



**THE RISE (AND FALL?) OF THE  
PAYMENTS FACILITATION  
BUSINESS MODEL**

**ALAN MCINTYRE @ PAYMENTS CANADA  
SUMMIT 2018**

VIDEO TRANSCRIPT

# VIDEO TRANSCRIPT

**ALAN MCINTYRE:** Good morning, everyone. So, if this wasn't a conference but instead a production of Charles Dickens' "A Christmas Carol," I would be playing the role of the Scottish ghost of payments future, because my story this morning is a somewhat cautionary one. But before I depress you, let me start with a little bit of the good news. And in that I will echo some of the comments that Jerry made opening the conference yesterday.

There are indeed a lot of reasons to be excited about what's happening in the global payments industry at the moment. And if you're looking for investment and innovation, there's plenty of it to go around. So, to justify that, let me take you back to 2005. And in this subset of the world's major banking markets there were just over 23,000 institutions. Over the last 13 years we've lost about 8,000 of them, some through voluntary consolidation, some a lot less voluntary and in that same period we've added just over 3,000 new players.

So, the industry is clearly consolidating, but around 17 percent of the companies in it are newish and remember that entrant number for 2017 is a snapshot. So, there's a strong survivor bias in there. So, it doesn't take account of all the fintech road kill that we've seen over the last 13 years, the companies that didn't make it out of their A-round funding. Despite being 17 percent of the institutions, our best estimate is that the new entrants have only captured around 5 percent of the revenue and even less of the profit pool. But that clearly varies by geography. The most disrupted developed market is probably the UK, where the new entrants have taken around 15 percent of the revenue.

But if you look at the composition of those new entrants, the licensed payments companies account for over 60 percent of them. So, this is a group where you have players like Stripe, like Square, like Klarna, like Revolut. And the rest of the new entrants are either new banks or they're unlicensed fintechs, so typically some sort of platform lender like a LendingClub or a Prosper.

Then in Canada, there's been a lot of new entrant activity with our estimate being over 50 percent of those active in the market at the moment didn't exist in 2005. And these new entrants are less payments-biased than we see in the rest of the world, but payments is still the largest group. Now the very high number of new entrants in Canada may come as a complete shock to all of you because despite the proliferation, they've had almost no impact in the Canadian banking business. Compared to the UK at say 15 percent, our research suggests that new entrants in Canada have captured less than 2 percent of Canadian banking revenue and probably less than 1 percent of the payments revenue pool.

Now all these new entrants need to get their funding from somewhere. Over the last seven years globally, about \$29 billion has gone into new payments ventures. It's been growing about 40 percent per year and in any given year it accounts for 20 to 50 percent of all fintech investments. We've also seen plenty of stimulation of payments innovations through national governments funding infrastructure upgrades, like we're seeing in Canada. So, if you take real-time consumer payments, if you go back to the beginning of the century, it was a very small and exclusive club, but now it's become a must-have piece of national infrastructure.

But if you really want to be dazzled by payments proliferation, you need to look at China, which has gone from cash to mobile in just a few years, bootstrapped to a large extent by the QR code systems of Ant Financial and Tencent. And in the process, they've completely skipped the caldera of consumer payments that is still dominant in most Western economies. And the numbers are truly staggering. There are now well over half a billion regular users of mobile payments in China. And the official data suggests that there was \$15 trillion dollars of mobile payments last year.

Just to put that in perspective, our estimate is that that accounts for two-thirds of all mobile payments in the world. And in some of the more technologically advanced coastal cities in China, 90 percent of consumer payments are now mobile. And if that isn't enough, they're getting ready for more. Alipay is scaling its transaction processing capability to handle a hundred billion transactions a day. Lately, even the phones have become optional, with the piloting of 'pay with a smile' using facial recognition.

So, when you look at these numbers China is clearly the leader, but many other emerging markets are beginning to make the same transition. India now has 50 percent penetration in the mobile wallets. And last year mobile payments in India were up 22 times on the previous year, largely facilitated by the Unified Payments Interface, a piece of national infrastructure.

Now, I remember some of our Western banking clients scoffing at the idea of using QR codes as a basis for mobile payments, but the reality is that they are easy and they are interoperable, so you have the ability for running—someone running a food stall in a marketplace to print a QR code, paste it to the cart and accept mobile payments without any infrastructure needed. There's a photo of which I couldn't find, of a beggar in Shanghai with a QR code in front of him, accepting payments through Alipay. Interestingly, even in a more advanced economy like Singapore, we also see them moving to adopting a common QR code as a standard way to have low-volume mobile payments.

So, in this respect, the developing markets are clearly playing catch-up. Penetrations of solutions like Apple Pay or Samsung Pay remain relatively limited. And even in a market like the UK, which has had real-time payments for a while, mobile payment penetration is still less than 25 percent—and instead contactless card payments are dominating. But the rapid change in the payments world is not just in retail. The world of cross-border B2B payments is also changing. There's an inexorable move away from slow, costly, multi-step, multi-intermediary processes to something that's going to be far quicker and cheaper. And whether that solution is underpinned by something like Ripple, whether it's the new Swift system, whether it's one of the emerging consortia, this change is going to happen.

And one of the impacts of better cross-border payments will be to transform global trade. Payments are going to be imbedded in smart contracts. And those smart contracts will automatically integrate the physical and the financial flows and they're going to grease the wheels of the global economy. And as these types of payments get easier and cheaper, there's going to be more of them. So, the idea of real-time micropayments is going to migrate from retail to B2B, although I've got to say that being said, we should not hold our collective breath waiting for blockchain proof of concepts to become the standard in business as usual.

So here endeth the positive part of this presentation. Everything looks good. We have exploding volumes of mobile payments. We have great innovation. We have gobs of investment funding. We've got infrastructure upgrades. And if you look at the totality of payments revenue globally, it seems to be growing at 6 to 7 percent per year. So, it's a great time to be working in payments, but—and the but is that—unless you've been living under a rock for the last decade you may have noticed that the upside from the digital transformation of the global economy outside the banking hasn't been evenly shared around. Instead there's been a lot of sectors that have felt the uncomfortable squeeze of digital compression.

And you can clearly see this if you look at something like global merchant services fees. The trend is circular and there's no reason to expect that it wouldn't keep going downwards. And I could show you exactly the same chart for mutual fund fees, for brokerage commissions and for almost any other fee-based business in banking. Why? Because fees generally pay for two things: They either pay for expertise or they pay for the work involved in administration and processing. And both of those are getting compressed by technology.

So, I think there's a critical distinction to be made here between the growth in payments as a sector, versus the economic returns that are going to flow to the existing players. If you look at Europe over this current five-year period, the organic growth in payments for the incumbent banks, we think is likely to be more than offset by the impact of fee compression and new competition. And as I will come back to talk about it later, maybe they can make it back through other services, but the base trend is strongly negative.

So, where's this external disruption coming from? Well, this is my morning ritual on the rare days I get off the train in New York at Grand Central. I order ahead on the Starbucks app with an invisible prefunded payment. Then I go join the scrum at the pickup line to get my coffee. Thirty-five percent of Starbucks U.S. payments now run through its proprietary app. They're not completely free. As my account needs to be funded periodically through a card or a bank transfer, but once the money is in the app, the payment is instant, it's invisible and it's free. And the threat to the banks is that Starbucks is not in the payments business. Starbucks is in the latte business. And the payment is just an enabler of a great customer experience, a great coffee experience.

In another example, if I asked you to guess who the biggest originator of small business checking accounts is in the U.S. at the moment, you may guess Wells Fargo or Bank of America. The answer is actually Uber, because Uber opens bank accounts for many of its new drivers so that payments can be instant, invisible and free. Their business model is powered by the drive, earn, spend cycle for the drivers. Again, it's payments enabling the core business. And you can see the impact of digital and the broader economy. This is a total EBITDA of the largest 1,500 companies in the world at the end of 2016. Despite a global recession, they had a good run last decade. They were up about 9 percent a year. And you would think this would have got better as the economy improved. Instead, we have an S curve. EBITDA has shrunk for this group. Why? Because digital is benefiting the few and it's crushing the many. Yes, the GAFA are fine; BAT, big tech are thriving. But 90 percent of the top 100 consumer brands in the U.S. lost market share last year. Google and Facebook control 90 percent of the growth in digital advertising. So, why wouldn't that level of crushing consolidation happen in banking and payments as we transition to digital business? It certainly is in China.

It's worrying if you look at the economics of the fastest growing fintechs in Europe over the last few years, and these are the stars, only the ones with the balance sheet are making money. Payments is break-even at best and if you're one of those other fintechs, you're chewing through your investors' money at a pretty fast clip.

So, turning to Canada, payments modernization will undoubtedly be a societal good, but if you're an incumbent in the payments industry, there's plenty to worry about in terms of fee compression, new entrants and a loss of information. Now, a crumb of comfort might be how conservative Canadian consumers are. In this chart, the nomads are the consumer group who would be okay with cutting the cord with the traditional bank if there was a good tech solution available. In some emerging markets like Brazil, it's up in the 60 to 70 percent-type range. In the U.S. it's about half, but in Canada it's only a fifth. So, the positive, nomads is just one more reason to wake up in the morning and give thanks that you're working in Canada.

However, consumer inertia is not a good reason to be complacent. So, my advice to you is to ask the question "what if?". What if the combination of digital fee compression, disruptive entrants and new regulations makes payments trend towards being instant, invisible and free? What happens if the banks become the dumb funding platforms for other people's information-rich business models? With the value migrating to the WeChats and the Amazons and the Starbucks of the world. The hard lesson from China is that in a digital world, primacy in social, in shopping, in lifestyle management confers strategic control on many other parts of the economy, including payments.

Now, the full impact of "if" wouldn't happen in my working life or for anyone else in this room I don't think, but from a planning perspective, it's wise to plan on the basis of this happening. So, how do you add value in this world? You could improve payments initiation—can use open APIs to plug into third parties to let them initiate products and services. You could build request to pay services that shorten the cash cycle for businesses. You can reduce fraud through biometrics that go beyond the basics on the phone. Even if the payment is free, you can still add value to any individual payment.

Reward cards have gone from 46 percent of card spend to 77 percent of card spend in the U.S. in the last decade. Consumers love rewards, as long as there's enough juice in the payment system to fund them. You can work to digitize merchant-funded rewards and maybe make a dent in the 99 percent of coupons that are still redeemed via paper. You can provide insurance for what someone has bought or provide an easy point-of-sale installment loan, a type of lending that is common in markets like Brazil, and is now being pushed by digital payments players like PayPal and a Klarna.

You can maybe enhance the information content of the payment, creating the track-and-trace capabilities that we see emerging in international trade. You can also add value at an aggregate level by looking across the payments flow flowing through your institution, and using it to provide cashflow optimization, advice to both consumers and businesses. You can lend based on those aggregate payment flows. You can extract insights and sell them back to merchants the way Amex, Visa and Mastercard have been doing. And you can also look to detect fraud at the central level and sell insurance or sell payment protection.

If you aren't ahead of the curve in these issues, then other players in the economy will be. In late 2017, Wal-Mart filed two blockchain patents—one to manage vendor payments and one to manage their Wal-Mart Pay product. The impact if you read those submissions, could be to turn Wal-Mart into a 100 percent consignment store where no vendor gets paid until the item leaves the store and on the other side Wal-Mart will capture an incredibly rich set of information on every customer transaction, while the account that funds Wal-Mart Pay will see next to nothing.

Now it's a little early in the morning for my glass to be half-full, but if I'm wrong, there's nothing much to worry about and life for people in this room will be good. But, if I'm right and base payments bend at an accelerating rate towards being instant, invisible and free, then thinking through these issues is going to leave you in a far better position to protect the economics of your payments business, because you really do not want payments climate change to be the theme of your earnings call in a few years, as your seemingly solid payments business sheds revenue at an alarming rate.

So, please take the time to ask yourself the question "what if?", but please don't let the anxiety spoil the rest of the conference for you. Thank you.

<http://www.accenture.com/PaymentsCanadaSummit2018>

<http://www.accenture.com/Banking>

© Payments Canada, 2018.  
Used with permission.

Copyright © 2018 Accenture  
All rights reserved.

Accenture, its logo, and High  
Performance Delivered  
are trademarks of Accenture