Overcoming Near- and Long-Term Revenue Challenges

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Most banks and credit unions are challenged to generate previous levels of revenue, much less meaningful increases, based on an array of industry-wide headwinds that are significantly impacting:

» **Interchange income**

» **Interest income**

» **Non-interest income**

The new and fierce competitive landscape is a fundamental contributor to these revenue challenges.

Fintechs and big techs have been extremely successfully developing payments solutions that disenfranchise banks and credit unions. Many of these innovators are now reinventing other channels like business and income payments and point-of-sale. Others are leveraging their brand equity and loyalty to further disenfranchise banks and credit unions by offering traditional financial services like deposits, loans, and cards – often with better digital experiences – to accomplish their ultimate goal of replacing financial institutions as the primary providers of financial services.

Digital reinvention has also expanded a financial institution's competition well beyond comfortable, physical markets. Consumers and businesses can now open new accounts or apply for loans in minutes with a credit union down the street, a bank across the country, or a fintech or big tech that is only an app away.

Banking as a Service (BaaS) also further threatens traditional banking since it will enable virtually any company in any industry to embed financial services into its customer experience. Banks and credit unions must begin strategically planning for the impact to their competitive environment when any company can offer traditional financial services.

Compounding these challenges even more, banks and credit unions are facing ongoing, increasingly complex financial management.

> "Revenue outlooks have been cautious and core profitability will likely remain pressured relative to pre-pandemic levels."
>
> **FITCH RATINGS** [1]

INTERCHANGE INCOME

The prolonged pandemic environment reduced debit interchange due to less overall spending and materially less big-ticket spending on luxury goods and travel. Card transactions are also shifting from debit to credit in the unsteady economic environment.

Interchange income has also attracted new regulatory scrutiny and faces a new risk. The legislation proposed by Senator Dick Durbin addresses the transaction routing options that are available for online purchases, since some of the large issuers and issuer processors only support or allow one designated network. But if the legislation is passed and the Federal Reserve enforces issuer cooperation, banks and credit unions of all sizes will likely see a decrease in debit interchange revenue. And if online transactions shift from a bank or credit union's card brand (i.e., Visa or Mastercard) and are routed to debit networks (i.e., Star, Pulse, etc.), they will generate less interchange.

Forward-thinking banks and credit unions need to begin diversifying revenue models to accommodate decreasing interchange. They also need to ensure that their card technology providers can help them respond to the dynamic regulatory environment while helping them optimize operating efficiencies, reduce operating expenses, and maximize ongoing card program performance.

INTEREST INCOME

Today's interest rate environment is significantly reducing interest income, which leads to pressures to increase loan volumes. Interest income is also at risk with fintechs, big techs, and neo banks often offering better rates, more innovative application and funding experiences, and borrower-defined terms. And in the digital/COVID-19 era, a "clean" digital application and origination experience is now an expectation, not a differentiator.

Considering the importance of interest income, today's rock-bottom interest rates, the unprecedented competition for consumer and business loans, and the seamless digital lending experience expected today, banks and credit unions need to more efficiently and effectively originate more loans and provide a modern borrower experience.

NON-INTEREST INCOME

Deposits are at risk too, with fintechs, big techs, and neo banks becoming fierce competitors with traditional banks and credit unions and typically offering higher interest rates on deposit accounts.

Deposit relationships are critical for an array of reasons. They translate into lucrative lending opportunities as well as fee-based commercial solutions, including payments and financial management services.

Finally, traditional fee structures are at risk as well. Again, fintechs, big techs, and neo banks can and will charge less for financial services, which is slowly but surely conditioning accountholders not to pay for financial services. For example, a fintech will offer fee-free deposit accounts to secure the payments being made using that deposit account for funding.

FINANCIAL MANAGEMENT

Financial management has become significantly more complex and virtually impossible to do effectively, efficiently, and accurately without automated, integrated tools that enable data access and aggregation, ongoing analysis, and financial forecasting.

To better manage anything – including financial performance – it must be accurately and consistently measured. And to improve anything – including financial performance – you must have ongoing access to data-driven, actionable insights.

TWO BIG FIRST STEPS TOWARD REINVENTING YOUR REVENUE AND BUSINESS MODELS

Technology has driven many of today's revenue challenges. For example, technology enabled the rise of the worthy new competitors and set the digital expectations for every financial interaction and transaction. But technology can also be the solution for forward-thinking banks and credit unions. There are two first steps you should take when planning the reinvention of your business and revenue models.

First, embrace open banking and the need to become a platform. An open platform leverages APIs (application programming interfaces) that allow you to partner with fintechs and third parties. You can then easily integrate their apps and solutions without "permission" from your existing technology providers and simplify the ongoing maintenance of your technology infrastructure. A platform approach provides absolute discretion over who you partner with, what solutions you integrate, and when.

Operating as a platform will:

» **Improve your customer/member experience, engagement, satisfaction, and retention**

» **Increase your operating efficiencies and agility**

» **Create competitive advantages and differentiators**

» **Enable you to proactively keep pace with the expectations that have been established by the alternative providers of financial services**

» **Ultimately drive near- and long-term growth**

An open platform is plug-and-play at its best.

> "All of this curtailed revenue is happening at the same time as (banks and credit unions) face extreme pressures to reimagine their businesses around digital, analytic, and automation technologies. This shift requires resources and dollars, and there's a shortage of both right now."
>
> **GONZOBANKER [2]**

Second, pick your platform partners wisely. With open banking widely considered to be the future of the financial services industry, if a potential partner can't clearly demonstrate its open strategy, it doesn't have the future-ready vision you need.

Embracing open banking, developing a practical open strategy, and evolving into a platform can't happen overnight – it takes time and a village. But time is money considering today's dauting revenue challenges. As you begin your journey to open banking, carefully consider the revenue-generating solutions you can deploy today.

Jack Henry is here to help with both. Long-term, we have a fundamental commitment to open banking and the unique ability to be your platform-enabling technology partner. More immediately, we can help you respond to today's revenue challenges with an array of modern solutions that can be leveraged as strategic components of tomorrow's platform.

For ongoing, timely insights and valuable information about our open strategy and revenue-generating solutions, visit **discover.jackhenry.com/overcoming-revenue-challenges** today.

SOURCES

1) Christopher Wolfe, Bain K. Rumohr, and Laura Kaster, "U.S. Banks See Loan, Revenue Pressure Despite Consumer Spending Pickup," Fitch Ratings, accessed August 9, 2021, fitchratings.com/research/banks/us-banks-see-loan-revenue-pressure-despite-consumer-spending-pickup-16-07-2021

2) Steve Williams, "Bankers Are Caught in a Revenue Recession," GonzoBanker, accessed August 9, 2021, gonzobanker.com/2021/07/bankers-are-caught-in-a-revenue-recession

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