Beyond Open Banking: how the API economy will disrupt the financial industry

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> Eventually, all things digital will connect to each other using APIs, making it crucial for the financial industry to understand the opportunities presented by the "API economy."

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Yogesh Sholapurkar, takes a look at the API economy and the future of the financial services industry.

Imagine that you had a time machine and could go back to 1886 Germany. Carl Benz has just launched the very first practical automobile. He offers you an investment opportunity in this new technology that will go on to revolutionise the transport industry forever.

Or let's travel to 1997. Jeff Bezos has launched his online marketplace, a company and a technology platform that is now the largest retailer in the world, a household name that has changed the face of the retail industry.

If you knew then what you know now, would you walk on by?

API (Application Programming Interface) technology is a similar opportunity that has already fundamentally changed the way the retail, telco, travel, hospitality, and several other industries work, and is about to do the same to the banking and finance industry. Treat it as "just a piece of technology" at your peril.

Most of us first heard of APIs as an enabling technology in the context of the UK Open Banking and the EU PSD2 (Payment Services Directive 2) regulations that mandate banks to allow approved third parties to access a bank client's account (to fetch balances and transactions, and make payments from) as long as they have client consent. This access is powered, in most cases, by APIs.

However, there is much more to APIs than just supporting a regulatory mandate, and not realising this means missing out on a significant opportunity to improve client propositions and remain relevant in the future economy.

What is an API?

An API is a technology that allows one piece of software to connect to another over the internet, irrespective of their physical proximity, and request information or ask for instructions to be actioned. APIs are all around us in everyday technology – every time you use a smart phone, when you use a map on your mobile, when you use social media sites, when you check your weather app or when your favourite financial website shows you stock or currency prices – these are powered by API calls.

Leveraging the API economy

APIs help us improve our client propositions and service offerings, but they also have the potential to fundamentally change a business. Here are a few ways in which they do so.

APIs as enablers for new financial services propositions

Propositions enabled by APIs include:

- real-time views of cash balances across multiple accounts for corporate treasurers – powered by APIs that pull cash balances from various banks in real time.

- asset finance, invoice finance and loan quotes to clients searching for deals on aggregator sites. The request for quote from the aggregator site, and the bank's response with an indicative or firm quote, are both secure API calls over the internet.
- real-time FX rates to clients as well as currency brokers, followed by booking of FX deals over the API channel, without any manual intervention.
- improved and faster credit decision making by sourcing, with client consent, relevant data in real time from multiple sources using API calls – accounting information from their accounting package or ERP system, credit history from credit bureauxs, banking data from other banks that the client banks with.

APIs as enablers for clients

Commercial clients make significant investment into technology platforms that support their business operations, but are forced to use the bank's systems for their banking needs – whether to check account balances, make payments or download transactions for reconciling with their ERP systems.

Most medium-to-large-sized clients demand better integration of banking systems with their own systems and processes. Traditionally, integration of banking systems with client systems has been complex and time consuming, complicated further by the absence of standards. But clients' need for seamless integration, straight- through processing and minimal manual intervention has never waned. With the advent of API technology, it is now possible to support easier integration between client and bank systems, providing real-time interactions, self-service, and supporting straight-through processing. This enables the bank's clients to make the most of their investment in technology.

The real-time nature of APIs also unlocks the ability for the bank's clients to build innovative propositions for their own customers. A long-standing frustration for businesses striving to build straight -through automated customer journeys is that these automated journeys come to a shuddering halt if one of the steps involves an interaction with the bank.

By their very nature, all bank interactions involve manual intervention – whether to initiate a payment, check an account balance, request transaction statements or look up FX rates. A bank that offers these interactions over an API channel will allow machine-to-machine connectivity and thus enable the customer journey to be seamless and without manual intervention.

APIs as a scalable sales channel

Traditionally, banks have offered their products and services through their proprietary channels – the bank's internet banking portal, mobile app, telephony, branches, or the sales team. An attempt to increase sales invariably leads to an increase in the sales team. By enabling a product to be discovered and delivered over an API channel, the bank can offer it on any channel that accepts APIs – like comparison websites, third-party apps, aggregators, multi-bank portals and third-party marketplaces, and increase the business volume. And all of this without a proportionate increase in the sales team.

APIs as a product

APIs can also be products in their own right. This happens when you charge for certain API calls made by third parties to your systems. Clients, partners and third parties may be willing to pay for information or insight that a bank or a financial institution has to offer. If they deliver this information over an API, there is an option to apply a tariff for these calls. In most cases this is a new product offering, leading to a new revenue stream.

What is the future for APIs in the finance industry?

Enabling smoother and more seamless interactions is just a start. Well-designed APIs also encourage and facilitate innovation, unlocking new business models that are not available to traditional businesses. That is the true disruptive nature of APIs.

We have all heard assertions that online marketplaces disrupted the retail industry or that certain computer companies disrupted the mobile industry. So what is the most important factor that allowed them to be disrupters? And, most pertinently, how is that relevant to the finance industry?

The common factor between them is that they are "platform" businesses. And the crucial enabling technology in platform businesses is APIs.

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Traditional businesses vs platform businesses

All businesses have core capabilities that they have built over the years through strategic investment. In a traditional business set-up, these capabilities are typically available only to internal users within the business, which helps them to orchestrate and devise products and services that meet client needs.

At the same time, no business has a bottomless pot of investment, so funding is targeted towards those limited core products and services that have the highest client demand. Invariably, this means that specialised variants of these products and services, with lesser demand, are not invested in. This in turn leads to the business turning down genuine incremental revenue opportunities.

On the other hand, some innovative third parties and new market entrants have the appetite and the expertise to address this unmet demand, but they face a very high barrier to entry in the form of significant capital investment to build the core capabilities upon which to develop specialised product variants.

A platform business differs in two crucial ways:

- While it delivers products and services to its clients using its core capabilities, unlike a traditional business, it also allows third party innovators and new market entrants access to some of those core capabilities (thereby reducing the investment barrier to entry) so that they can create specialised product variants and innovative solutions to address the unmet demand.
- It allows these third-party providers to sell these innovative solutions to its clients (sometimes taking a % of revenue as fees). This is a completely different business model to that of a traditional business.

Third parties and APIs

The most elegant mechanism to open up these core capabilities to third parties is via APIs.

Third parties exploit the platform's capabilities to develop new and innovative solutions that attract more clients. In turn, this growing number of clients attracts more third-party innovators who wish to benefit from an established client base. Thus the platform business enjoys the benefits of this two-sided growth.

Mobile tech companies are a very good example of a platform business. They make available, via APIs, a large number of their core capabilities to third parties (app developers) through their operating system's platform: camera, biometric security (face ID), gyro meter, notifications, calendar, clock, timer, geolocation, and many more.

And when these developers build innovative apps that address an unknown or unmet client demand, they are allowed to host the apps on app stores – after rigorous quality checks, of course. A growing number of useful apps in the app store attracts mobile users to the mobile tech company's ecosystem, and the growing number of mobile users in turn attracts further app developers to the platform. Every cent that the mobile tech company makes as commission from a third-party developed app is revenue that they wouldn't have made otherwise.

Online marketplaces operate in a similar manner – allowing third-party sellers to list their products, access warehousing, transport and packaging capability, take advantage of one-click checkout models – all while charging a commission on any sales made.

Equivalent core capabilities of a bank include:

- current accounts
- access to payments schemes
- correspondent banking network
- security and authentication
- Know your customer (KYC) process
- data and insight on client transactions and behaviour
- credit assessment
- balance sheet
- liquidity management
- risk management

These are not just foundational capabilities that a third-party innovator needs to enter the financial market, but also the most expensive capabilities to build. By strategically opening up some of these capabilities to selected third-party innovators via APIs, the bank can accrue the benefits of a platform business.

It can federate innovation and investment (and the risk that comes with it) and participate in the upside of successful products built by third parties, while being shielded from the downside of any failed investment.

We have seen how APIs enable banks and financial institutions to improve their client propositions, build more efficient interactions with third parties, and support easier discovery and fulfilment of products and services. Whether this article also nudges you to start exploring benefits of evolving your business into a platform business, or you consider it a leap too far, no business should ignore the possibilities that APIs offer in the brave new digitally connected economy.

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