

INNOVATION READINESS PLAYBOOK

SCALING PAYMENTS INNOVATION 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.

MAY 2018


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

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ABOUT



Over the past few years, American consumers have become almost as acquainted with FinTech startups as they have with the banks and credit unions on which they have relied for generations. Credit Karma, Mint, NerdWallet and Venmo are now household names, companies that serve a growing demand for new, improved and personalized financial services that no one even knew existed 10 years ago.¹

The FinTech sector is overflowing with startup companies like these. They may be small, but these firms are disrupting the financial industry with their cutting-edge innovations.

Meanwhile, big banks and other established financial institutions (FIs) are adapting, realizing and accepting that they, too, may have to try their hands at innovation if they want to keep ahead of the consumer demand curve. JPMorgan Chase, for example, recently revealed it had been testing the issuance of financial instruments on a new blockchain-based platform. Its experiments drew the interest of established organizations like Goldman Sachs Asset Management, Pfizer and Legg Mason, all of which participated in the testing process. JPMorgan hopes the platform will help streamline and secure certain financial services, as well as attract and satisfy customers.²

This change in conventional attitude toward blockchain technology conveys an important truism about the modern financial sector: Banks, credit unions and other traditional FIs are still the big dogs in the game, but they recognize that they need to keep pace with experimental FinTechs and challenger brands — like PayPal and Amazon — when it comes to innovation.

¹ Author unknown. Ranking the top fintech companies. The New York Times. 2016. <https://www.nytimes.com/interactive/2016/04/07/business/dealbook/The-Fintech-Power-Grab.html>. Accessed May 2018.

² Irrera, Anna. JPMorgan, National Bank of Canada, others test debt issuance on blockchain. Reuters. 2018. <https://www.reuters.com/article/us-jpmorgan-blockchain/jpmorgan-national-bank-of-canada-others-test-debt-issuance-on-blockchain-idUSKBN1HROCM>. Accessed May 2018.

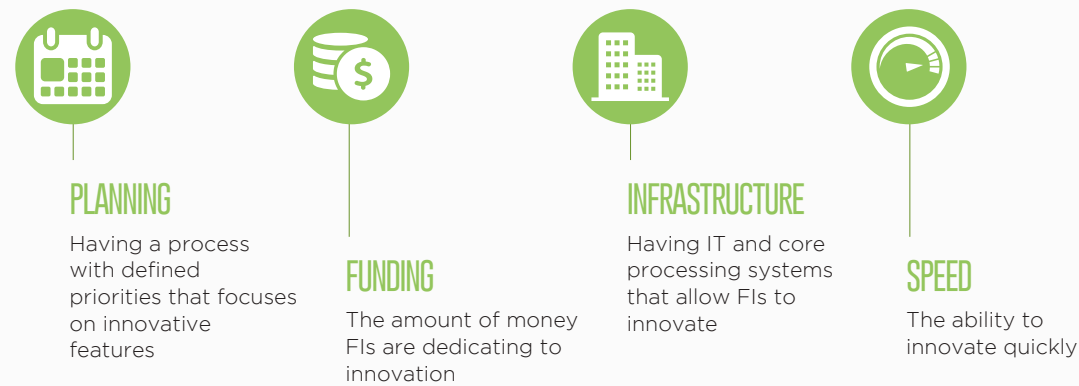
Quickly getting new payments products and features to market may be important, but how can FIs ensure their innovations meet demanding market expectations and requirements before rolling them out at scale? What tools do the most successful innovators use to build, test and more effectively get payments innovations to market?

We rolled out our [Innovation Readiness Index™](#) last fall, in collaboration with i2c, to gauge where FIs are on the road to becoming payments innovators. [The Innovation Playbook series](#) was subsequently developed to zone in on specific patterns in our dataset. The first, published in January, was our [Top Payments Performer Edition](#) and dug deep into what top innovators are doing to make an impact. The next edition, published in March, examined [mid-sized FIs](#), and we studied the innovation performance of different [bank types](#) — including credit unions and commercial and community banks — in April.

This month, we are assessing the role of the sandbox environment in helping banks test new ideas and innovate payments products, revealing both how they are using the methodology and the extent to which it contributes to their success. To accomplish this, we analyzed the FIs in our study that implemented testing programs and compared their outcomes to those of the top performing banks in our Index.



Top Performers distinguish themselves in four categories: planning, funding, infrastructure and speed.³ They define priorities for the next three years and dedicate at least 50 percent of their budgets to innovation. They also have flexible technology, with 60 percent reporting their IT infrastructures and core processing systems make it easy to innovate.



As the name suggests, a sandbox allows an FI to test innovations either in a closed environment — to isolate and test new products, features or programs — or in a live production environment, with a limited set of consumers for real-time feedback before releasing to the wider market. This allows FIs to experiment and build new payments features and products, test them with a small sample of customers, make needed adjustments, then roll them out to the market at scale. Sandbox functionality, when available, is typically supported by an FI's core payments processing solution.

³ PYMNTS 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.

“With sandboxing, even FIs that are not among the Top Performers **CAN INNOVATE** with similar outcomes.”

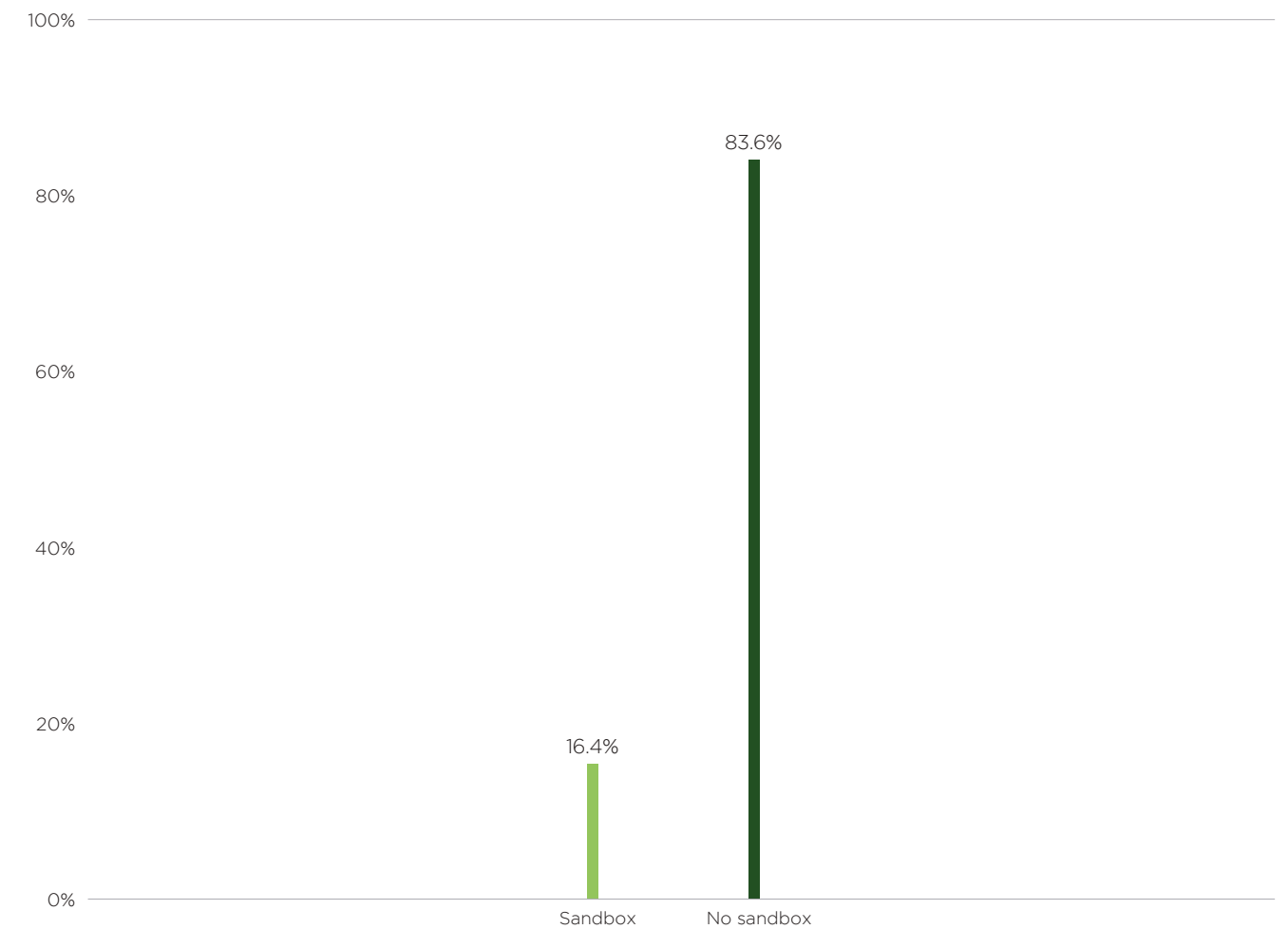
Just 16 percent of the FIs in our Index have core payments systems that allow for sandboxing, but our analysis shows those that employ sandboxing enjoy better outcomes in their payments innovation efforts. These FIs report more successful innovations, delivering higher return on investment (ROI) in terms of more customers and revenue per customer. In addition, sandbox testing gives FIs a clear advantage when it comes to innovation success, enabling any FI — no matter its size — to achieve outcomes like those of the top performing innovators.

In other words, banks don't necessarily require enormous budgets to be effective innovators and maintain an edge against the growing number of fast-moving competitors — including ambitious FinTech startups. What *is* required is a cohesive, adaptable business strategy that incorporates testing mechanisms to ensure high quality in new products and features.

REPORT METHODOLOGY

Who, exactly, are sandbox users?
Our research revealed just 16 percent of all FIs have a core payments processing system that includes a sandbox for testing new technology, as seen in Figure 1. Furthermore, sandbox-to-scale as an innovation methodology is relatively uncommon: Only 22 percent of our surveyed FIs report having used it.

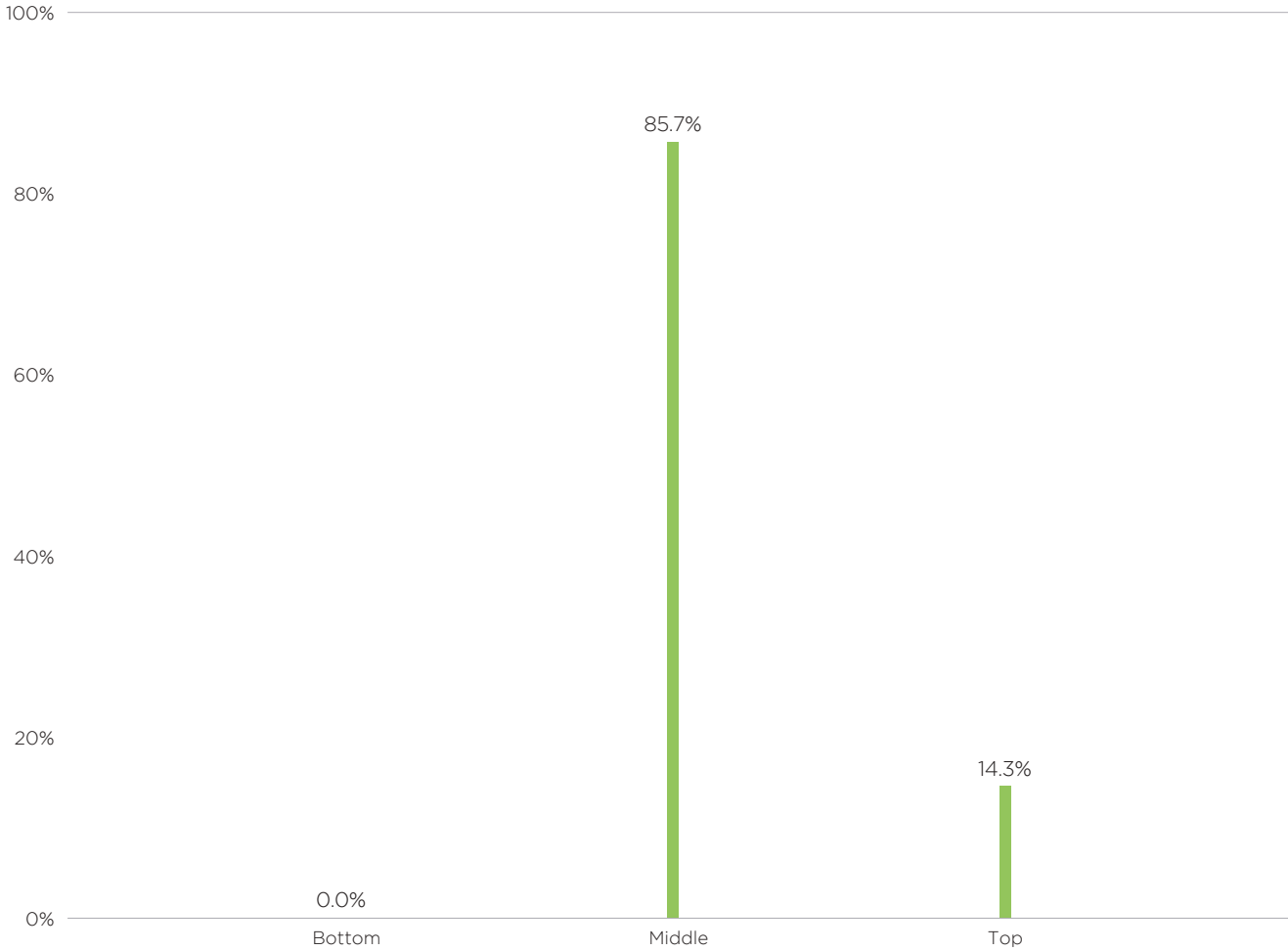
Figure 1: Proportion of FIs with core payments systems that allow for sandboxing



If the sandbox testing methodology is so helpful, why is it so rare among FIs? The answer is simple: The overwhelming majority of legacy core payments systems simply lack the capacity to support sandboxing.

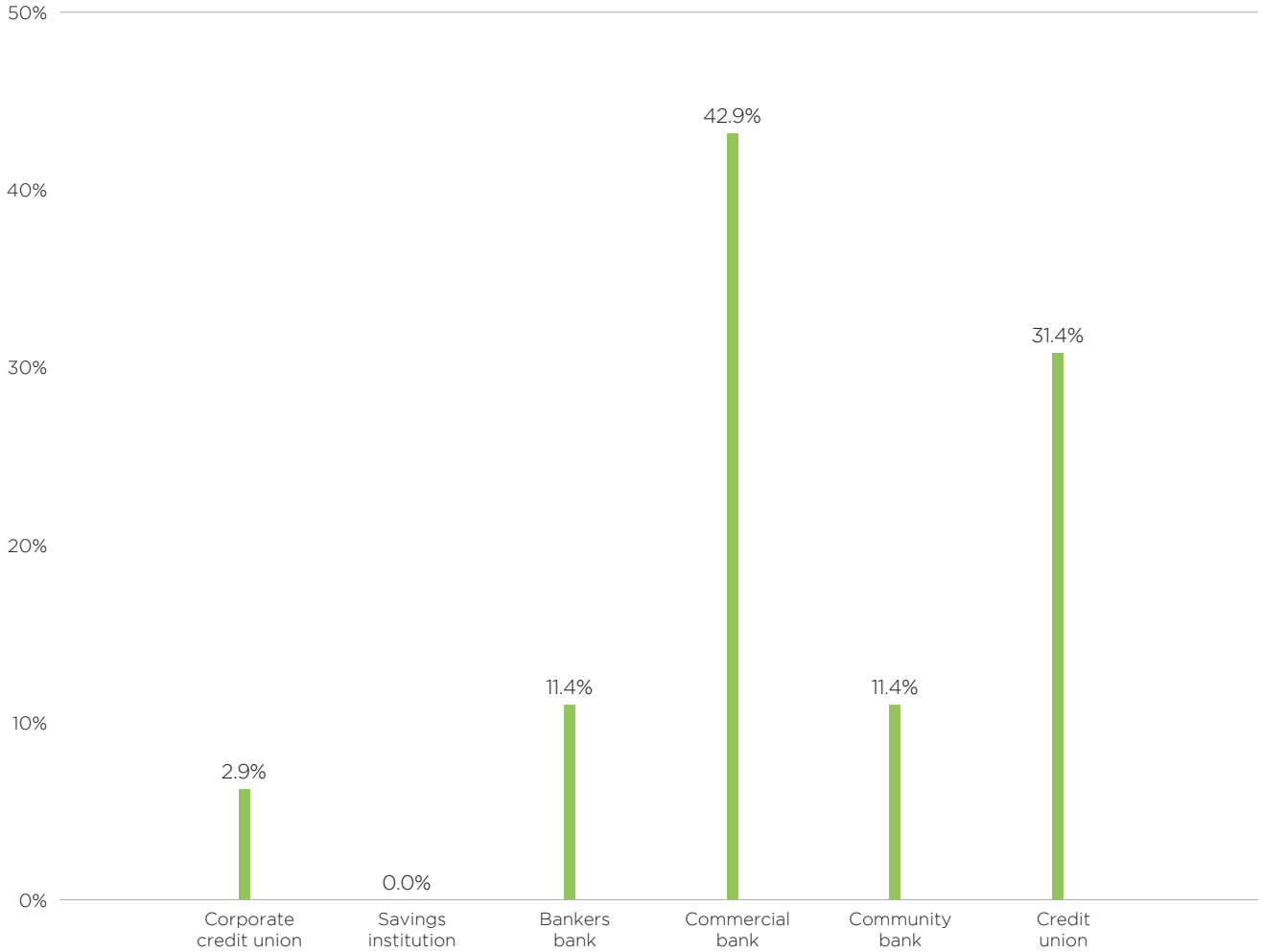
Though rare, sandbox users are overrepresented among the Top Performers in our sample. Forty percent of our Top Performers use sandbox-to-scale functionality and say it is an important innovation strategy. That is not surprising, considering this group reports having more flexible and configurable technology. Still, 86 percent of the FIs with sandbox-supporting core payments processing systems are Middle Performers, as seen in Figure 2, and none of our Bottom Performers used the technology.

Figure 2: Performance of sandboxing FIs

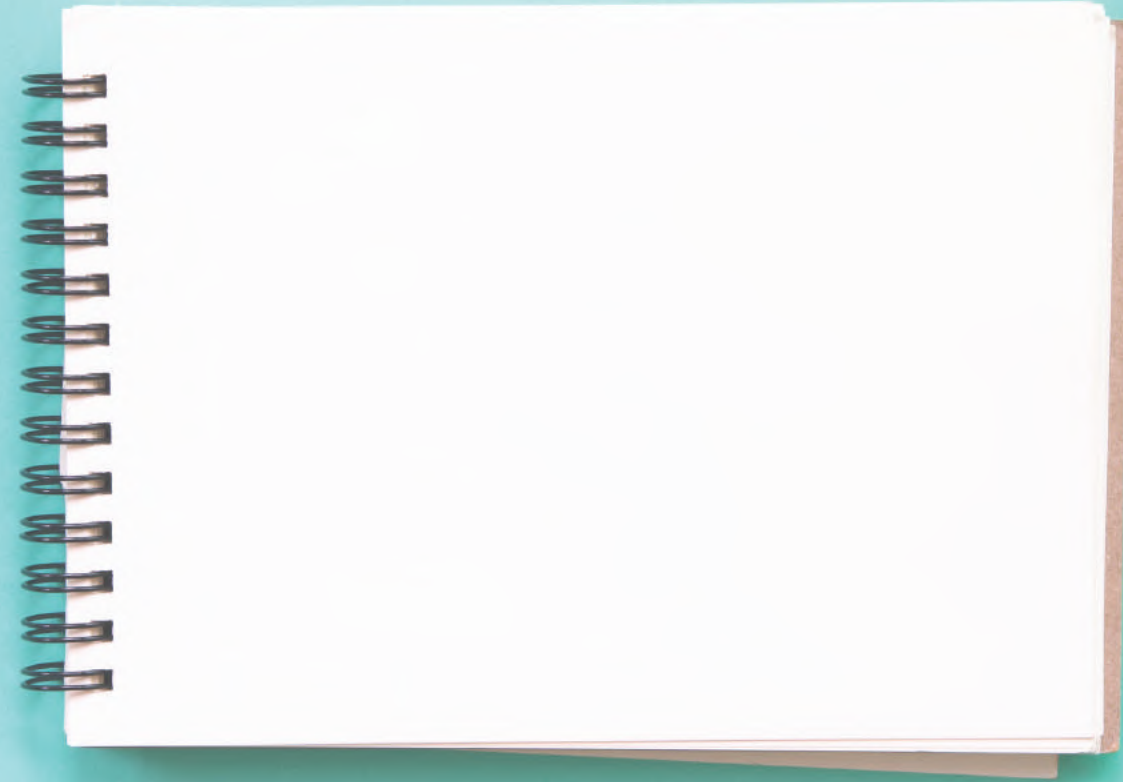


Sandbox users are a diverse bunch, but certain types of FIs appear more likely to use sandboxes than others. Figure 3 shows that 43 percent of sandboxing firms were commercial banks, 31 percent were credit unions and 11 percent were community banks. Most in our study held between \$500 million and \$1 billion in assets, so there appears to be a correlation between holding greater assets and sandboxing.

Figure 3: Sandboxing, by institution type



FUNDING

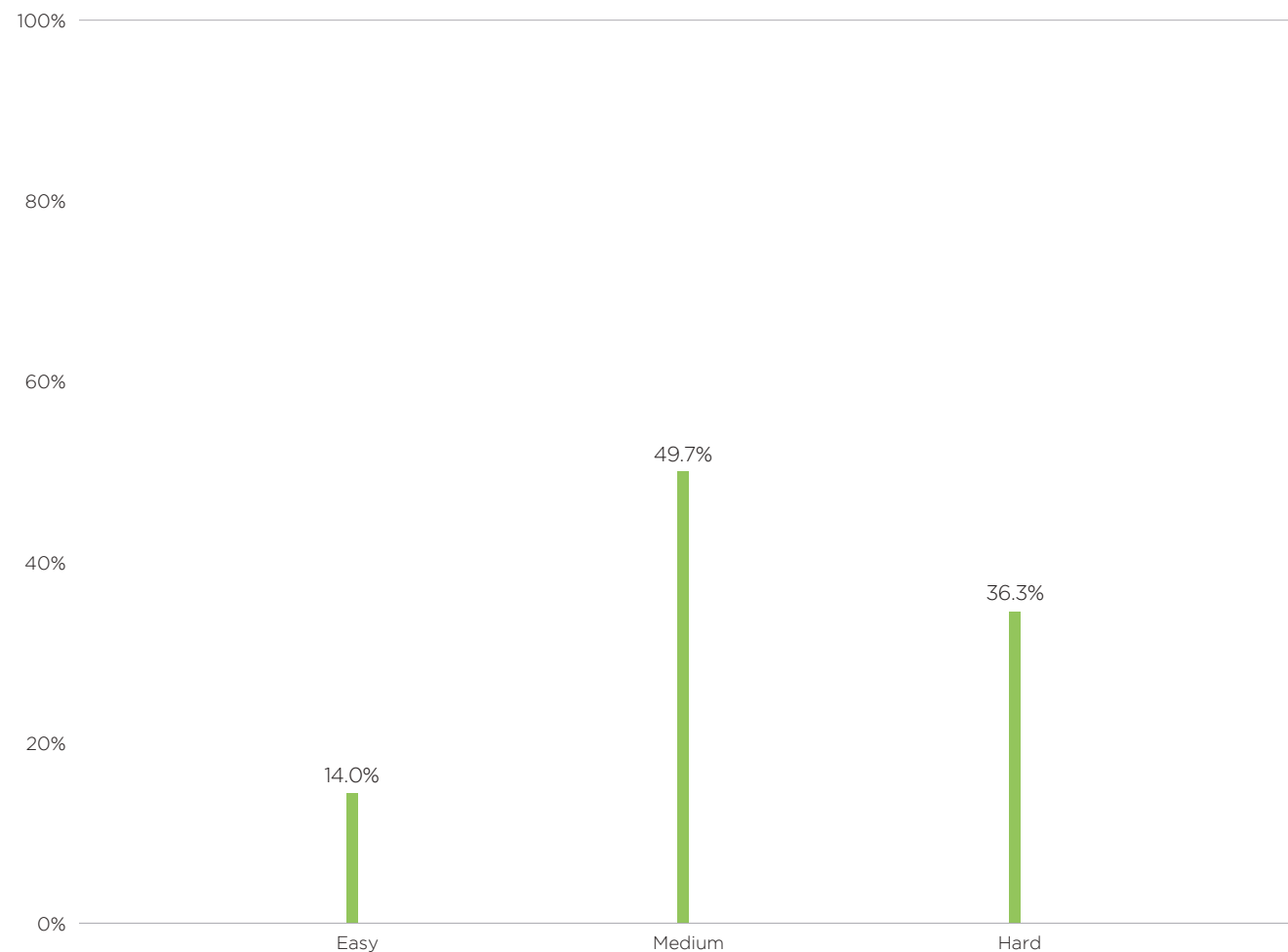


INFRASTRUCTURE

Adaptive, flexible technology is a necessity for modern FIs, allowing them to create new features and complete projects in a quick and relatively painless manner. Seventy percent of our FIs with flexible IT infrastructure said their most recent innovations were extremely successful — more than twice the average. It is no surprise, then, that IT infrastructure was a top concern of all FI groups in our sample.

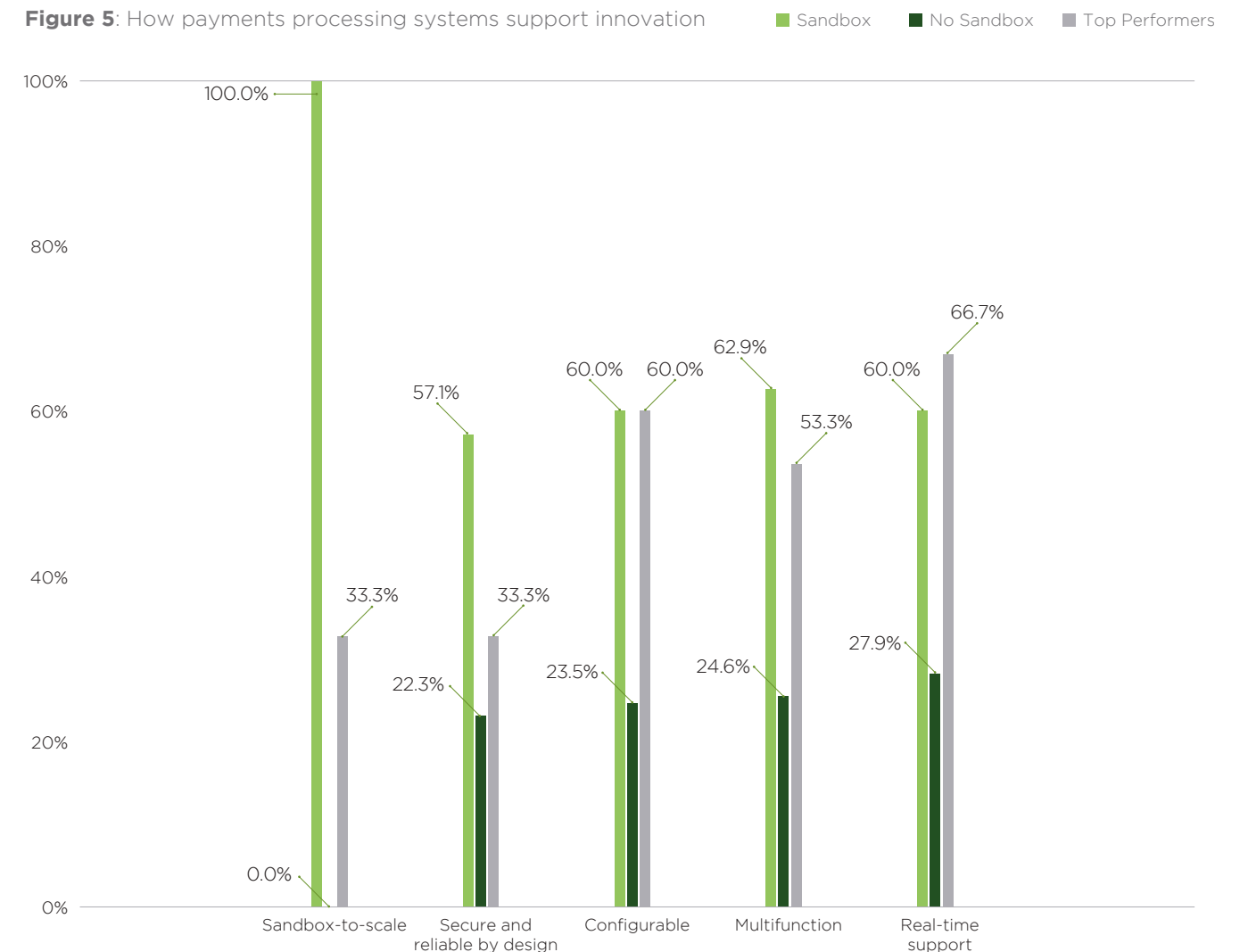
Most FIs consider their legacy systems' infrastructure a significant innovative hindrance, as shown in Figure 4. Specifically, they report that the inflexibility is difficult to improve upon, making their businesses less agile than they need to be to compete in today's rapidly evolving financial market. It's difficult for them to quickly scale innovations, hampering their ability to compete against FinTechs and other, more agile financial services providers.

Figure 4: Proportion of FIs reporting their IT infrastructure makes it easy, medium or hard to innovate



“70% OF FI GROUPS
 WITH FLEXIBLE IT INFRASTRUCTURES
 SAID THEIR MOST RECENT INNOVATIONS
 WERE EXTREMELY SUCCESSFUL
 — MORE THAN TWICE THE AVERAGE. **”**

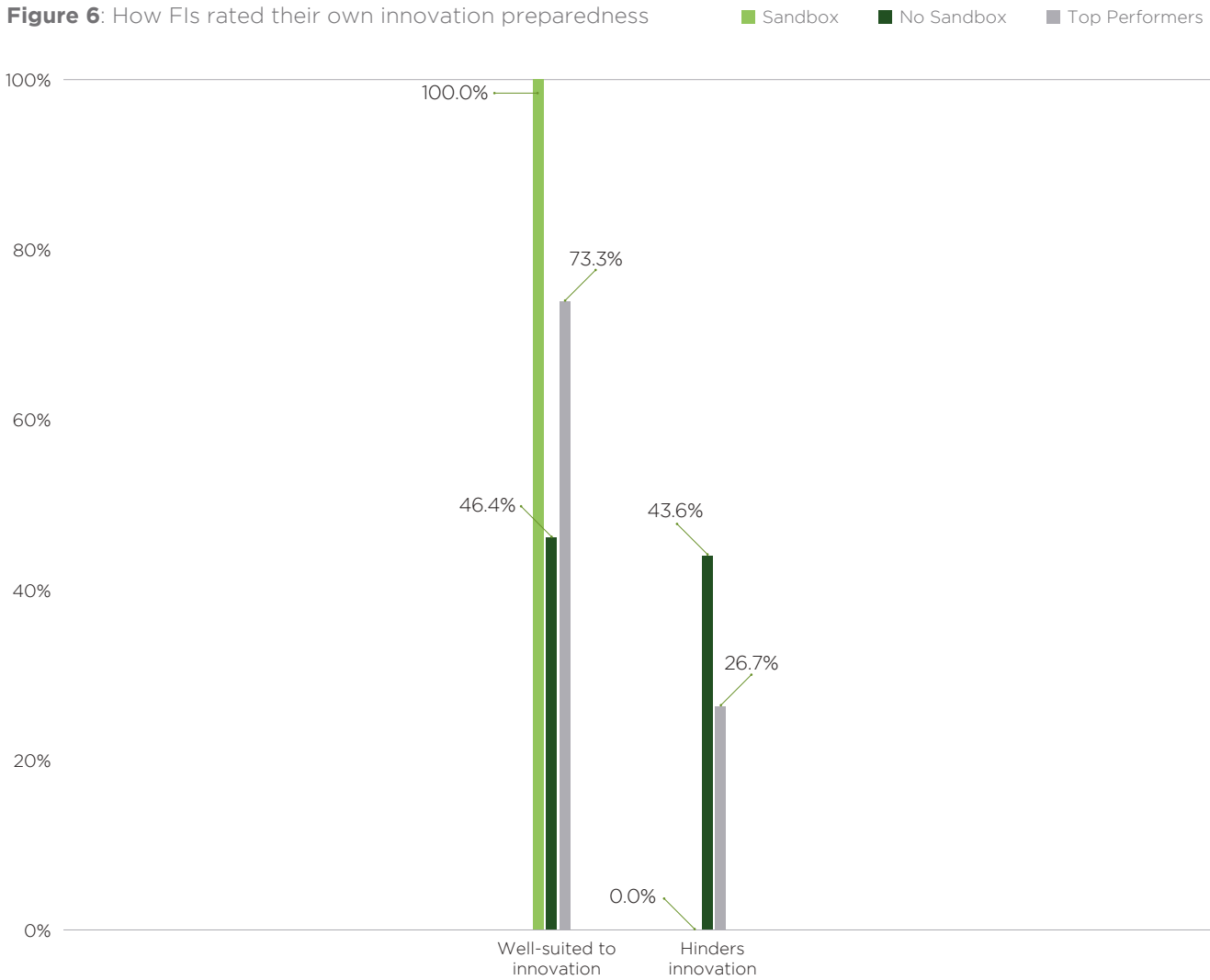
Figure 5: How payments processing systems support innovation



Sandbox users share many of the same attributes as Top Performers, so it is unsurprising that these FIs also report having more flexible IT infrastructures. As previously stated, sandbox-to-scale functionality is typically supported by more modern core processing systems. More than half the sandboxing banks report multifunctional systems that were configurable, secure and offered real-time support for their innovative endeavors, as

seen in Figure 5. This is in stark contrast to FIs that do not sandbox. An FI's innovative preparedness appears to correlate with its usage of sandbox testing. Sandboxing FIs revealed they enjoy a particularly robust innovative capacity. All sandbox users in our study said their IT infrastructures were well-suited for innovation, as did 73 percent of our Top Performers.

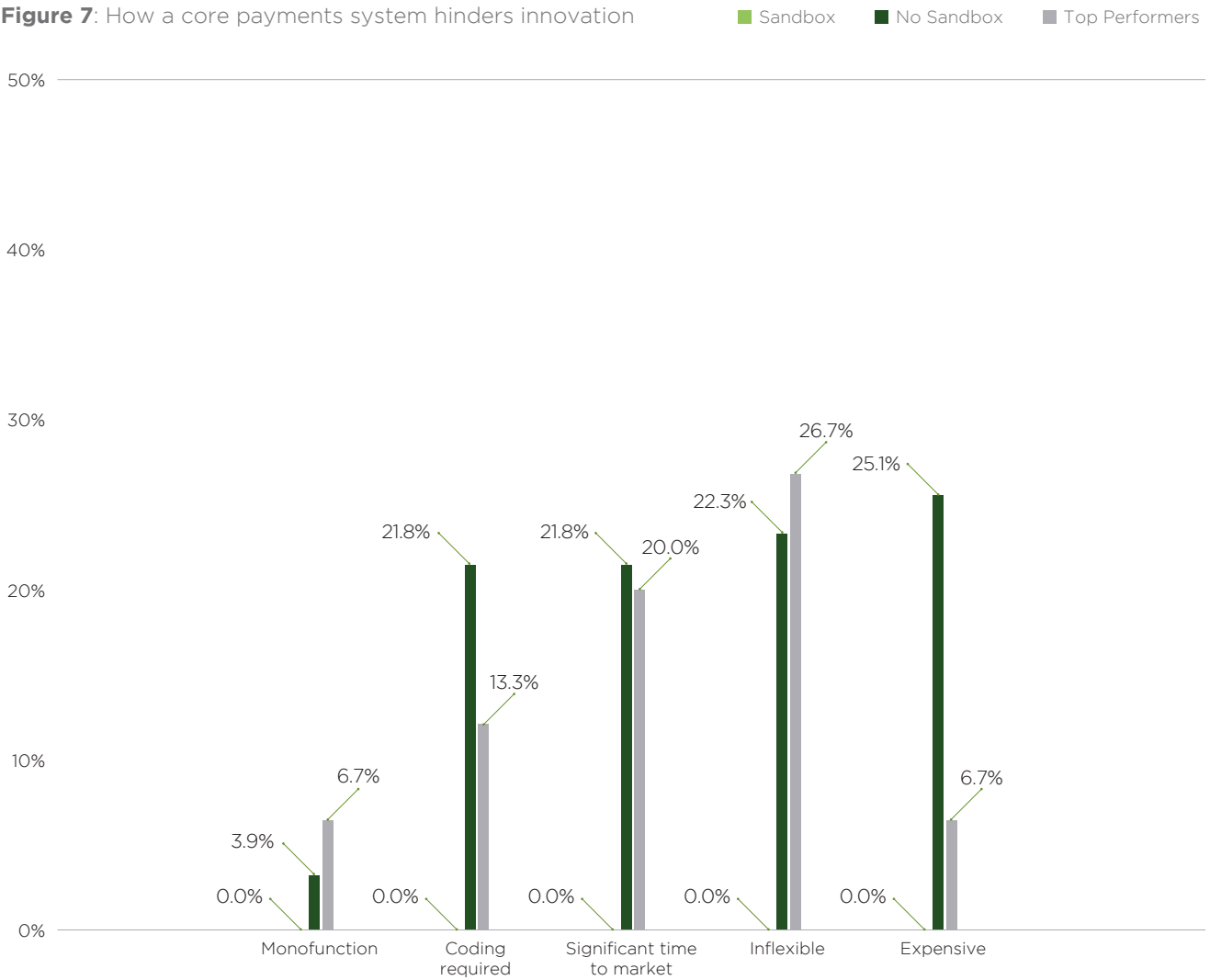
Figure 6: How FIs rated their own innovation preparedness



On the other hand, core processing technology can hinder innovation. Non-sandbox users in our sample reported further hurdles like additional coding required, inflexibility and a lack of speed — all reasons their past innovation projects had suffered. That additional coding is required to render some core payments systems more innovation-friendly is an understandable problem.

Many FIs' legacy IT infrastructures require extra coding to make even simple change to their programs, and they therefore cannot support sandbox testing.

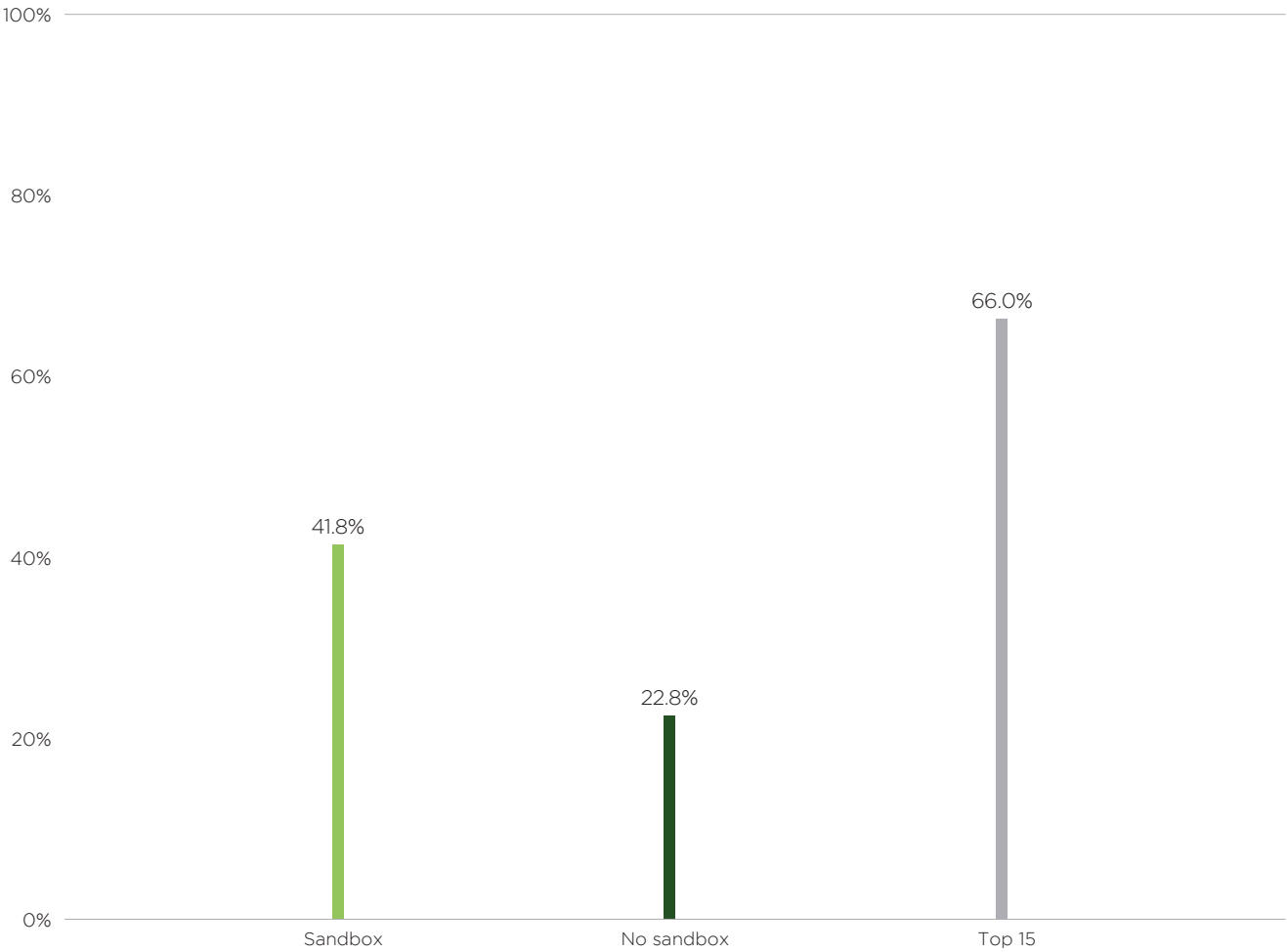
Figure 7: How a core payments system hinders innovation



As reported in our previous Playbooks, funding is a major attribute distinguishing top innovators from other banks. Top performing FIs plan for and monetize innovation, and devote considerable funding and planning to support those initiatives.

Sandboxing FIs also fund their innovations at a much higher rate, allocating 42 percent of their budgets to payments system innovations, on average, as seen in Figure 8. This is nearly twice the amount set aside by non-sandboxing FIs, which report only devoting 23 percent of their financial resources to similar activities.

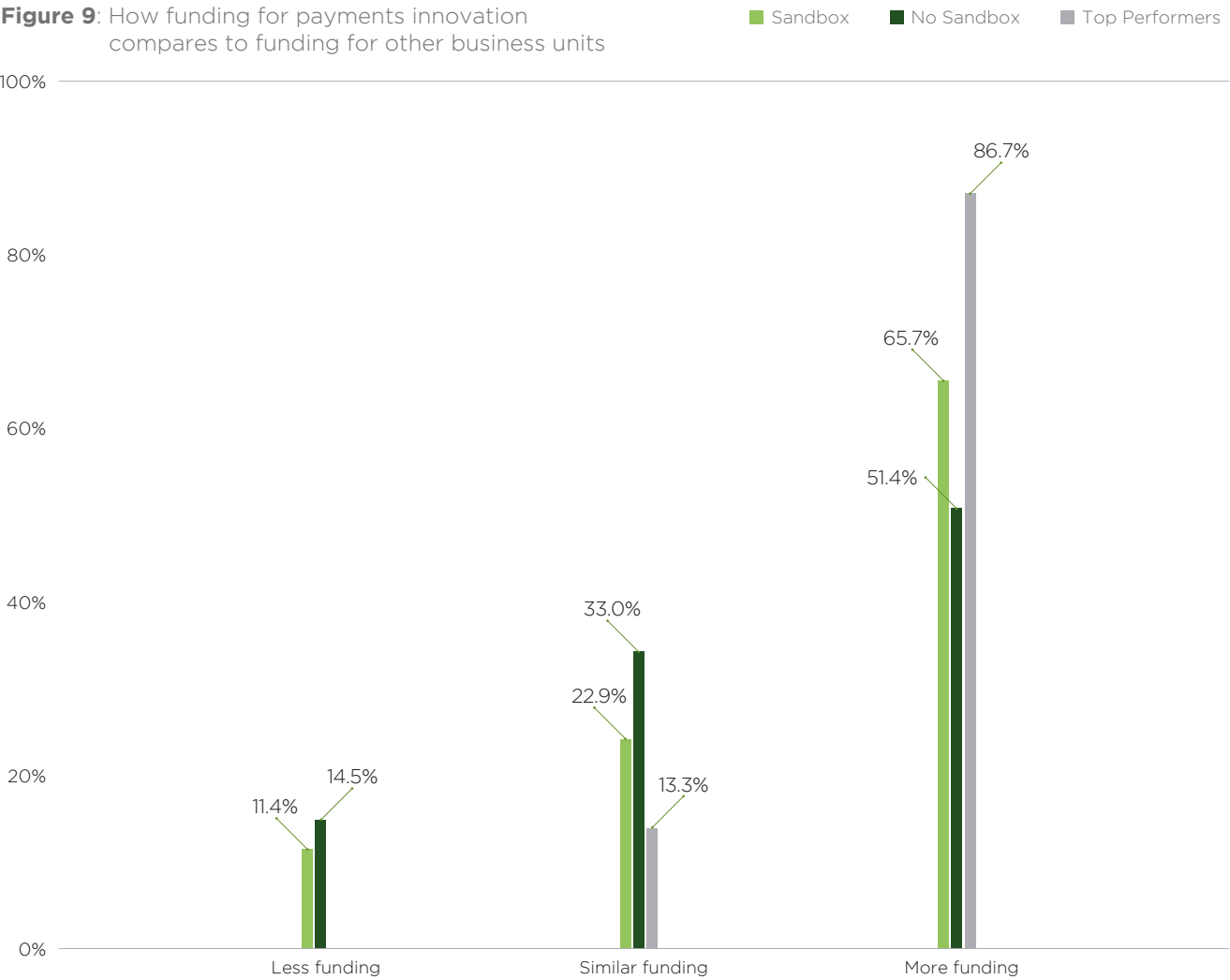
Figure 8: Budget allocated to new products initiatives



Banks that support sandbox testing also tend to assign larger budgets to their initiatives. Sixty-six percent of sandboxing FIs allocate proportionally more resources to their innovation projects than to other projects, as show in Figure 9. Conversely, 51 percent of non-sandboxing firms devote greater funding to tech-related innovation projects than to others.



Figure 9: How funding for payments innovation compares to funding for other business units





**INFRASTRUCTURE
& FUNDING**
CHECKLIST

- ☐ Leverage flexible, configurable payments processing technology that supports a sandbox environment and allows for immediate scale to market.
- ☐ Test and iterate new products and features in a sandbox environment.
- ☐ Commitment to a payments innovation strategy means supporting it with a proper budget.
- ☐ Analyze your current investments and the ROI for existing projects, then reallocate funding based on performance.

KEY TAKEAWAYS AND
LESSONS LEARNED



Sandbox functionality can enable any FI, no matter its size, to achieve Top Performer outcomes.

- The ability to test in a sandbox and rapidly scale to market gives FIs a clear advantage when it comes to innovation success.



Flexible payments platforms that support sandboxing enable rapid innovation and reduce long-term costs.

- All sandbox users in our study said their IT infrastructures were well-suited for innovation.



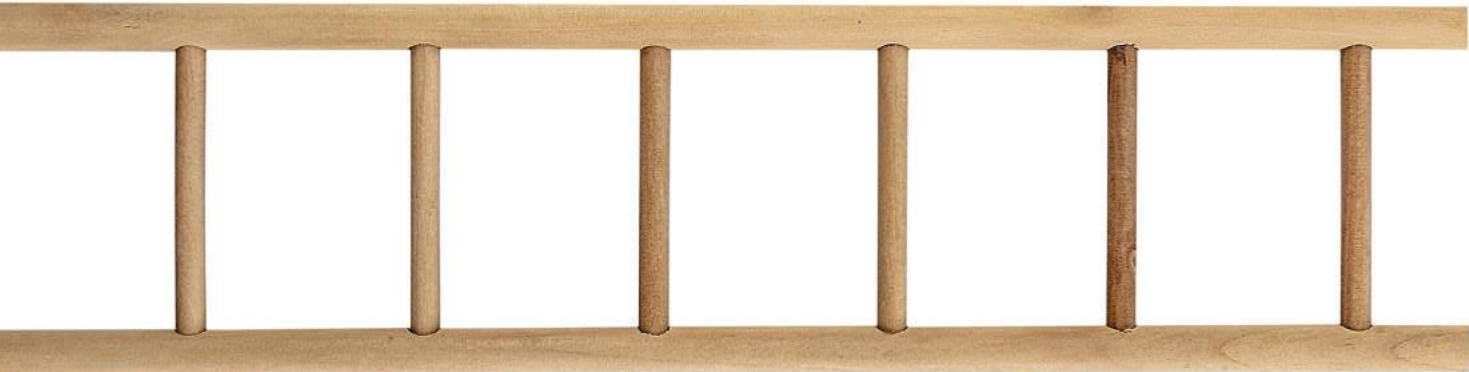
The overwhelming majority of legacy core payments processing systems can't support sandboxing.



PLANNING



Planning is a key attribute for innovation readiness. After all, it’s difficult to execute the right product strategy without a roadmap and defined priorities. Top Performers define their innovation strategies for the next three years while focusing on multiple areas — like payments technology, consumer engagement and mobile/digital payments — instead of limiting themselves to just one option. They also use a variety of innovation methodologies, primarily cash and ROI calculations and testing innovations with employees and customers.

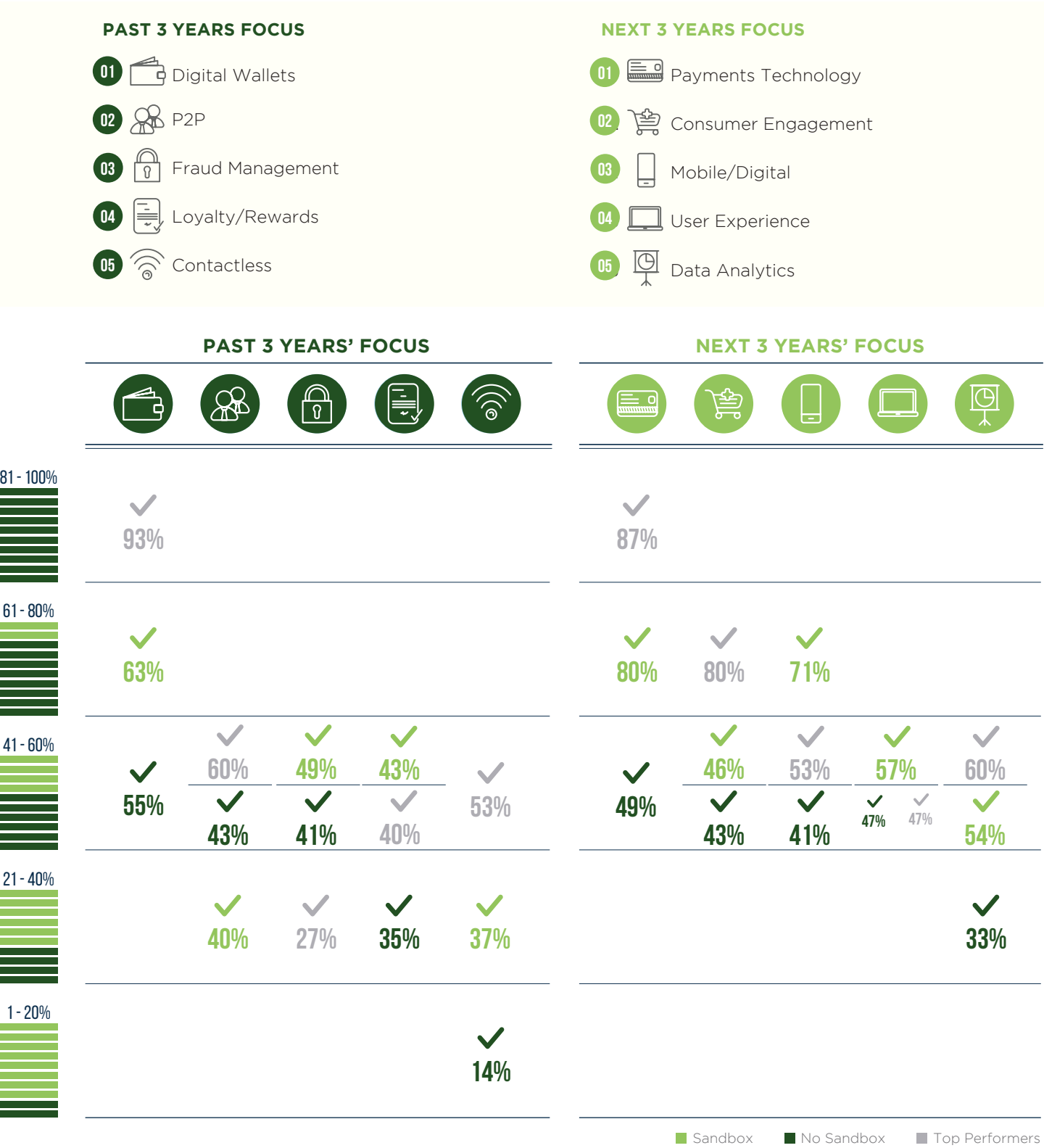


SETTING PRIORITIES:
THE PAST VS. THE FUTURE

Upon closer examination, we found sandboxing FIs have innovation priorities that closely map to those of Top Performers, and were focused on the same areas in the past three years: mobile and digital payments, payments technology and user experience. Sandboxing FIs were also attentive to data analytics and user experience, both of which were important to Top Performers.

Table 1: Past vs. future areas of focus for scaling innovation with sandbox testing

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



Non-sandboxing FIs focused less on user experience and payments technology, such as contactless, in-authorization events and mobile remote deposit. We observed that they focused their innovation efforts on mobile and digital payments over the last three years, and were particularly interested in perfecting their digital wallets, fraud

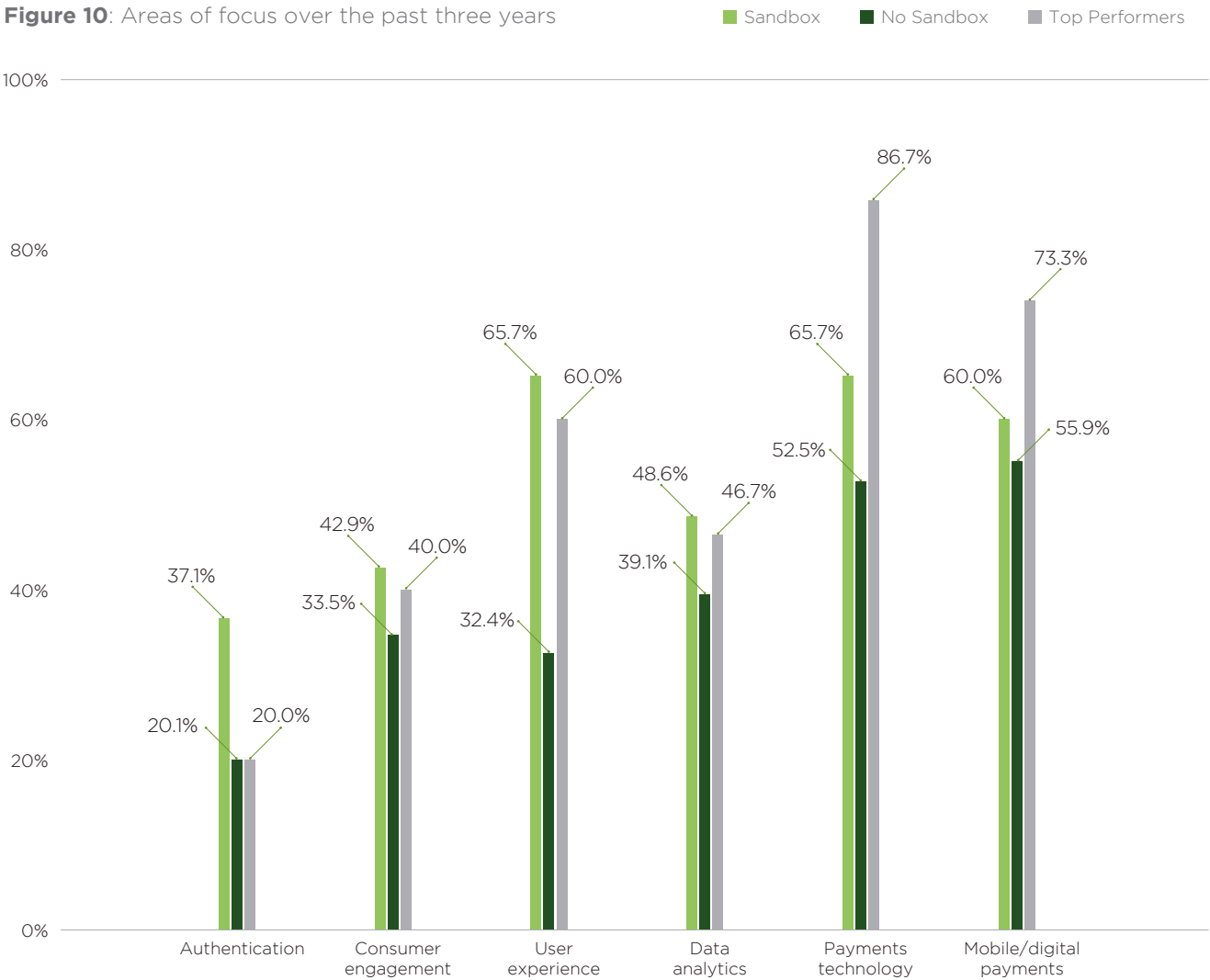
management and person-to-person (P2P) payments capabilities.

Although perfecting contactless payment functionalities was not the top priority for sandbox-using FIs, it was still a significant consideration. Sandbox-friendly FIs considered this feature more important than those that lacked a sandbox testing system.

Sandboxing FIs more closely resembled Top Performers in terms of the factors driving innovation efforts over the next three years. They plan to use sandbox methodology to innovate mobile digital payments, data analytics and, importantly, consumer engagement – a critical area of focus for Top Performers. Sandboxing FIs also say they will focus on payments technology at almost twice the rate of those who do not sandbox, another primary focus for Top Performers. In fact, 87 percent of top innovators report their future innovation efforts will include payments technologies like contactless, in-authorization events and mobile remote deposit capture.



Figure 10: Areas of focus over the past three years



KEY TAKEAWAYS AND
LESSONS LEARNED



PLANNING
CHECKLIST

- ☐ Assess your company’s core payments infrastructure to ensure it has the flexibility to support testing and the rapid roll out of key features.
- ☐ Create a strategy around consumer engagement innovation.
- ☐ Plan for investments in digital engagement, payments technology and data analytics.
- ☐ Set priorities that align with Top Performers’ future innovation efforts.



Sandboxing FIs’ priorities are in line with those of Top Performers.

- These FIs prioritize new payments technologies, user experience and mobile/digital payments, while others lack focus in these important areas.



The ability to test new features helps make planning more effective.

- Having a sandbox to test ideas and perfect new products makes it easier for banks to address both market needs and competition in key areas.
- The right payments technology is critical for testing and scaling innovation.



Engagement will be key in the future.

Engagement = User Experience + Digital + Data Analytics

- Sophisticated consumer engagement is a must, and a priority for both Top Performers and sandbox users.
- Sandboxing FIs are testing and iterating engagement features.

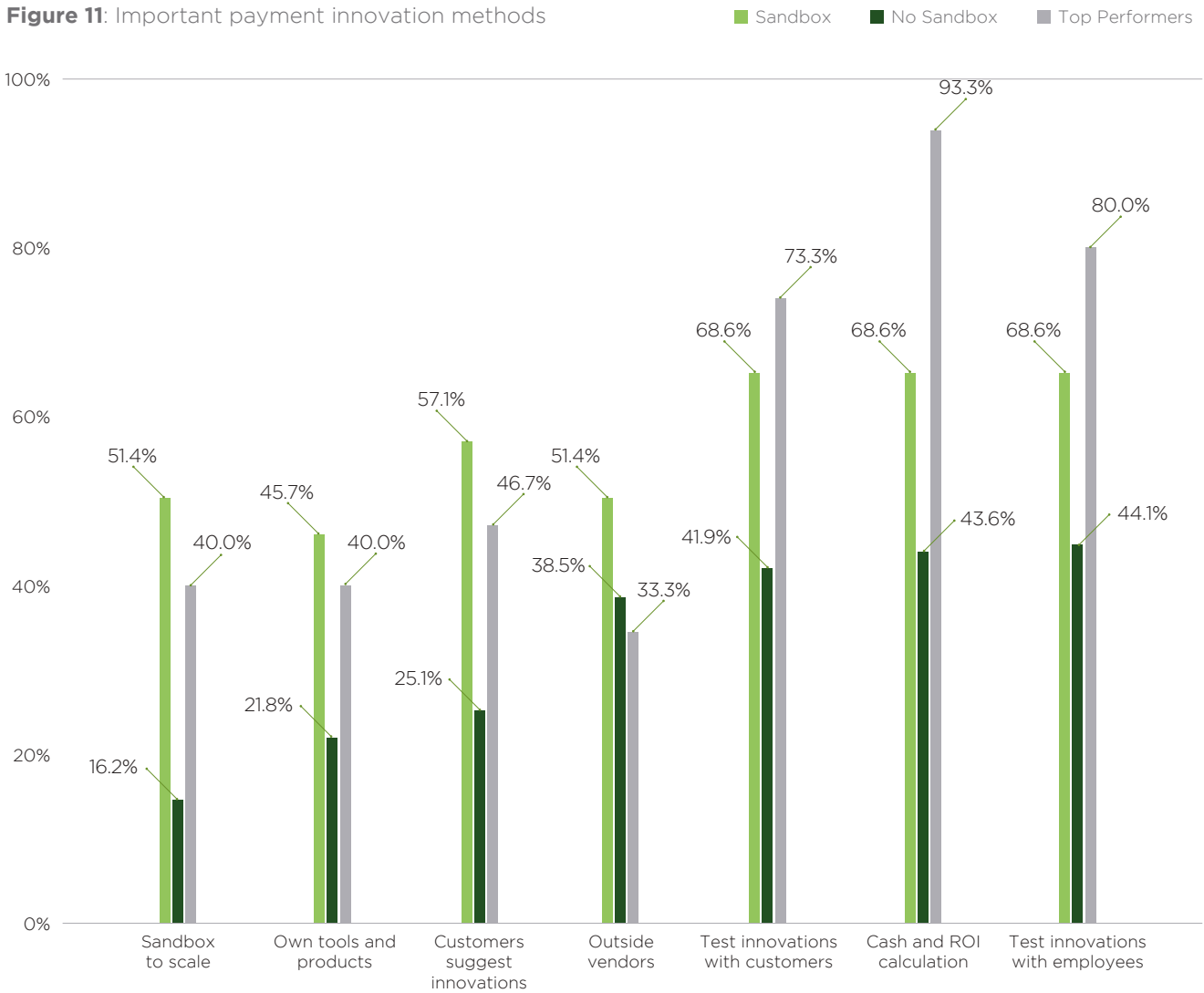
INNOVATION
METHODOLOGIES





Testing is a common feature enjoyed by our Innovation Readiness Index’s highest scoring FIs. Top Performers aren’t just diverse in their areas of focus, but also in the number of innovation methodologies they use — including testing. They favor cash and ROI calculations, testing innovations in a sandbox, testing with employees and paying attention to customers by listening and acting on their suggestions.

Figure 11: Important payment innovation methods



Sandboxing FIs share the same attributes as Top Performers, and there appears to be a correlation between a firm’s sandbox usage and its willingness to use other testing procedures for new products and features. Sixty-nine percent of sandbox users test innovation with employees, and 69 percent test with customers. Conversely, just 42 percent of non-sandboxing FIs test with their employees and customers.

Sandbox users also reported greater implementation rates of other innovation methodologies — such as ROI calculation — than non-sandboxing FIs and even Top Performers. Only 44 percent of firms that did not use sandboxes cited performing cash and ROI calculations on new products, while 69 percent of firms using sandboxes did.

It makes sense that there would be a positive correlation between a company’s willingness to test new offerings in an innovative way and its performance as an innovator. After all, if it is not willing to test its technologies before releasing them into the market, then there is no system in place to guarantee those offerings will meet customer expectations or function properly once commercially available. The best innovators are those that take the most steps to both ensure their new

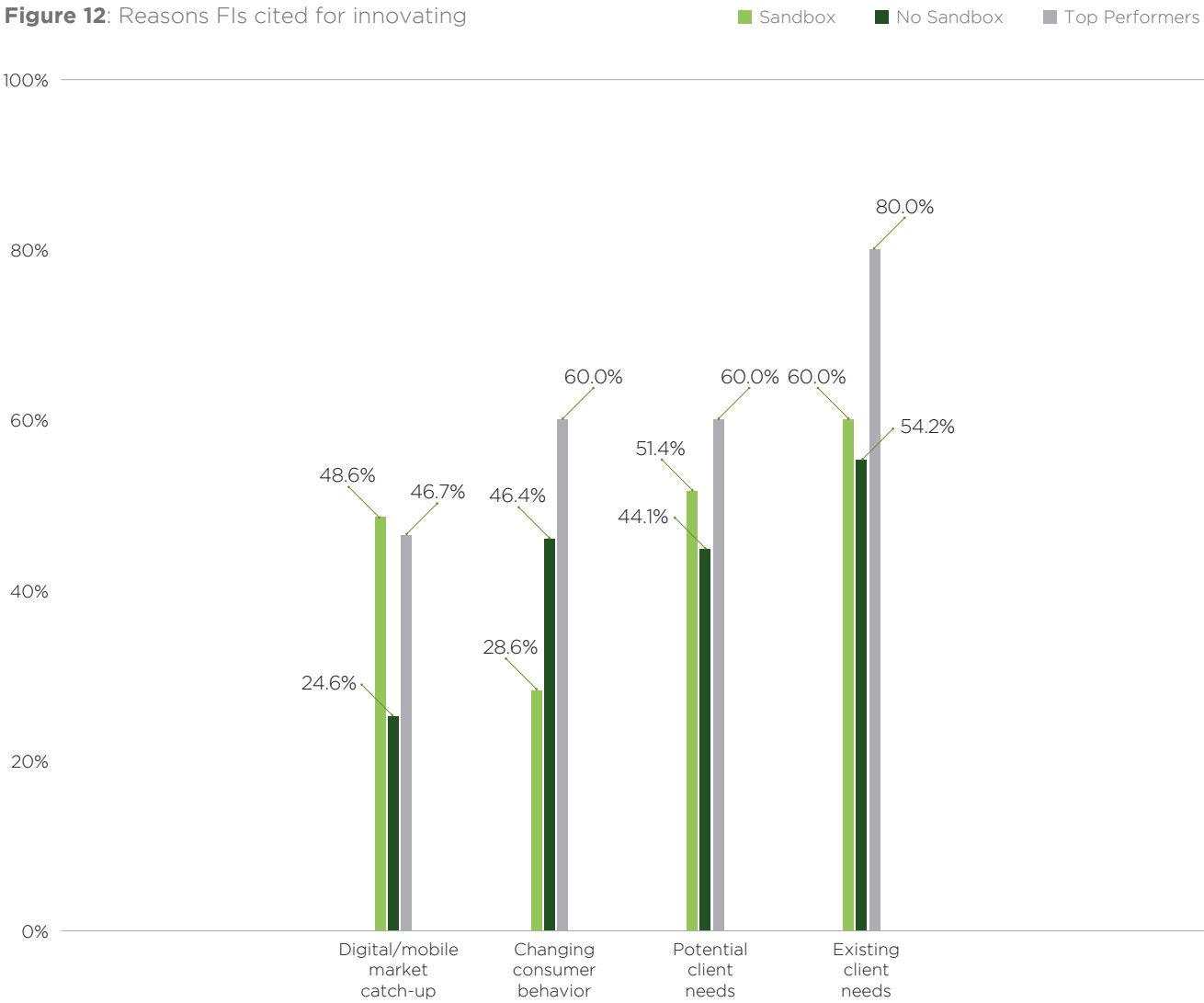




products meet customers’ changing needs and function as designed.

In terms of the factors driving where FIs focus their innovation efforts over the next three years, all in our sample said meeting existing and potential client needs were most important. In addition, sandboxing banks were more concerned with digital/mobile market catch-up.

Figure 12: Reasons FIs cited for innovating



KEY TAKEAWAYS AND
LESSONS LEARNED



Sandboxing FIs use multiple innovation methodologies.

- Like Top Performers, they test new features and products with customers and employees, and use cash and ROI calculators.



Leaders tune in to both customer and market needs.

- Top Performers and FIs that use sandboxing are more likely to listen to customer needs.
- They also measure the ROI of innovation efforts.



Leaders test for success.

- Top Performers and sandboxing FIs test and iterate innovations in a sandbox, then quickly scale them to market.



METHODOLOGIES
CHECKLIST

- ☐ Use multiple innovation methodologies to plan, measure and test new features.
- ☐ Use cash and ROI calculations to gauge success.
- ☐ Test innovations with customers and employees.
- ☐ Understand new innovations’ impact on top line revenue and bottom line costs.

SPEED



Speed — the length of time companies require to develop and implement new features and products — is another important component of our evaluation. Again, sandbox-capable FIs appear to be nimbler and perform better than non-sandboxing FIs. It took the former less time to design and create new technologies, averaging only 7.1 months to roll out their latest products compared

to 7.6 months for the latter. Further, 57 percent of sandboxing FIs spent fewer than six months completing the process, as did only 51 percent of non-sandboxing banks. Eighty-five percent of sandboxing FIs completed their programs early or on time, on par with Top Performers and 10 percent better than other FIs.

Top Performers have IT infrastructures and core processing systems that make it easy to innovate, enabling 80 percent of them to take a product from development to market in under six months. Sandboxing FIs did not fare quite as well, which supports our analysis that achieving Top Performer status requires more than speed. FIs must excel in other attributes, too, including a focus on planning, proper funding and, most importantly, flexible and configurable IT infrastructure that enables both testing and rapid scaling of new, innovative products and features.



Figure 13: Product development and implementation time

Sandbox No Sandbox Top Performers

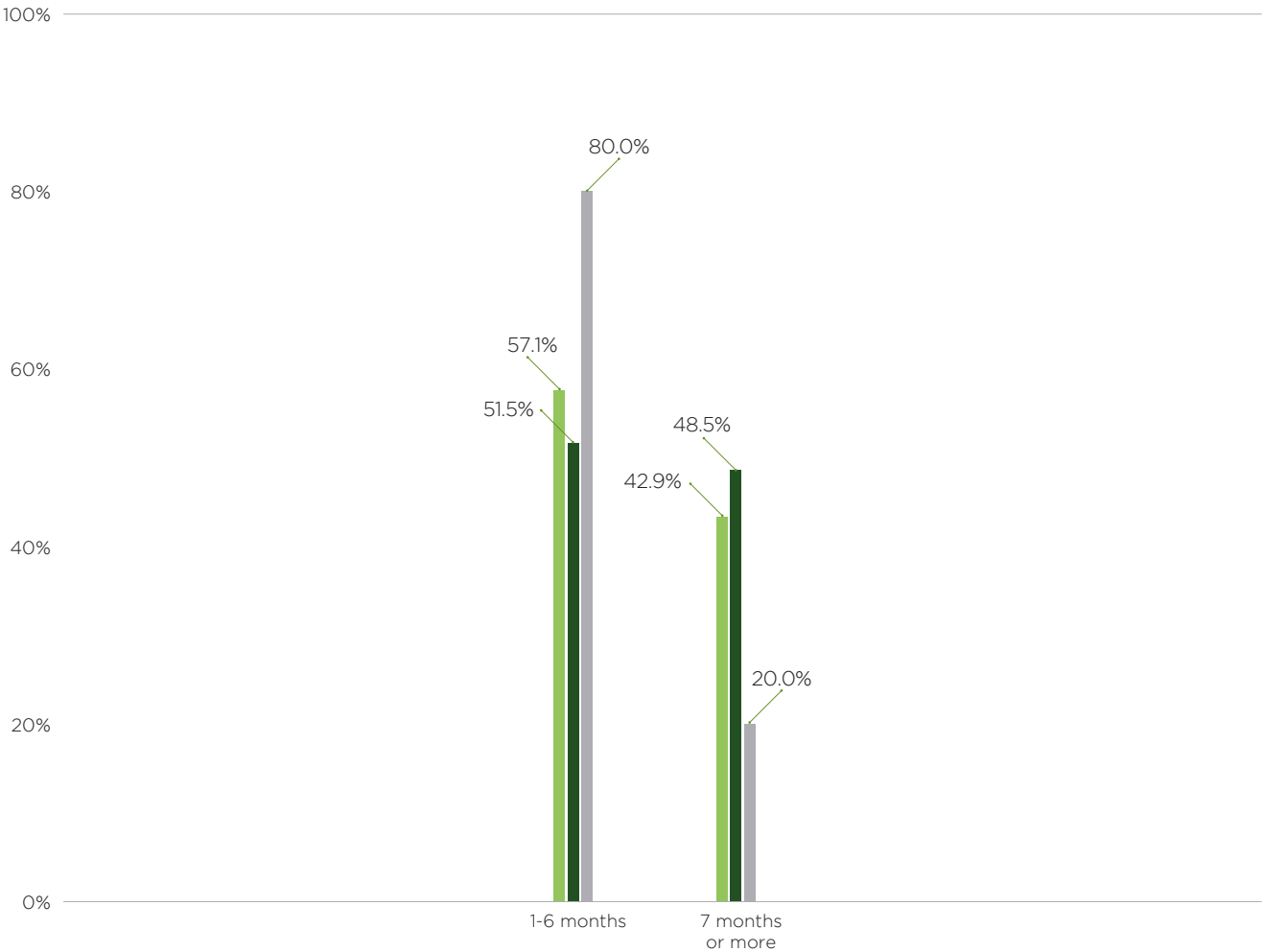
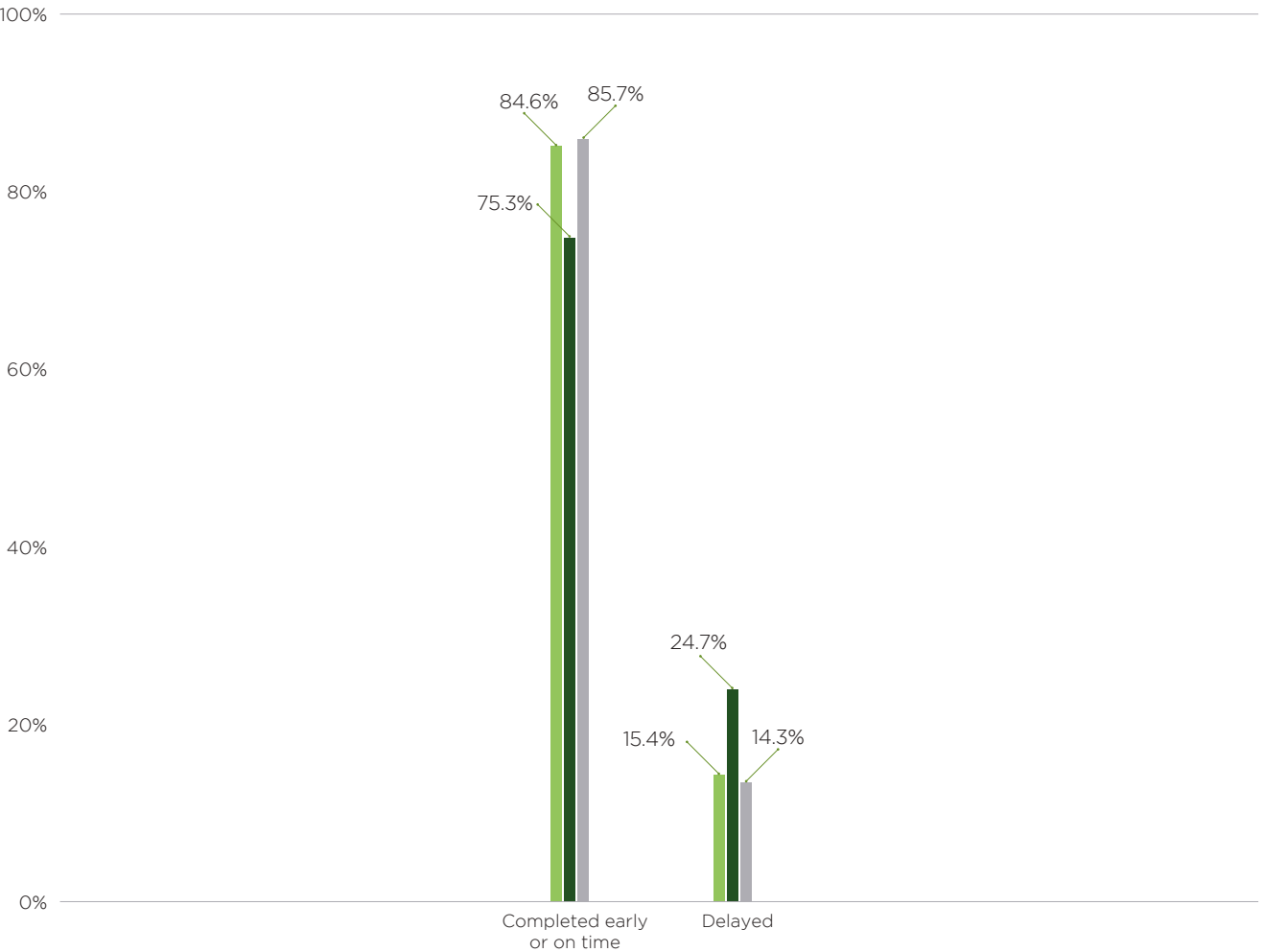


Figure 14: Roll out time for product development

Sandbox No Sandbox Top Performers



PERFORMANCE AND MARKET SUCCESS



Our analysis demonstrates that sandbox functionality enables any FI to outperform its peers and execute at Top Performer levels. Having the ability to test new features and make changes to them based on market feedback makes payments innovations are effective and efficient. Does this mean these innovations are more successful and provide a higher ROI?

It turns out there is strong evidence linking sandboxing to market success. The sandbox-using FIs in our study measure ROI in terms of increased revenue per customer, number of customers and demand for high-margin services. They report significantly higher innovation success ratings than their peers, indicating a correlation between sandboxing and increased topline revenue. These FIs say they will

“Sandboxing FIs are more successful at rolling out new features and products that **CONTRIBUTE TO CUSTOMER AND REVENUE GROWTH.**”

Figure 15: How banks measure ROI of new payments innovations

■ Sandbox ■ No Sandbox ■ Top Performers

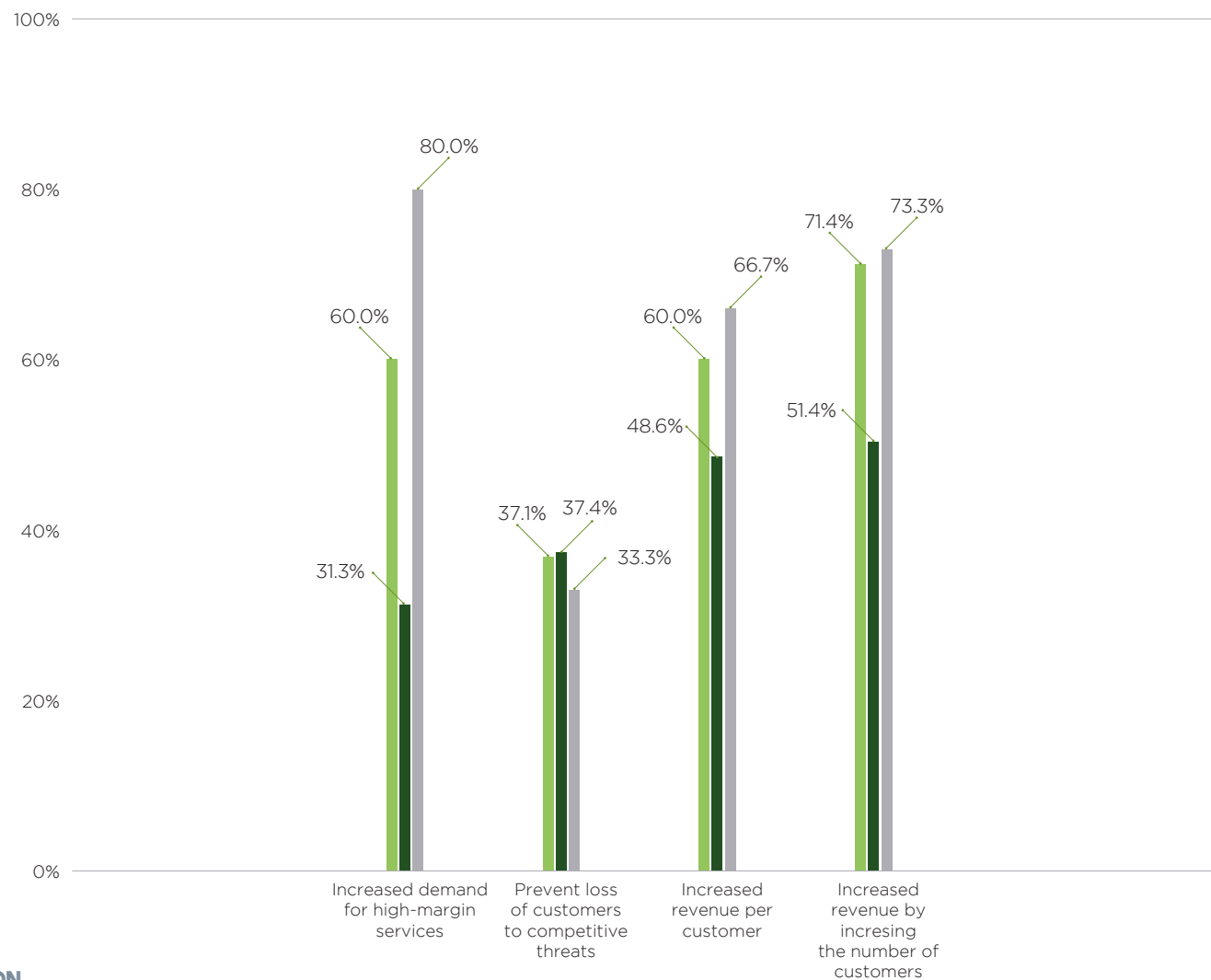
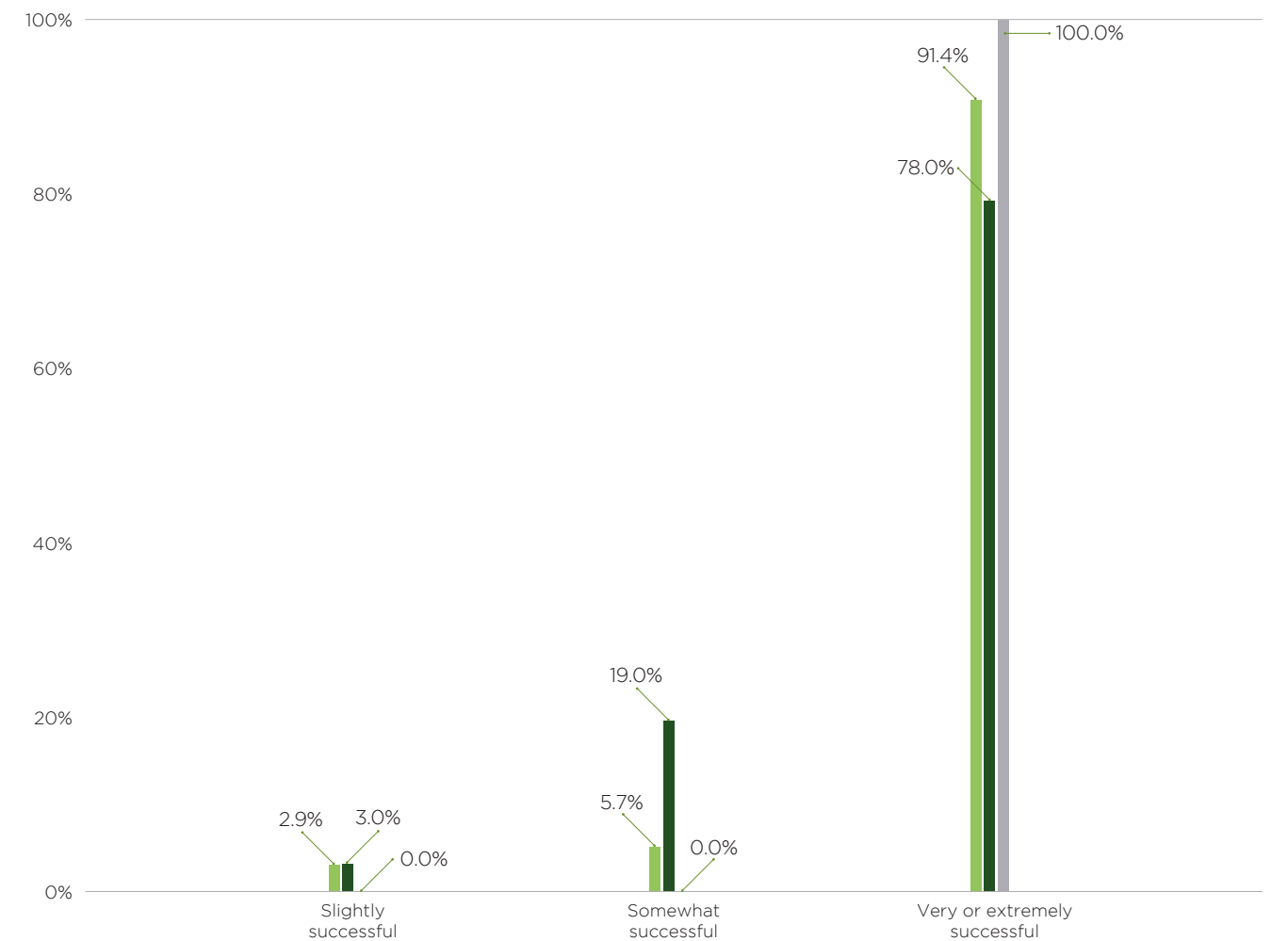


Figure 16: Success rating of firms' latest innovations

■ Sandbox ■ No Sandbox ■ Top Performers



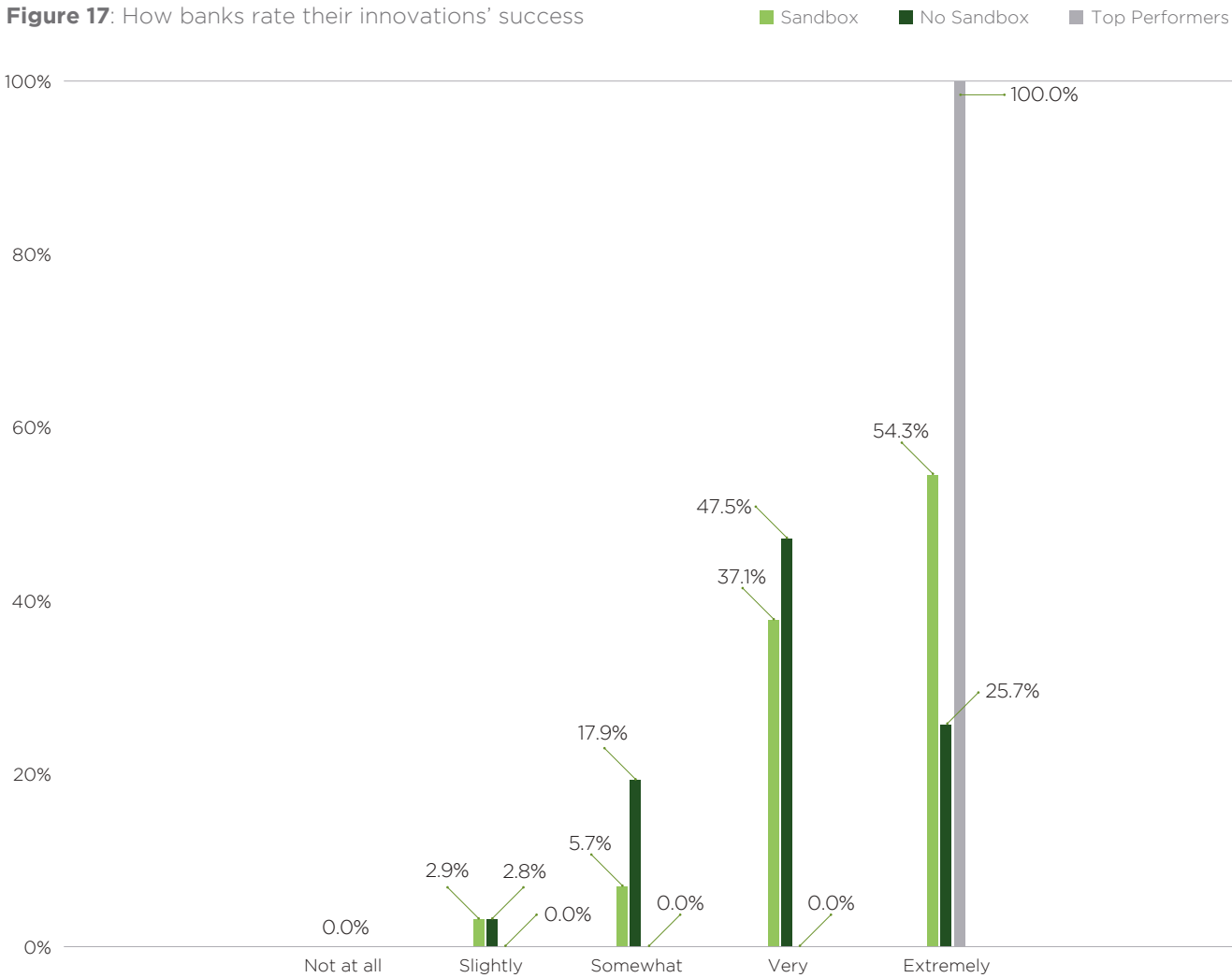
be investing in payments technology, mobile/digital payments and consumer engagement over the next three years, and doing so at a higher rate than their peers. One can assume they expect these investments to pay dividends.

As shown in Figure 16, sandboxing FIs and Top Performers largely measure

ROI from new payments innovations in the same way. These findings are reinforced by the 91 percent of sandboxing FIs that reported being “very” or “extremely successful” in their most recent efforts. In fact, 54 percent of this group rated their last efforts as “extremely successful,” compared

with 26 percent of non-sandboxing FIs. As seen in Figure 19, the Top Performers’ innovation projects earned the highest success ratings, with 100 percent reporting their projects were “extremely successful.”

Figure 17: How banks rate their innovations’ success



KEY TAKEAWAYS AND
LESSONS LEARNED



Strong evidence links sandboxing to market success.

- FIs that use sandboxing report significantly higher success ratings.
- They measure their innovation efforts’ ROI by the increased number of customers, revenue per customer and demand for high-margin services.

“ More than half the FIs using sandboxing report having multifunctional systems that are configurable, secure and offered real-time support,

IN STARK CONTRAST TO FI GROUPS THAT DO NOT TEST IN A SANDBOX. ”

CONCLUSION



A sandbox is an ideal place to innovate, giving FIs a space in which to play, test new ideas and efficiently bring innovations to market. Sandboxing FIs can be more market-responsive when supported by flexible and configurable core processing systems, quickly iterating new product ideas based on customer and market feedback. In addition, assuming their processors support it, these FIs can immediately roll out the right solutions at scale.

Our analysis reveals that FIs with core processing systems that support sandboxing are better innovators than those that do not. Top Performers are consistent in their use of testing methodologies — testing with employees and with customers — and are nearly twice as likely to use sandbox functionality in their core IT assets. As a result, both Top Performers and sandboxing FIs are more successful at rolling out new features and products that contribute to customer and revenue growth.

Sandboxing is also a powerful innovation accelerator. Our data shows these capabilities can help any FI execute payments innovations on par with our study’s Top Performers. For these reasons, making sandbox environments more accessible could go a long way toward addressing the IT-related challenges FIs face — and put more of them on a more efficient path toward enabling their latest innovations.



01

TUNE INTO CUSTOMER AND MARKET NEEDS.

Successful innovators use multiple testing methodologies to gain insights into which innovations to pursue and their potential success. They use sandboxing to test and iterate before scaling the right solutions to market.

02

MAKE INNOVATION A CORE COMPETENCY.

Flexible payments and IT infrastructure that allows for sandbox-to-scale testing makes innovation an everyday practice — a necessity in today's payments business — and enables iteration of ideas, creation and testing of new innovations and rapid scale-to-market.

03

DITCH INNOVATION LABS.

Sandboxing allows for testing and incorporating real-time customer feedback, then immediately scaling the feature or product to market. Customer feedback and iteration matter in today's social and mobile economy, meaning innovation labs are no longer optimal.

04

MAKE STRATEGIC IT INVESTMENTS

Investing in flexible technology that supports sandboxing leads to faster innovation cycles and lower long-term costs. This gives FIs the ability to compete and win in a rapidly changing market.

“Sandboxing capabilities can help any FI
EXECUTE PAYMENTS INNOVATIONS
on par with our study’s Top Performers.”

ABOUT

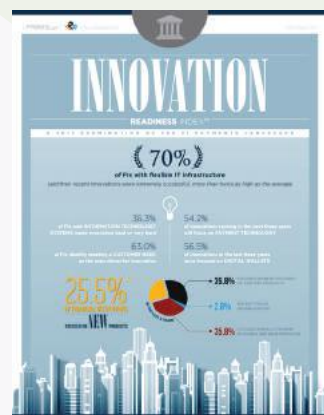
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