Is Nigeria Ready for an API-Led Banking?

An Open Banking Nigeria Perspective

Open Banking

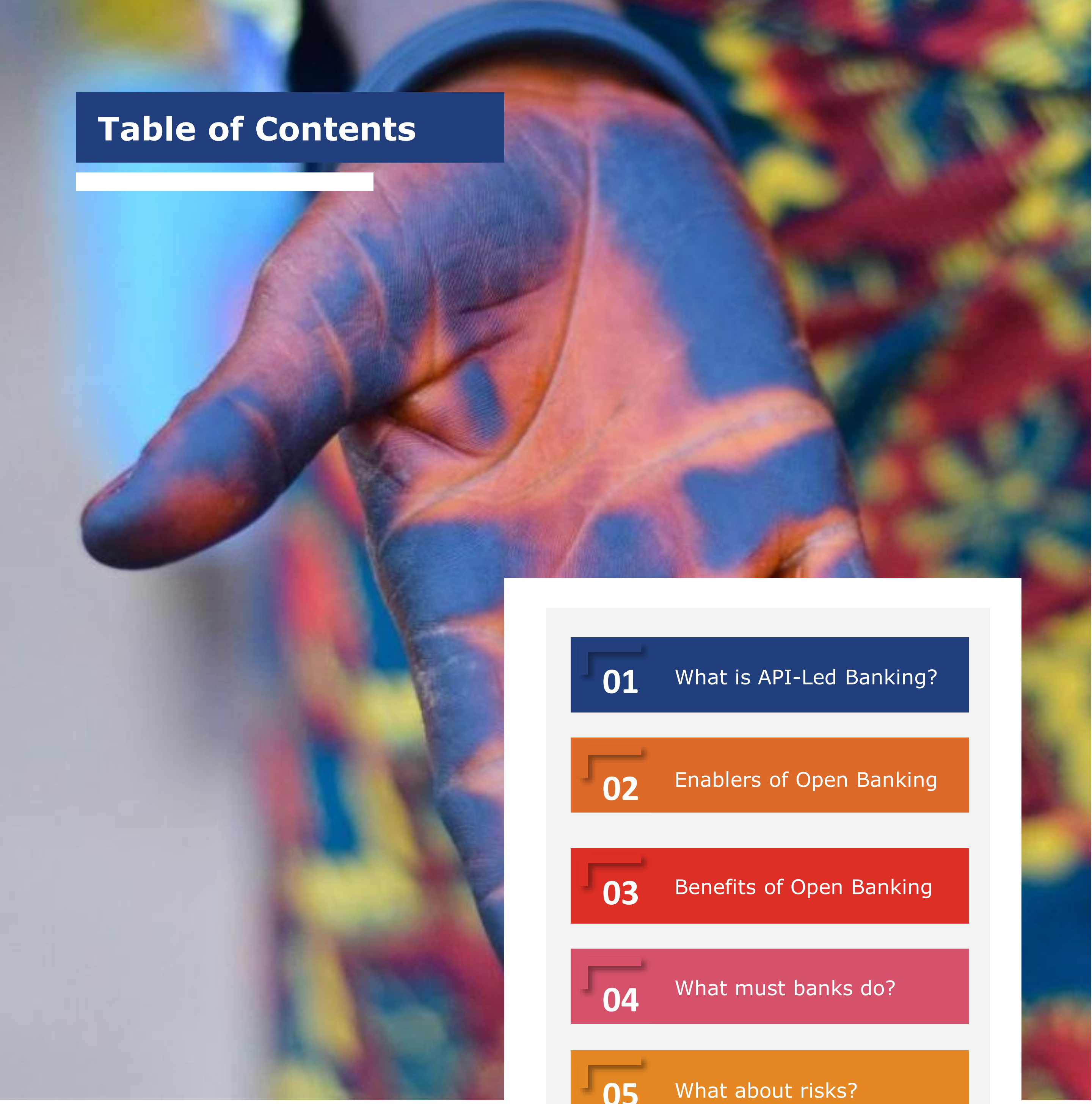


Table of Contents

What is API-Led Banking?

Overview

The term "API" (Application Programming Interface) refers to "a documented set of connecting points that allow an application to interact with another system". It is an intelligent conduit that allows the flow of data between systems in a controlled yet seamless manner

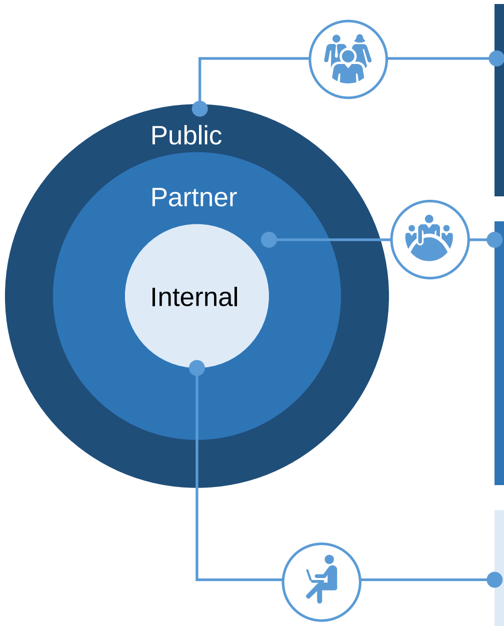
Simply put, an API enables communication between software applications, providing access to data or functionalities.

APIs are built on the underlying principle that interfaces should be scalable, reusable and secure while offering ease of use for developers through self service

A typical example of an API enabled functionality is the social media "share button" which allows users to post to their social media profiles from almost any other site. By clicking this button, a call is made to the respective APIs of the major social media outlets to create a post with a certain content.

There are different categories of APIs as shown in ***Figure 1*** below ranging from private/internal to partner (between organisations) and public (open) versions.

Figure 1



Model type	Attributes
Public/Open APIs used by external partners and developers who build innovative apps and products	Innovating through engaging developer community Extended market reach
Partner/B2B APIs used by business partners, including suppliers, providers, resellers and others for tighter partner integration	Reduced partner costs API monetization Enhanced security
Internal APIs are used by developers within enterprise	Cost reduction Operational efficiency Enhanced security

Source: McKinsey Payment Practice

What is Open Banking

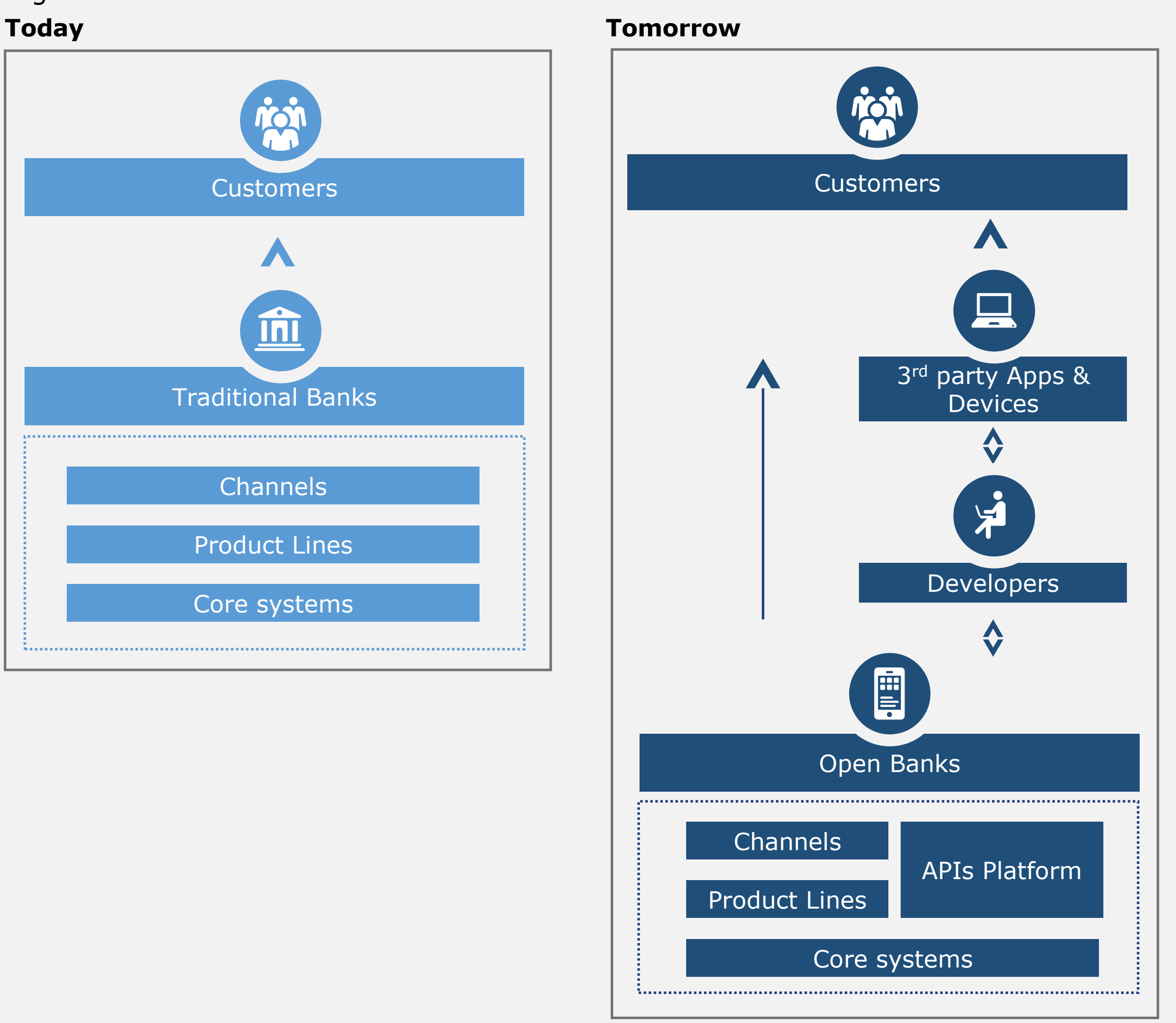
Riding on the understanding of APIs, an Open API allows developers outside a proprietary organization access to data, either to enhance their applications or develop new ones guided by open standards. ***Open Banking*** is a technology driven evolution of banking accelerated by Open APIs, making it possible for customers to use banking services in the context of other services (e.g. services provided by Fintechs) thereby combining innovative functionalities from banks and non-banks leveraging available infrastructure. Open banking provides opportunities for leading banks to re-invent themselves as giants in a digital financial ecosystem.

Open standards are not unusual having sprung up from software development in the 1950s. A vivid example of open standards is the Android platform.

The rapid adoption of the Android system, being the most popular smartphone operating system in the world, is a clear demonstration of the benefits of adopting "open" standards. It is important to note especially in the context of banking and financial services that ***open does not mean free or unrestrained,*** rather it means publicly accessible in a controlled manner i.e. interfaces are publicly facing, however parties in the ecosystem determine who can access data based on agreed terms.

How does Open Banking differ from the traditional banking model? Figure 2 below sheds light on the differences between the two models. The concept of being open suggests that a bank will need to operate as business run via a platform model, essentially connecting people and processes with assets and technology to manage interactions.

Figure 2



Source: Accenture Research

"Open Banking is a technology driven evolution of banking, accelerated by Open APIs, making it possible for customers to use banking services in the context of other services (e.g. services provided by Fintechs) thereby combining innovative functionalities from banks and non-banks leveraging available infrastructure”

Enablers of Open Banking

The emergence of Open Banking is catalyzed by the interaction of related and unrelated factors, resulting in changing and emerging roles in the financial services ecosystem. Highlighted below are some of the enablers that encourage the emergence of Open Banking as a model

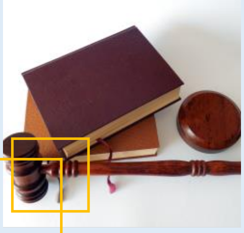
Advances in Technology and Innovation

The evolution of the digital landscape is a key enabler of Open Banking as previously closed systems are becoming networked. The increasing affordability of technology both for consumers and businesses is driving significant developments in Open Banking. A case in point is the level of mobile phone penetration globally which has increased drastically in recent years. Technology driven innovation will bring about benefits such as enhanced credit scoring, new payment methods, etc.

Changing Customer Behaviour

With the evolution of customer journeys, the approaches to offering financial services, especially banking are moving from a product-centric dimension to a customer-centric stance. The emergence of new customer generations such as Gen Z also contributes to the change in customer requirements. They demand for an unprecedented level of transparency and variety of offerings designed with convenience and flexibility in mind. The potential to adopt open banking is hinged on the changes in customer behaviour

Regulation



Regulation is a significant enabler for Open Banking because it carries the weight to put forward explicit policies that financial institutions must consider, thus fostering innovation and compliance from Industry players. The Revised Payment Services Directive (PSD2) in Europe, Open Banking Initiative in the UK are prime examples of regulatory enablers

Benefits of Open Banking

Open Banking provides an avenue for players to unlock the value of digital assets and customer data. To reach the aspirations of this new model, there is need for a cultural shift. A "go-it-alone" approach will stifle the ability of financial services players especially banks, to grow in a platform focused economy.

An Open Banking landscape combines the strengths of core traditional players in the financial services space who have assets such as customer information, brand recognition, etc. and non-bank innovators who are likely to be more agile and flexible to adapt to the changing needs in the market. Simply put, the open banking model holds benefits for all players in the banking ecosystem of the future

So why should key industry players especially banks embrace Open Banking? Adopting an open banking model will enable banks and other players to unlock new business value and opportunities as described below.

More Tailored Product Offerings and Improved Access to Finance

Delivering a unique customer experience is positioned at the core of the Open Banking model. With open APIs, the experiences of customers with respect to banking services will be markedly different from the previous situations. By allowing banks and third-party providers access to their data, customers are provided more suitable offerings which align to their needs and expectations. Another side of the coin is that it has the potential to improve access to finance and inclusion as there are easier ways to obtain necessary information to open an account. For example, permitting lenders to obtain more detailed transaction data as part of credit assessment will allow for more accuracy in risk decisions and loan pricing.

Open Banking will result in more transparent competition, essentially enabling customers to switch products more easily.

Cost Reduction

Open Banking will reduce costs in terms of time to market and application delivery costs as a result of easy integration with traditional banking platforms and service providers. Rather than multiple investments on delivery, participants in the open banking marketplace save effort, time and money

Interoperability and Collaboration

Open APIs and standardized open data protocols provide the background for incumbents and new entrants into the market to collaborate in an agile manner compared to the applicable situation in a traditional model. This will enable co-development of products to meet customer needs and wider distribution

Revenue Generation

Although Open banking seems like a threat to the business models of incumbents, it will open new sources of revenue for banks such as allowing them to provide data brokerage and authentication services i.e. bank can charge third party providers for access to data, etc.

What must banks do?

At the core of the open banking model is customer-centricity and this means that the future will favour banks and other players who are willing and ready to invest in this direction.

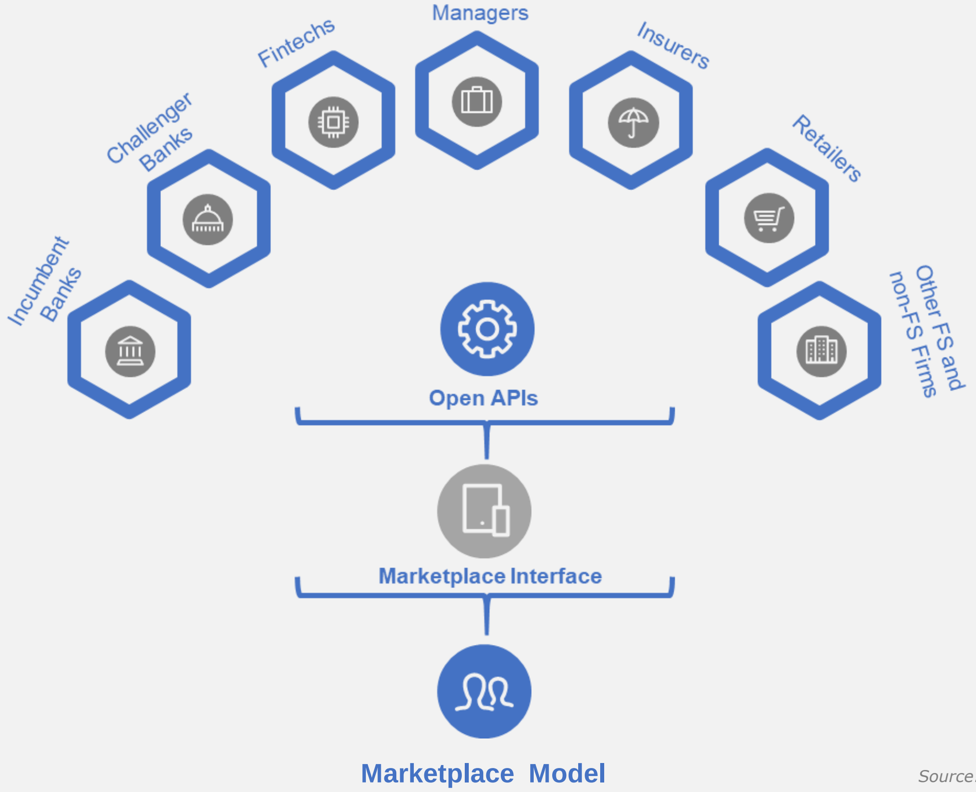
According to a white paper on Open Banking by IBM, "Open Banking offers opportunity for banks who choose to lead. Getting ahead of the curve on embracing and implementing Open Banking can give banks a head-start in their efforts to become more effectively connected into ecosystems which will power future banking offerings". Failure to align to Open Banking will see banks missing out on the platform opportunity and ultimately being unable to meet consumer demands.

The report further posits that Open Banking will better position banks to compete with platform businesses such as Alibaba and Tencent because these businesses if left unchecked will exploit Open Banking to capture the customer but leave the cost and complexity to incumbent market participants. To compete effectively, banks must take a "beyond banking" approach and not just focus on core financial service offerings by accessing the open ecosystem

According to a Deloitte report on Open Banking, in the emerging banking as a marketplace model, traditional banking services will be augmented by variety of offerings through an ecosystem of providers.

Open Banking presents an opportunity for banks to transform and re-think their delivery approach. To leverage the benefits of the emerging model, banks would have to make strategic choices with respect to the role they want to play in the ecosystem. The revenue model might switch from the net interest margin model to one based on fees or profit sharing. Open banking will unleash new forms of distribution and enhanced service capabilities, driven by a widespread network through third party relationships.

Figure 3



Source: IBM, Deloitte

> *If you're competitor-focused, you have to wait until there is a competitor doing something. Being customer-focused allows you to be more pioneering"*
>
> Jeff Bezos

What about risks?

Beyond the obvious benefits of aligning to developments in API-led banking and adopting open standards, the associated risks is one of the "major unknowns" facing key stakeholders especially incumbents and regulators. We believe the discussion on risks can be dimensioned into two perspectives – one relates to the response by incumbents to the Open Banking model and the other to the outcome of adopting the model.

In the event that incumbents adopt a "wait and see" approach, they run the risk of losing customer relationships to third parties who would provide better value-adding services to customers, thus leaving banks as merely transaction providers. Remaining bureaucratically complex and rigid will relegate incumbents to the background instead of being the epicenter of an emerging ecosystem of customer-centric models. To address this risk, incumbents have a choice to make. They can decide to align, however to the barest minimum, thus keeping the current business model largely intact or they can choose a proactive approach by developing new customer driven services/products using new distribution channels by leveraging third-party providers

On the other hand, as the financial ecosystem evolves, increased chances of data privacy and security breaches will mount as well. The dependencies created as a result of open interactions with third parties will lead to increased regulatory and compliance risks.

However, just like in the case of closed systems, there is need for stakeholders to set up and uphold high standards of data security and integrity by putting additional layers of protection in place. A guiding rule for designing a secure Open Banking model is to embed data security and privacy protection into the ecosystem design

The adoption of an Open Banking Model is considered as a mix of threats, costs and opportunities. However, each stakeholder must decide how they would rather view the model to make the most of it and its impact on their business aspirations in the long term. In a disruptive era, the line of action taken by incumbents would determine if they have a future or not.

How does Nigeria Stack up?

The case for Open Banking in Nigeria is reinforced by the current realities of the Nigerian market. Several factors enunciate this, such as ;

- Structure of the financial system
- Consumer behavior and realities
- Trends in service/product offerings
- Regulatory developments

The Nigerian financial system is one of the largest in sub-Saharan Africa with an array of industry players including commercial banks, merchant banks, development finance banks, merchant banks, etc. and emerging third-party providers such as Fintechs, Payment Service Solution Providers (PSSPs), mobile money operators, Payments Terminal Service Providers (PTSPs) amongst others. Other third-party providers include utility service providers such as mobile network providers, electricity distribution companies, etc. The increasing complexities in the financial services space largely due to the emergence of digital service offerings led by Fintechs demands a new framework for interaction between these players. Open APIs hold the promise of binding all these players including non-banking players into a collaborative ecosystem

A look at the consumer related conditions such as mobile phone penetration shows that Nigeria has a high mobile penetration rate of 87 percent as reported by Jumia in 2019. GSMA also predicts that Nigeria will record the fastest growth rates in Africa in terms of mobile subscriber base between now and 2025. Another angle to the Nigerian story is the demographic composition. With an adult population of 99.6 million, about 56.9% are 35 years and younger. The demographic mix therefore leans more to the younger generation such as the Gen Z, Gen Alpha, etc. whose demands have evolved from just financial services that are product based to those which are tailored to suit their lifestyle needs.

"It is not the strongest of the species that survive, nor the most intelligent, but the one most responsive to change"

Charles Darwin

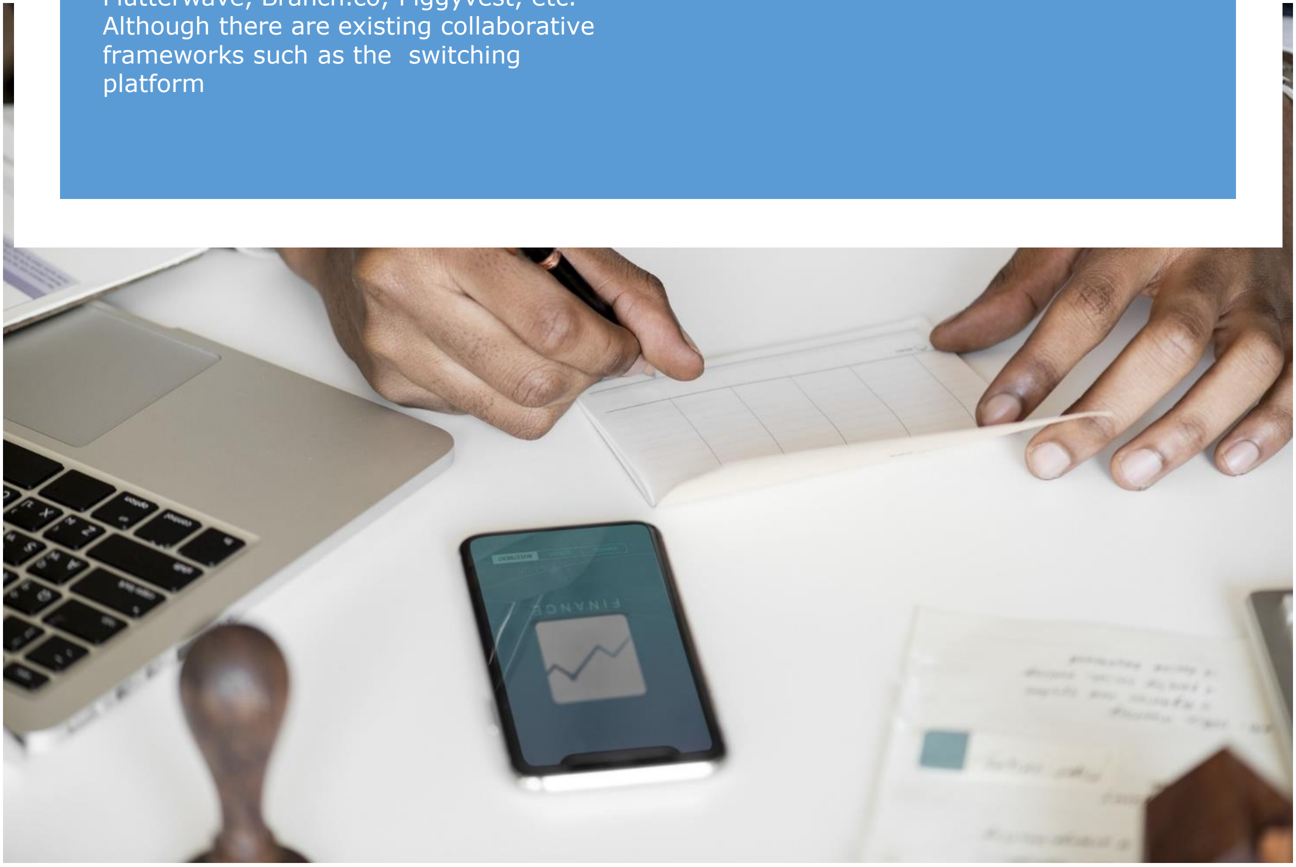
Source: Jumia, GSMA

EFInA study on access to financial services in Nigeria reports that 36.8% of the adult population are financially excluded. Nigeria has the highest number of MSMEs in Africa with a huge potential to contribute to economic growth. However, this possibility is stymied by several challenges of which limited access to finance stands out. An Open Banking standard will play the role of easing the onboarding of the excluded and improving access to finance by offering alternative methods of calculating lending risk leveraging data shared across platforms

In terms of trends in product and service offerings, the Nigerian market is replete with several digital solutions from banks and Fintechs riding on USSD platforms, social media, etc. These are championed by banks and Fintechs such as Paga, Flutterwave, Branch.co, Piggyvest, etc. Although there are existing collaborative frameworks such as the switching platform by NIBSS, an Open banking standard will extend the ecosystem to non-bank players, unleashing endless possibilities

The role of regulation in propelling growth cannot be overemphasized. The release of the guidelines for creation of Payment Service Banks (PSBs) in October 2018, allowing mobile operators to obtain licenses will further spark discussions on the need to have an Open standard which will guide interaction between incumbents and third party providers in the country's financial ecosystem

Although the journey to an Open Banking model in Nigeria is in its embryonic stages, the presence of a myriad of enabling conditions will go a long way in paving the way for the desired future



Source: EFInA, NIBSS

Will Nigeria play catch-up or take the lead

As the financial ecosystem rapidly evolves, the key challenge major stakeholders in the Nigerian market especially policy makers will face is how to structure an Open Banking model that recognizes the need for innovation, data security and privacy and creates an even playing field for both incumbents and emerging third party providers

In the light of the emerging models, it is important to note that for the market in Nigeria to align to global trends and expectations, a **"do nothing strategy" is not an option.** Rather than sit on the fence and observe the action, specific actions must be taken to turn the emerging model into an advantage for all players in the Nigerian market.

Stakeholders must strategically align by understanding the direction of the current wave. This can be done by leveraging the experience of regulators and competitors around the world on the Open Banking model.

Concerted efforts must be taken to engage all stakeholders especially customers by elevating the conversations beyond the technicalities of an Open Banking model to the practical realities of an ecosystem where better value is delivered for all, leveraging data.

In order to prepare, stakeholders especially incumbents must take several actions

- Develop strategy to help enable operational readiness for an Open Banking model
- Enhance their capabilities around APIs and analytics
- Maintain a strong focus on data and cyber security. Embed data security as a core system and product design principle
- Form strategic partnerships with third parties to create new products and experiences for customers

Other considerations will touch on customer consent management, data storage, digital identity, etc.

Open Banking: Focus on Africa

What does open banking mean for Africa?

Africa is one of the fastest growing hubs for Fintechs in terms of investments. Investments in African tech startups nearly quadrupled in 2018 to $357 million with startups in Nigeria, Kenya and South Africa accounting for the largest share. Despite these developments, issues such as low rate of financial inclusion remain a challenge. A study by McKinsey reveals that the retail banking penetration in Africa is half the global average for emerging markets, standing at 38 percent of GDP

Although Fintech and mobile banking players in Africa have largely influenced progress in the rate of financial inclusion, harnessing the power of Open Banking will unleash the potential of the African market. Apart from addressing the issue of affordability and access to financial services, Open Banking will ensure consumers receive better financial services. It will also enable start-ups in the continent who grapple with several challenges such as payment integration, to scale their operations.

Open Banking related developments in Africa

Although Africa has taken baby steps towards embracing an Open Banking standard, there are notable developments catalyzed by the actions of various players – regulators and banks alike in some countries.

Take for example the publication of a regulation by the National Bank of Rwanda (BNR) modelled on the European Union's PSD2, to formalize the approach for integration between Fintechs and banks in Rwanda. Elsewhere in South Africa, Nedbank has taken the lead with the release of the "Nedbank API Marketplace", an open banking aligned bridge to its data warehouses, thus empowering tech-innovators

What's next for Africa?

To accelerate the acceptance of Open Banking in Africa, it is important for policy makers and regulators to enter the discussion by creating frameworks which will guide the activities of all players in the emerging ecosystem. However, they must do this bearing in mind the peculiarities of the African market, leveraging lessons from other developed markets as a starting points rather than taking a "copy and paste" approach. Having the regulators at the table alongside other market participants will make consumer protection a top priority and encourage a level playing field for all by checking the influence of the all-too-powerful incumbents.

Source: CB Insights, GSMA Intelligence, McKinsey

Contacts

Adedeji Olowe

Trustee, Open Banking Nigeria
Email: adedeji@openbanking.ng
Mobile: +234 703 413 8291

Ope Adeoye

Trustee, Open Banking Nigeria
Email: ope.adeoye@openbanking.ng
Mobile: +234 802 222 1412

About Open Banking Nigeria

Open Banking Nigeria, is a legal entity propelling the Open Banking journey in Nigeria. Set up in June 2017 as a non-profit organization, the foundation comprises of industry leaders who recognize the importance of Open Banking in driving the next level of growth in Nigeria's financial sector. The activities of the foundation are targeted at unlocking growth potentials through the improved collaboration of players within the financial space. A set of standards are being defined as a guidance framework for API integration, data accessibility, and security. An overarching objective of the open banking team is boosting the country's economy through the reduction of barriers to innovation and consumer's access to essential financial products and services.

https://openbanking.ng
contact@openbanking.ng

openbankingnigeria

openbanking_ng

openbankingnigeria