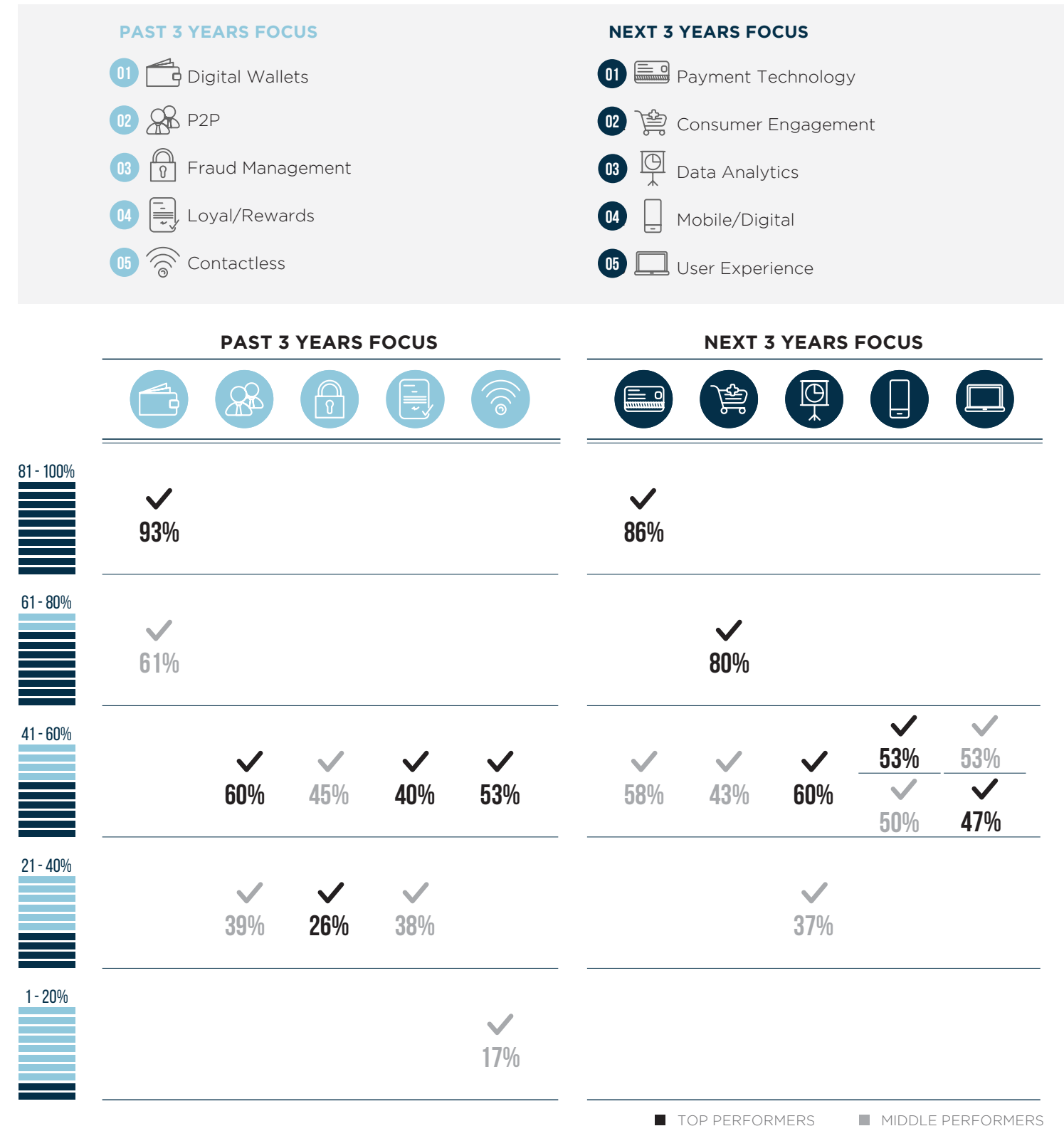
SETTING PRIORITIES:

Significant differences emerge when we compare Top Performers' focuses during the past three years to the present and the next three years.

As shown in Table 2, the most recent product that both Top and Middle Performers brought to market is the same: digital wallets. However, the next priority for Top Performers is P2P payments, while Middle Performers are focusing on fraud management — likely due, in part, to the continued growth in consumers applying for credit cards.

Table 2: Past vs. Future Areas of Focus for Banks

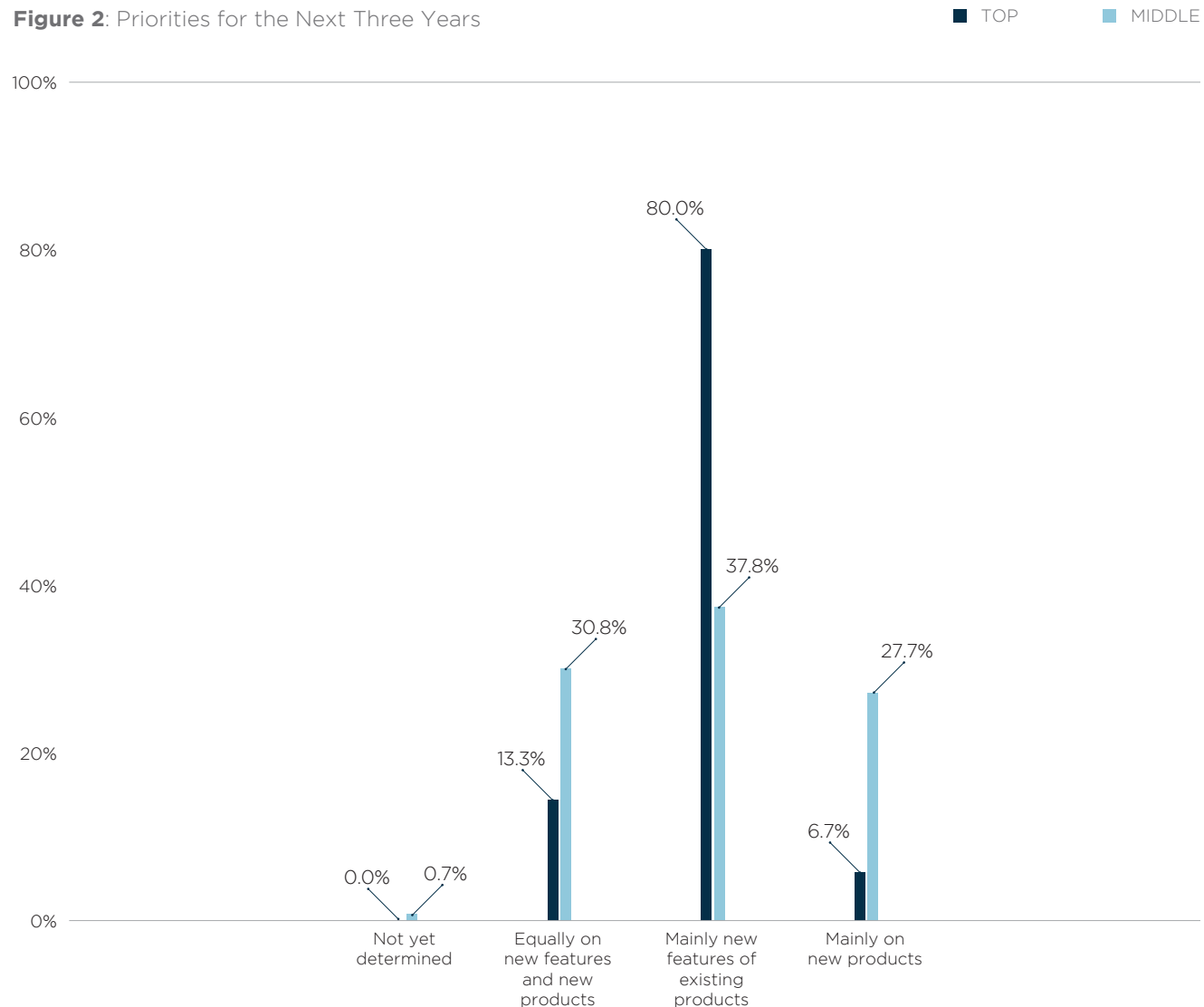
Top Performers will turn their attention to payments technologies, consumer engagement, and data analytics



Going forward, Top Performers also said they would focus on payment technology, consumer engagement and data analytics, a stark difference from the past three years. Middle Performers share the main interest of Top Performers — payment technology, user experience and mobile digital payments. Interestingly, user experience and mobile digital payments are the least important to Top Performers.

Differences also appear when we examine strategy. As shown in Figure 2, 80 percent of Top Performers are planning to focus on adding new features to existing products, while Middle Performers are split: 37.8 percent are planning to focus on adding new features to existing products, while 27.7 percent plan to emphasize new products.

Figure 2: Priorities for the Next Three Years



Overall, Top Performers are a step ahead. They've already executed on P2P, digital wallets and fraud management. They're now looking at the new frontier, adding contactless, in-authorization and mobile deposit capture features, and investing in data analytics and consumer engagement.



SETTING PRIORITIES CHECKLIST

- Create a strategy around engagement.
- Determine the features that will support your company's engagement strategy over the next 18 months.
- "Table stake" functionalities like P2P, digital wallets, and mobile/digital are in place.
- Be sure your company's core payments infrastructure has the flexibility to support rapid roll out key features.
- Secure the budget to support your company's innovation initiatives.

KEY TAKEAWAYS AND
LESSONS LEARNED:



P2P and digital wallets are now table stakes

- Top banks have already implemented these innovations.
- Both are considered tactical features.



Engagement will be key in the future

Engagement = User Experience + Digital + Data Analytics

- Sophisticated consumer engagement is a must. This includes UI, digital and data-driven elements.
- Companies must have payments technology that can execute this engagement.



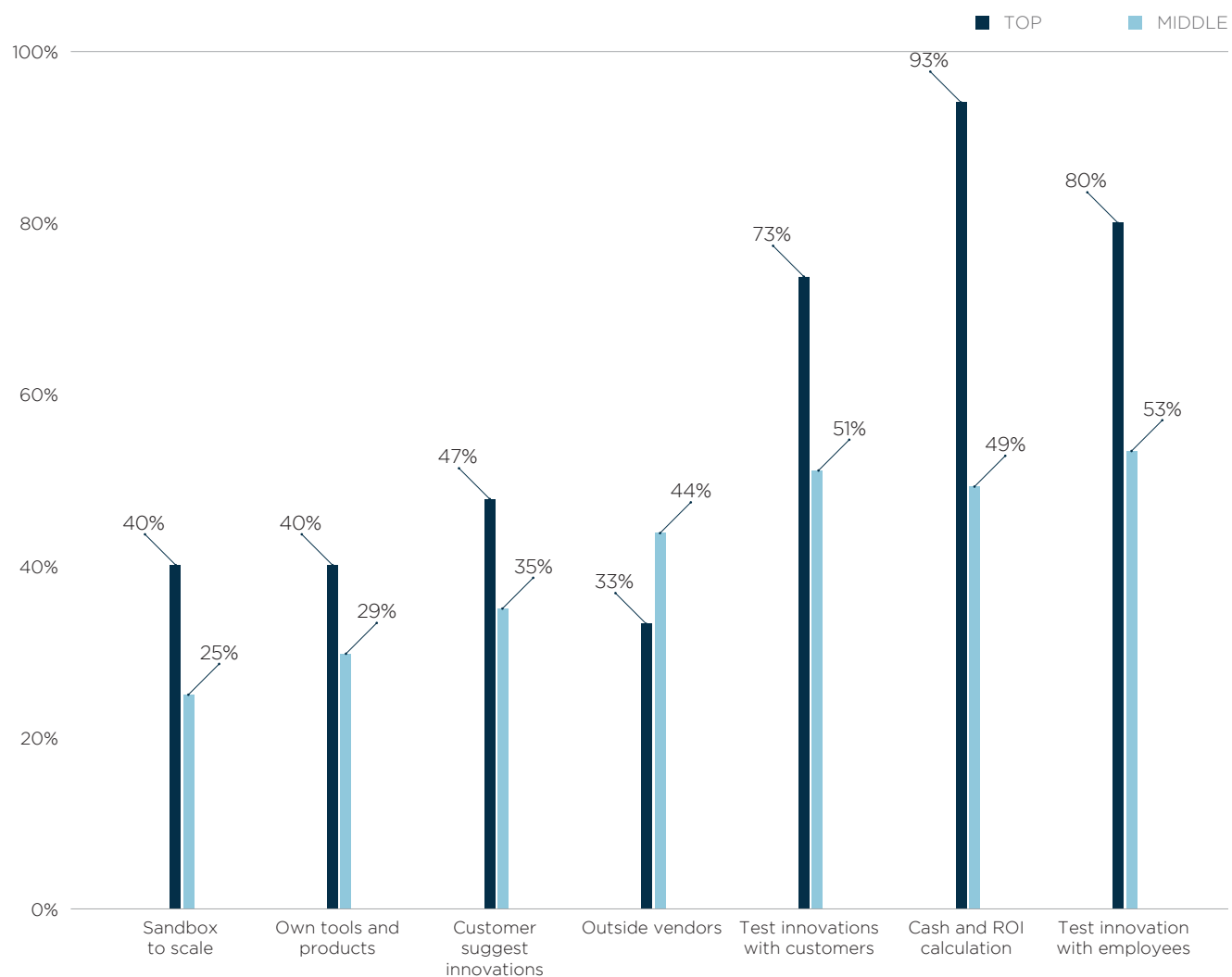
Having the right payments technology is critical to execution

- Banks that outperform others have flexible and configurable payments technology in place.
- Technology is a key reason why some institutions have emerged as leaders.

INNOVATION METHODOLOGIES

Top Performers have also zeroed in on a broad range of innovation methods. There are three such methods used by more than 70 percent of Top Performers. Only two innovation methods are used by more than 50 percent of Middle Performers.

Figure 3: Important Innovation Methods



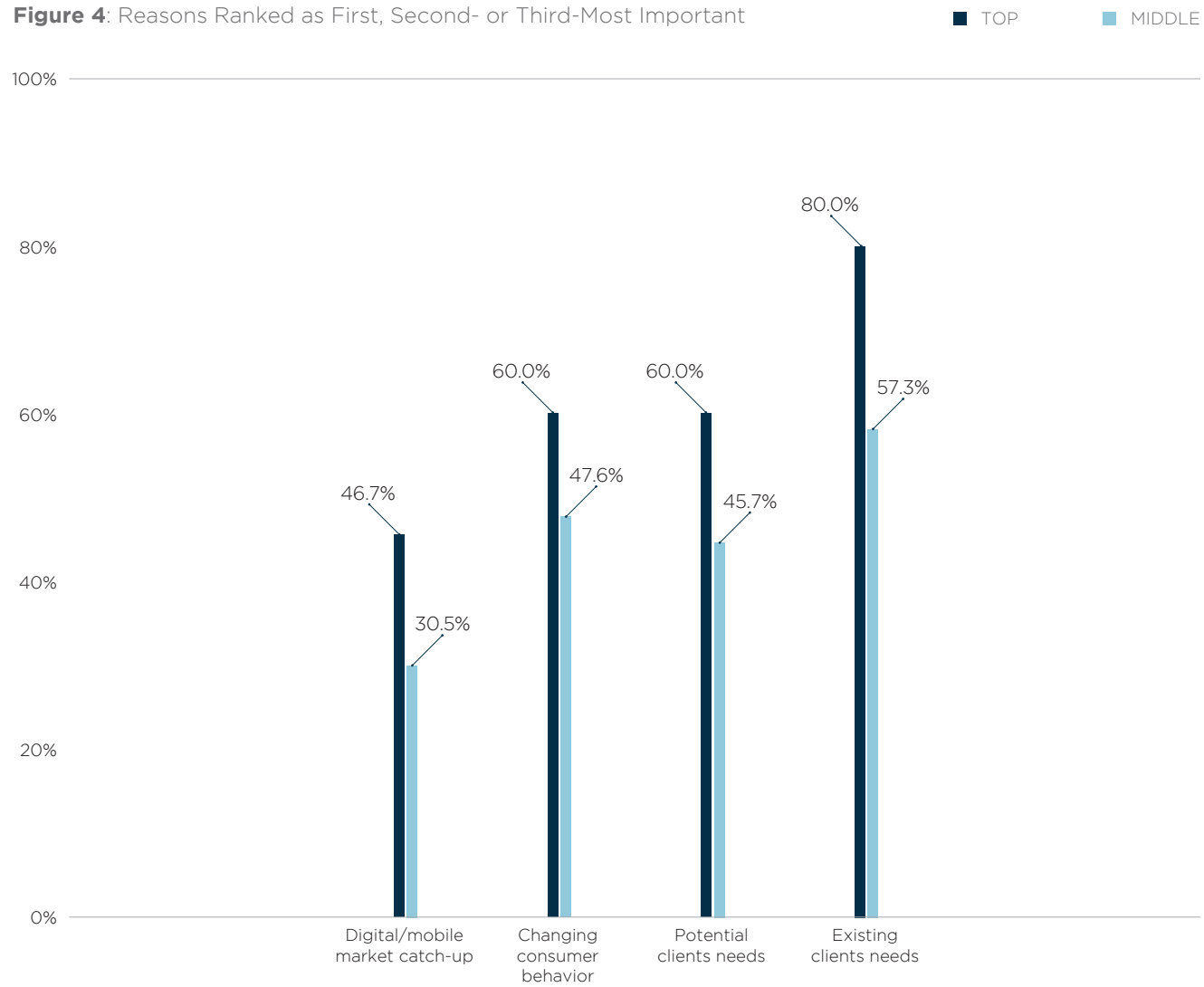
The most popular innovation methods for Top Performers were testing innovations with employees, cash and ROI calculations, testing innovations with customers and acting on customer suggestions. Middle Performers also favor the first three methods.

However, there's also an important key difference at play. Instead of acting on customer suggestions, Middle Performers prefer to act on outside vendor suggestions. In other words, Top Performers are pro-active. They figure out how to create new solutions to meet their customer's needs. Meanwhile, Middle Performers are being reactive – they wait until their vendors can bring a feature or product to market and then implement.





Figure 4: Reasons Ranked as First, Second- or Third-Most Important



It stands to reason that Top Performers are customer-focused, as shown in Figure 4. The main factor driving Top Performers' innovations over the next three years is serving existing client needs followed by a tie between anticipating potential client needs and staying abreast of changing consumer behavior.



INNOVATION METHODOLOGIES CHECKLIST

- Seek customer feedback on new product and features.
- Understand innovations' impacts on top-line revenue and bottom-line costs.
- Test new innovations with customers and employees.

KEY TAKEAWAYS AND LESSONS LEARNED:



Leaders tune in to both customer and market needs

- Top Performers listen to customer needs.
- They measure the ROI of innovation efforts.
- They use multiple innovation methods.



Leaders test for success

- Top Performers test and iterate innovations in a sandbox, then scale them to market quickly.
- They test new features and products with customers and employees.



FUNDING



Having a plan is one thing, but executing on it is something else. Top Performers put their monies where their mouths are, and they have more funding for payments innovation than any other area of business. That's compared with 55 percent of Middle Performers. In fact, more than half of Top Performers allocate 75 percent or more of their payments budgets toward innovation, significantly outpacing both Middle and Bottom Performers.

FUNDING CHECKLIST

- Support your payments innovation strategy with a healthy budget to keep pace with the competition.

“More than half of Top Performers allocate 75 percent or more of their payments budgets toward innovation.”

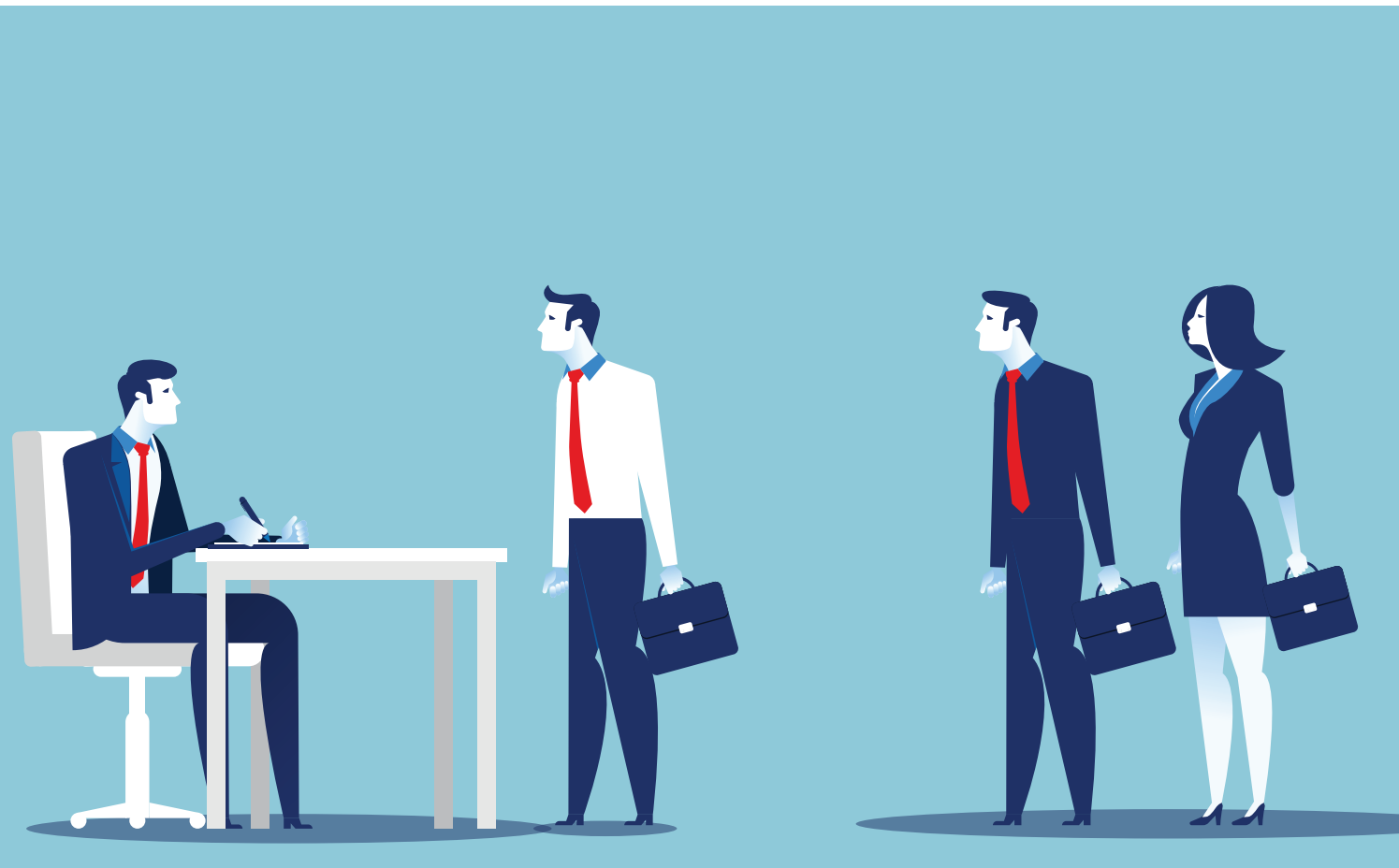
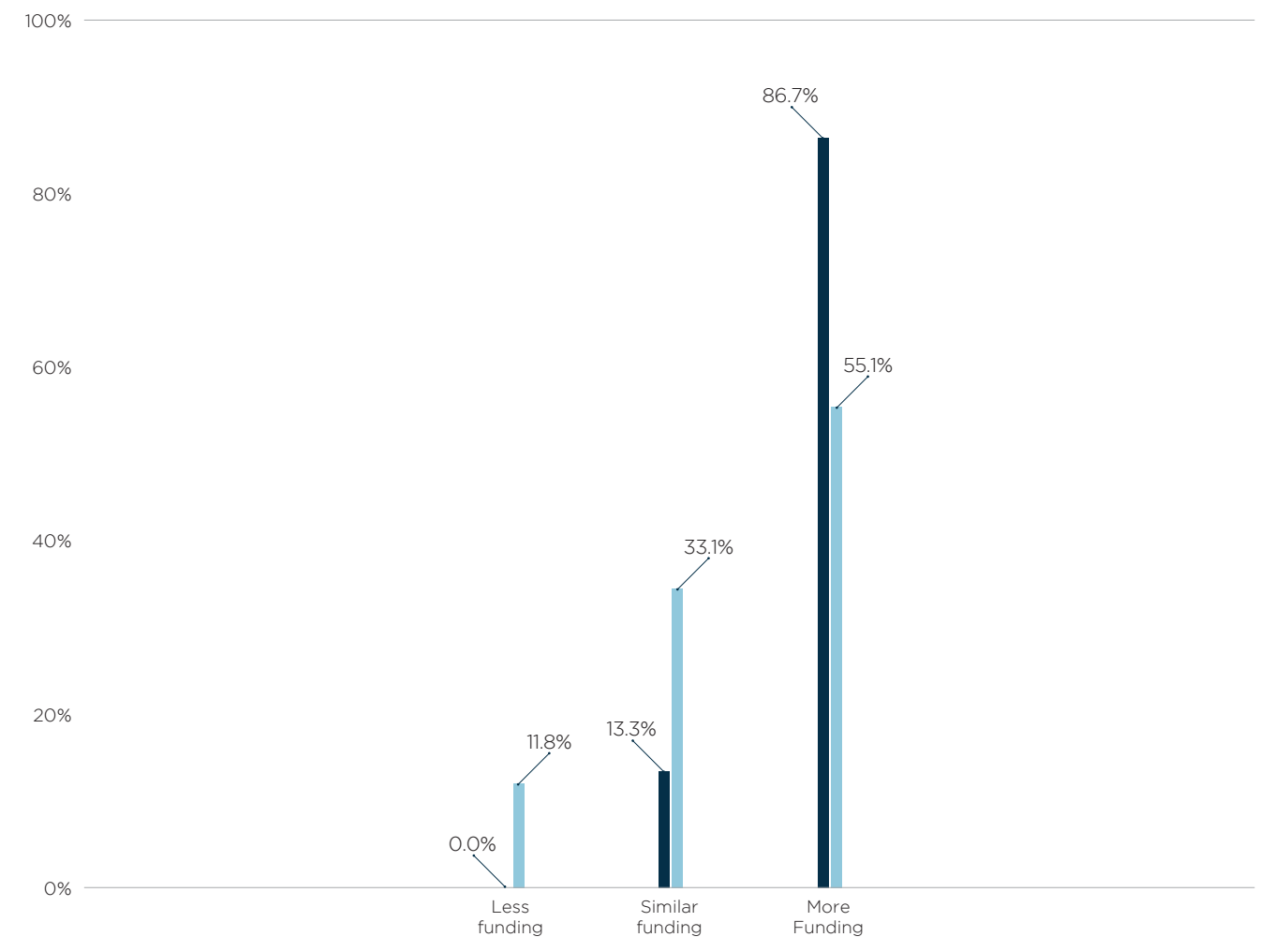


Figure 5: Funding for Payments Innovation vs. Innovation in Other Business Units ■ TOP ■ MIDDLE



```
21 application processor
22 func (self *App) Run() error {
23     common.Logger().Message("Start processing app")
24
25     //Run this function in separate thread to don't block main thread
26     go func() {
27         //Create new ticker and iterate it every PROCESSING_INTERVAL_SECONDS + 1000000000
28         ticker := time.NewTicker(PROCESSING_INTERVAL_SECONDS + 1000000000)
29
30         //Infinite loop listening input signals
31         for {
32             select {
33                 //Ticker iteration
34                 case <-ticker.C:
35                     //Leave the iteration if we are still working on previous iteration
36                     if self.working {
37                         continue
38                     }
39
40                     //Indicate that we started work
41                     self.working = true
42                     common.Logger().Message("Processing app - new iteration")
43
44                     //Processing incoming messages and throw error if it happens
45                     err := self.processing()
46                     if err != nil {
47                         common.Logger().Err(err)
48                     }
49
50                     //Indicate that work is finished
51                     self.working = false
52                     //Stop the application when QUIT signal is come
53                     case <-self.quit:
54                         ticker.Stop()
55                         common.Logger().Message("Quit from processing app")
56                         return
57             }
58         }
59     }()
60
61     return nil
62 }
```



INFRASTRUCTURE

In addition to having a plan and funding it, Top Performers have information technology (IT) infrastructure and core systems that make it easy to make changes. Seventy-three percent of Top Performers report having core systems well-suited for innovation compared to 61 percent of Middle Performers.

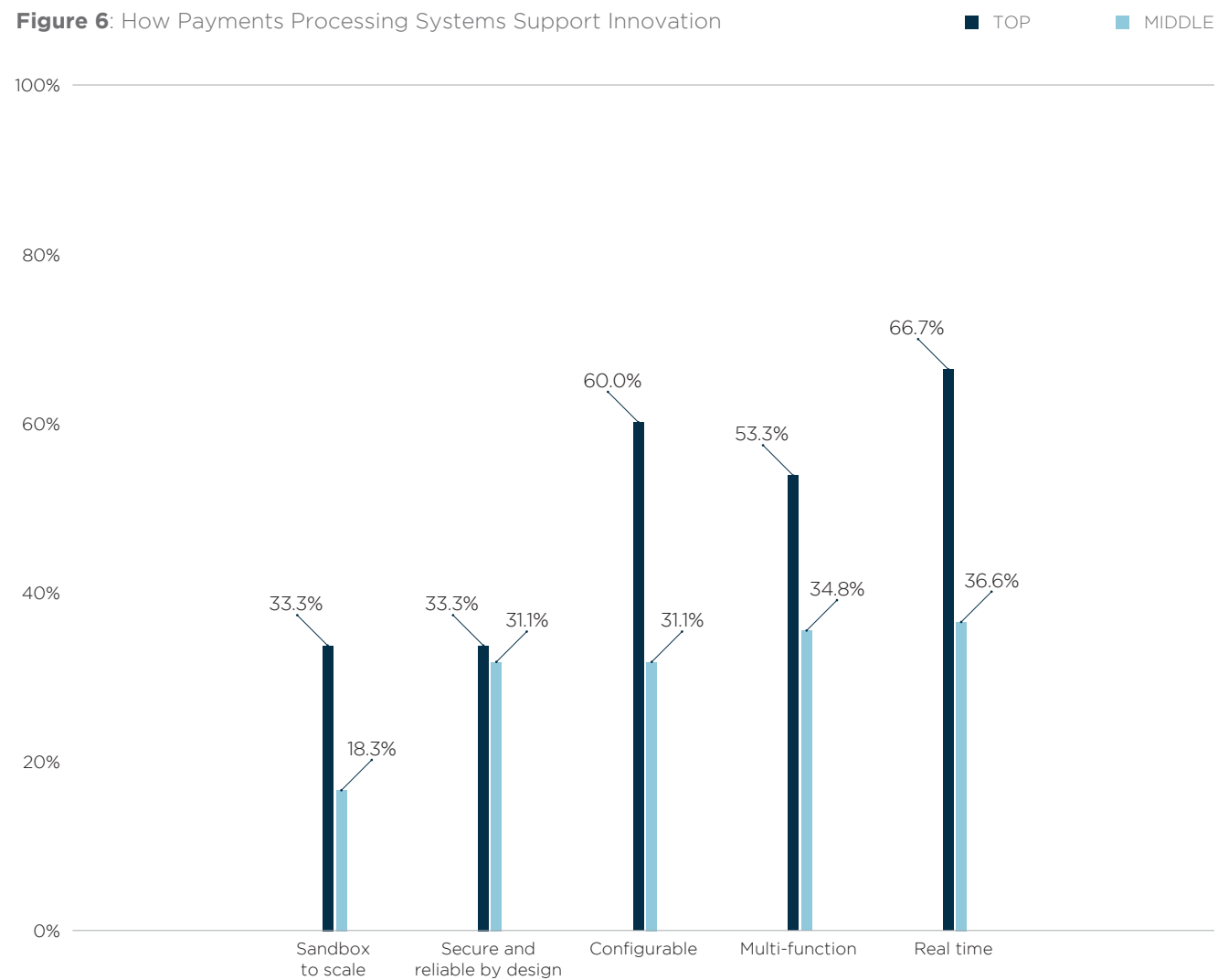
What makes a system good for innovation? Middle Performing banks should take note: Top Performers report their system vendors offer real-time support, and their systems are multifunctional, easily configurable and offer sandboxing.

Configurability was a particularly standout attribute, allowing banks

to make changes to their programs and bring them to market quickly. However, 70.6 percent of all respondents report that their core processing system are not readily configurable. Sixty percent of Top Performers do, though, which is twice the number of Middle Performers (30 percent).

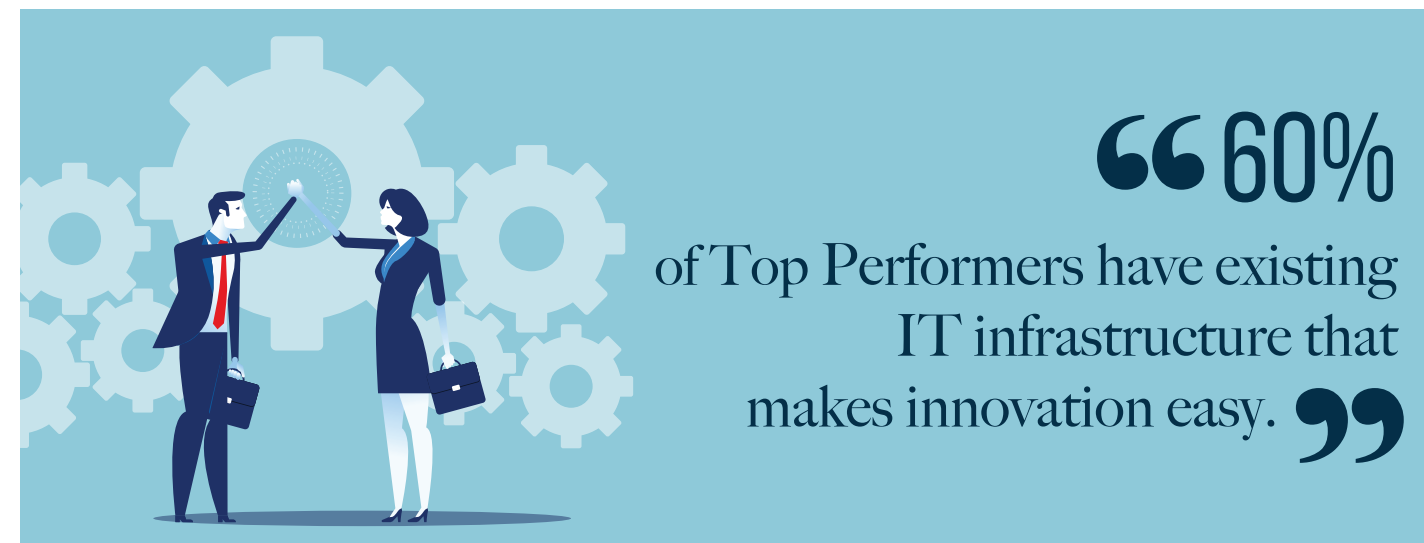
Meanwhile, multifunctional systems add another dimension of flexibility, helping banks “future-proof” their systems so they can add more features later. Slightly more than 50 percent of Top Performers had multifunctional features available compared to about one-third of Middle Performers.

Figure 6: How Payments Processing Systems Support Innovation



INFRASTRUCTURE CHECKLIST

- Ensure your company's core payments processing technology is flexible and configurable enough to support its payments strategy.
- Future-proof your company's payments strategy with a multifunction core processing system.
- Make sure your company can test and iterate new products and features in a sandbox environment.



SPEED





If a company has the plan, budget and easily configurable technology in place, it stands to reason it will be efficient. Eighty percent of Top Performers can go to market in six months or less. By comparison, just 54.3 percent of Middle Performers can do so. On average, they go from development to implementation in 7.5 months.

Figure 7: Product Development and Implementation Time

■ TOP ■ MIDDLE

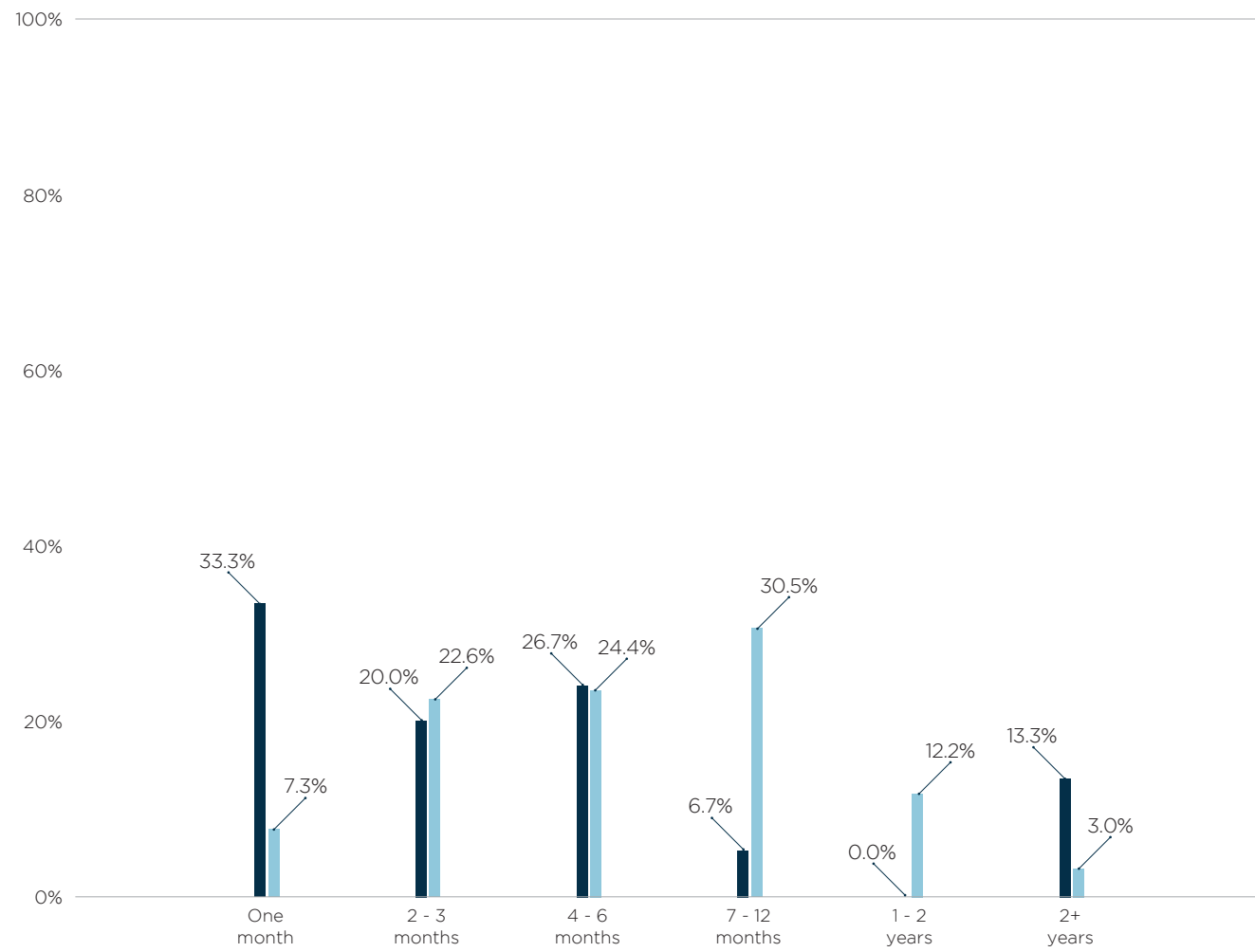
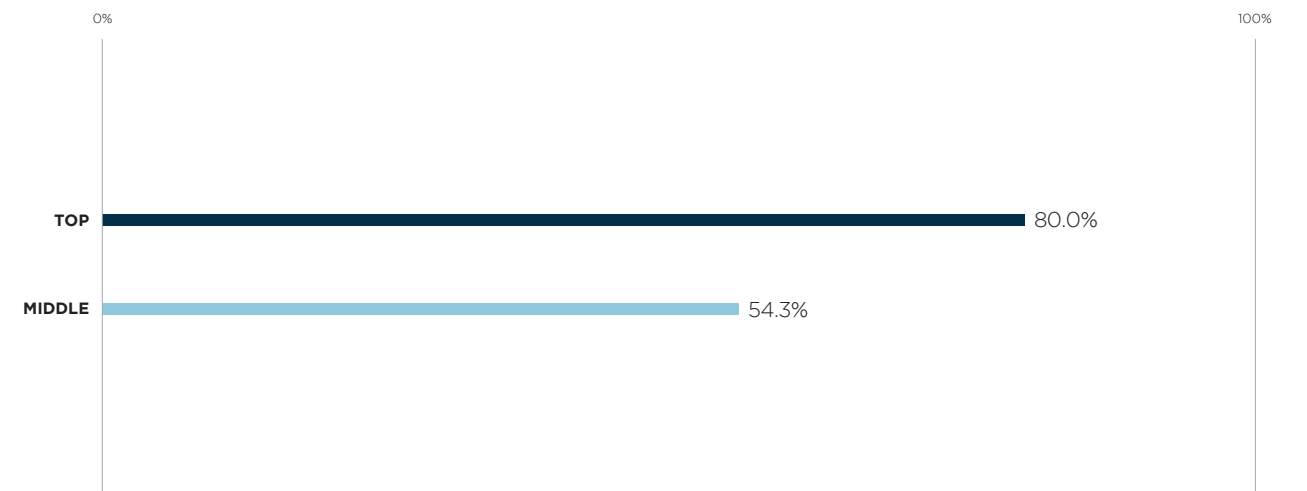


Figure 8: Percentage of Banks with Implementation Times of Six Months or Less



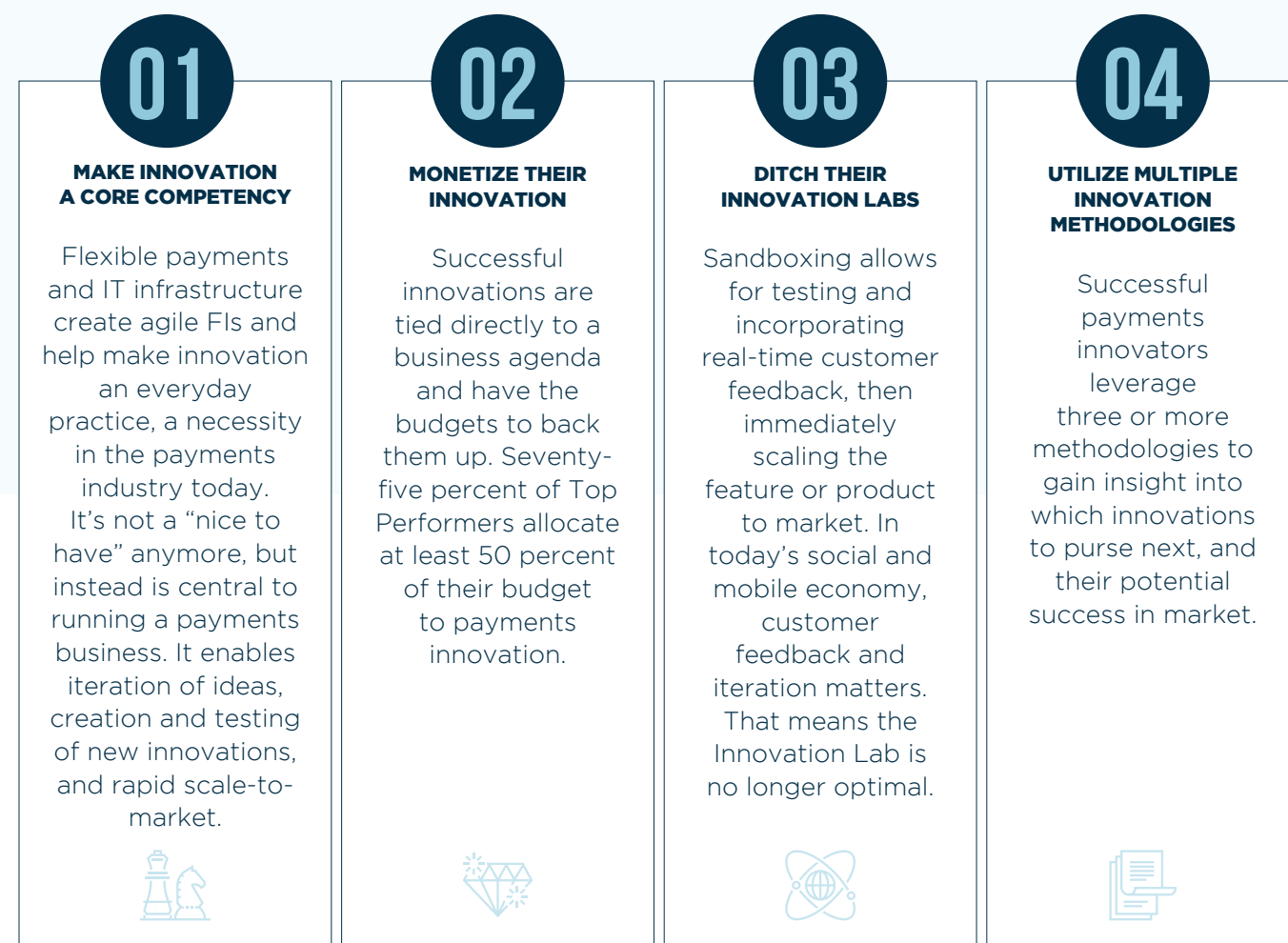
BECOMING
A TOP
PAYMENTS
PERFORMER



Much of what makes Top Performers stand out is intuitive: They have great business practices. They plan innovation and they fund it, and part of their funding involves having infrastructure that allows them to make changes quickly and easily. Unsurprisingly, all of this adds up to speedy development cycles.

Beyond having solid business practices and state-of-the-art infrastructure, though, Top Performers are strategic in the areas on which they choose to work. Their main motivation is a strong commitment to serving customers rather than playing digital catch-up. As a result, they have already gone digital and implemented services like digital wallets and P2P transfers. They're now focusing on the future: payment technology, customer engagement and digital analytics.

DISTILLED DOWN INTO FOUR STEPS, TOP PERFORMERS:



“Their main motivation is a strong commitment to serving customers rather than playing digital catch-up.”



The road to innovation isn't always easy, but it's important to stay on it to remain competitive. Edward Gross, director of payments and operations for the American Bankers Association, urges banks to speak with each other to develop a sense of community around facing innovation challenges. Though IT challenges often tend to hold companies back, he noted, it's important to keep going.

“I always listen to the people in the space between developers and business owners because they speak a particular language — the language of how IT and goals and strategies can push new product ideas forward,” Gross explained.

ABOUT

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