The Impact of Open Banking in the Banks' Business Model

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Abstract

Open Banking is bringing a significant impact to the financial sector offering business opportunities which go beyond the need to comply to a mandatory regulation on the enhancement of functionality and security of the underlying technology. New players and FinTech companies are riding the Open Banking wave and, by a certain extent, paving the way for traditional large banks to access to innovative revenue models through partnership and collaboration archetypes. Banks are asked to recalibrate their investments and adopt a holistic strategy in order to take advantage of the extensive and deep client relationships and to exploit new revenues streams mainly related to the use of data. Indeed, Open Banking represents a natural evolution as the financial ecosystem becomes more and more digitally capable. Within this context, banks' competitive positioning is that of being the primary custodian of financial data and building on their own strengths to enrich customer experience so to guarantee the long-term sustainability of the business in the decades to come.

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Introduction

More than a decade ago the idea of Open Innovation was beginning to make its way in the innovation policy circles. The idea was simple yet pathbreaking. Rather than protecting their invention innovators should share their ideas with other innovators so that a growing pool of new ideas were made available. This would benefit all innovators at a limited cost. The idea rested on the aspect of public good that innovation carries.

Transition strategy towards an Open Innovation model includes flexible and service-oriented business models able to integrate customers, moreover, put customers in the center of business focus through the adoption of appropriate architecture, IT infrastructure and business strategies. Today this approach seems to be extended to Open Banking, a banking practice that provides third-party financial service providers open access to consumer banking, transaction, and other financial data from banks and non-bank financial institutions, which can be seen as a powerful accelerator of innovation in banking. In what follows we will discuss some of these aspects, which deal with innovation in products, technology, business models, companies data generation, and as a consequence bringing new opportunities for policy making.

From regulatory driven implementation to business opportunity: a holistic view on the impact of Open Banking on the business model of large banks

Open Banking is bringing a significant impact to the financial sector and is progressively becoming a strategic leverage to expand products and services, increase transparency and empower customers to take more informed financial decisions. Banks are embracing the business opportunity represented by Open Banking shifting their investments beyond the need to comply to a mandatory regulation and focusing on the enhancement of functionality, performance, security and stability of the underlying technology.

While moving the first steps in the adoption of the Open Banking, many banks had to put their effort mainly in the implementation of the new regulations and technology framework to allow the networking of data across institutions for use by consumers, other banks, and third-party service providers. Today, with the foundation of the new technological structure implemented, the threat of merely meeting a regulation can be diverted to build further and stronger on the business opportunities created by the Open Banking paradigm.

The shift from mere costly compliance to a business opportunity to take advantage of, calls for a holistic approach. In fact, each bank needs to select its relevant business case and assess the investments needed, exploring new and innovative revenue models together with partnership and collaboration archetypes. The strategy adopted will direct both the quality and the benefits of products and services for the different customer segments.

In this context, financial services are asked to identify the scenario that provides the greatest value with the shortest time to market while continuing to invest in capabilities to keep up with technological progress. The key areas defining the Open Banking strategy for incumbents currently concern new payment solutions as real-time payment initiation, less cumbersome processes especially for corporate customers as well as digital customer identity verification, personal and business financial management and enhanced credit risk scoring. Clearly, Open Banking is impacting a wide range of products, some of which are driven by standardized technology or proprietary methods while others are offered partnering with external providers including emerging players and FinTech companies.

How are new players and FinTech companies riding the Open Banking wave?

Turning the gaze to the broader financial ecosystem, it is worth to mention that prior to the introduction of Open Banking, FinTech companies had already started developing and offering services based on the aggregation of different data sources, such as personal finance management tools or digital accounting capabilities for corporates. Now, most of the FinTech companies active in this sector, are focusing on providing other businesses with solutions to integrate Open Banking technology into their propositions. Services in this space include platform to collect and share specific set of data, processes to streamline digital onboarding, tools to facilitate fast payment initiation and platform for account and asset aggregation. Within this framework, traditional banks are mainly interested in the possibility to integrate authorized third-party data of current or new clients to enhance identity verification and anti-frauds processes and to refine customer segmentation to improve client's engagement. On the other hand, neo-banks are using these FinTech solutions to enable easier ways to transfer money towards their accounts and offer to final customers advanced payments solutions on their highly technological channels. Another relevant case is that of non-banks entering the market introducing brand new services as the so called "Buy Now Pay Later". These players are using Open Banking capabilities coming from third party providers to offer the possibility to purchase online and split the ticket installments without any additional charge with a smooth digital process.

Open Banking: exploration of new revenue opportunities and innovative business models for large banks

It is evident that Open Banking is providing enhanced capabilities for a wide range of players opening the doors to a new wave of digital products and services. Reduced time-to-market, low infrastructure maintenance costs, greater level of specialization offered by emerging players or FinTech companies, are all advantages that could potentially lure away bank customers with fast and user-friendly services. But all these do not tell the entire story though, as banks' extensive and deep client relationships, grounded in years of mutual trust, will prove difficult to prise apart. In addition, incumbents deal in comprehensive offerings, covering the whole spectrum of financial services. With these differences in mind, collaboration represents a highly promising avenue for both parties – with banks benefiting from FinTech's technological expertise, and FinTech companies gaining access to banks' deep industry experience and client bases.

A strategic approach for large banks could be the creation of an "ecosystem" of partners to offer a broad range of innovative products tailored on different segments and needs and act as intermediaries between them and the customers. In turn, banks could sell specialized services for which they still hold a dominant position to either fintech companies or smaller banks. Last, another promising concept could be the "revenue sharing model", which sees banks and third parties collaborate in the co-creation of new products and services and share future revenues.

The value creation enabled by Open Banking encompasses also brand-new revenue streams that could support the mitigation of the pressure on traditional margins. Examples are represented by the possibility for banks to leverage external data and analytics-driven information, such as status of liquidity management and payment flows to anticipate client needs. For their part, banks can explore data monetization use cases to provide actionable insights to other players.

In addition to new revenue streams, Open banking is also paving the way for the adoption of innovative business models. Traditionally, when new products or services are launched, the monetization strategy is to charge customers fees to use them, as happens for example by charging for real-time payment collections and reconciliation. When providing a service in partnership with an ecosystem partner instead, a common model is represented by the revenue sharing, a sharing system that ensures each entity is compensated for its efforts. But banks can also start considering the adoption of digitally native models such as *pay-per-use*, a payment model that charges based on resource usage, whose scope of application is expanding in other industries (as manufacturing) and could be potentially borrowed and tailored for banking use cases.

Strategic moves and Investments needed to unlock Open Banking opportunities

Targeting the innovative revenue streams and business models enabled by Open Banking, requires a holistic strategy and the assessment of significant investments. With this respect, key factors with a huge impact are the creation of compliant application interfaces and the task of overhauling legacy infrastructure to meet current and future technology requirements.

From an infrastructure perspective, managing the complexity of bank legacy systems, the interoperability of current and future offering and the integration of external providers with the existing environment is all but trivial. IT Architecture efforts to migrate or complement legacy systems and the implementation of external solutions demands a significant amount of resources, people, time and money. In addition, for what concerns the pure application development, it is crucial to endow programmers with tools allowing them to create valuable connection and not just standardized interfaces to comply with regulation; this will turn the costs into an investment able to maximize the interaction with other players' interfaces as well.

Another unquestioned spillover of Open Banking is the large data network generated. Large financial institutions risk being unable to exploit new incoming data, while providing other players with the considerable and increasing amount of banking data available thanks to their own clients. Hence, the definition of a proper data strategy and a clear investment roadmap to acquire technology, tools and skills to enhance data integration and advanced analytics is another significant expense to be carefully evaluated.

Finally, it is central to focus on the cyber-threats and cyber-security risks of Open Banking. Although the regulatory framework is laid on strict rules on security and data protection, it is important for banks to invest in new protection strategies to safeguard application, prevent, assess and fight cyber-attacks in the new era of interconnectivity.

On a higher level, for banks to stay relevant in this competition arena, the shift towards Open Banking calls for multiple activities of process transformation and optimization. More broadly this concerns the transformation of process characteristics, methodologies, tools, but also investments in upskilling and reskilling programs for employees, to be paired with onboarding of the right resources from the outside.

As Open Banking picks up pace, organizations must figure out not only the best investment strategy but also the best pricing scheme for their customers. Older pricing models may not fit in the Open Banking system as the increased demand for price transparency and matching, could fuel a growing willingness by customers to switch banks. This dynamic is forcing banks to assess new effective pricing strategy able to offer the best return on investment while ensuring value for third parties involved.

The path to transforming Open Banking investments into business opportunities

It appears evident how Open Banking represents a natural evolution as the financial ecosystem becomes more and more digitally capable. Within this context, banks' competitive positioning is that of being the primary custodian of financial data, acting as regulated intermediaries between technology vendors and customers. Traditional financial institutions can really exploit the advantage of being perceived as the ones providing greatest protection.

At the same time, banks are asked to build on their own strengths to enrich customer experience, and with it, enhance acquisition, retention and revenue performance, as well as improving back and middle office functions and efficiency. In addition to the internal transformation, a key component in achieving this end is also to partner with the right external player to complement bank offering.

Comparing the investments needed with the new business opportunity powered by Open Banking, it is reasonable to assume that the balance can hold. A plausible expectation for the short term is that infrastructural investments will weigh the most while in the medium to long term, what will account for the greater part will be new revenue flows and minor costs given by increased efficiency. All this needs to go hand in hand with skillful strategic and tactical choices, continuous efforts towards clients' retention and a boost in infrastructures' readiness to expected evolution in markets and regulation.

Balancing the benefits and opportunity with costs and investments needed to make large banks ready to fulfill the task, is challenging. But the path is clear: Open Banking must be integrated in the strategy for product and service development, to guarantee the long-term sustainability of the business in the decades to come.