

The global state of payments

Ron van Wezel

Strategic Advisor, Aite

Aite Novarica

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Ron van Wezel

Strategic Advisor

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Agenda

- ❑ Introduction: State of the Industry
- ❑ 6 Disruptive Trends in Payments
- ❑ Bank Response: Transformation of Payments
- ❑ Conclusions

Introduction: State of the Industry

Main drivers behind the financial services industry's rapid change

Empowered customers

New players / digital disruptors

Competition within the industry

Regulatory initiatives

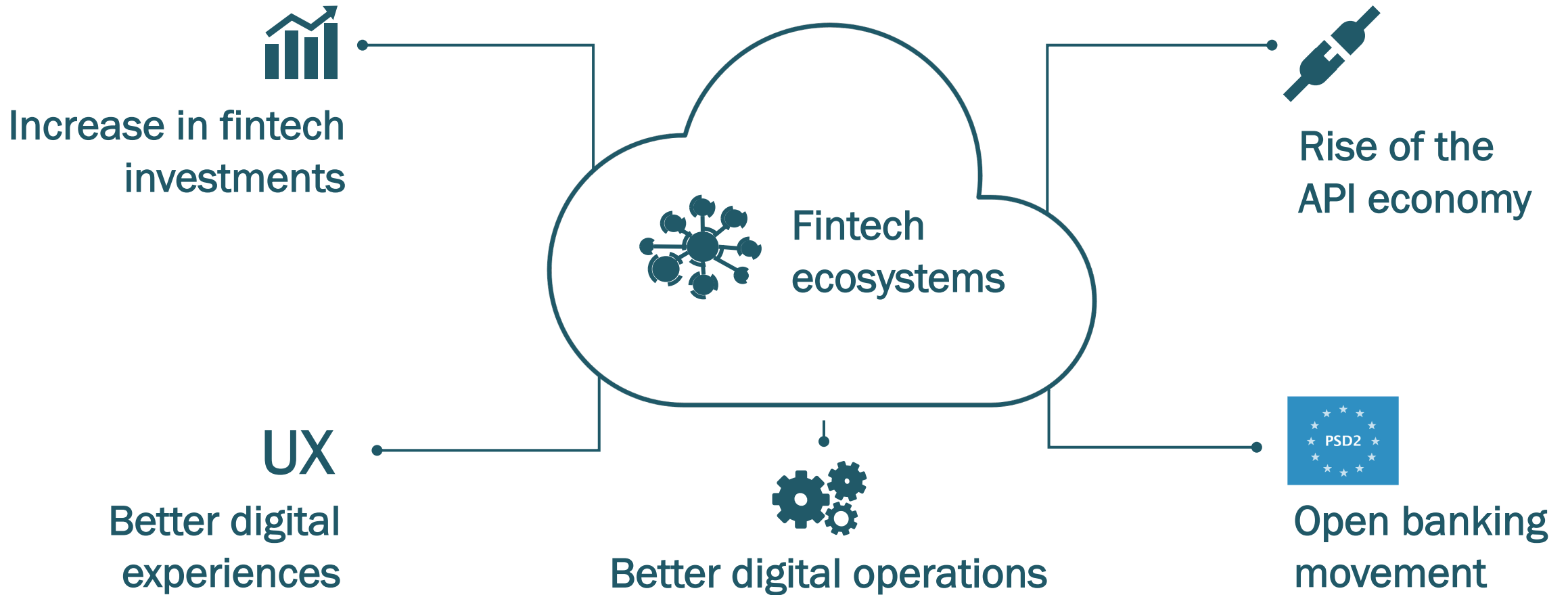
Confluence of emerging technologies
(AI, IoT, robotics, blockchain)



Main drivers behind the financial services industry's rapid change

- ❑ Operating models and structures
- ❑ Sales through digital channels
- ❑ Customer experiences
- ❑ Lines of business silos
- ❑ Integration challenges
- ❑ Speed and time to market
- ❑ Processes
- ❑ Structured and unstructured data

The orchestration of fintech ecosystems has accelerated



Complexity and disruption are the new normal in payments



Payments used to be simple, consumer choices were cash, check, credit card, or debit card



The emergence of mobile and the internet has radically changed the playing field



Payment cards are no longer the only way to pay anymore

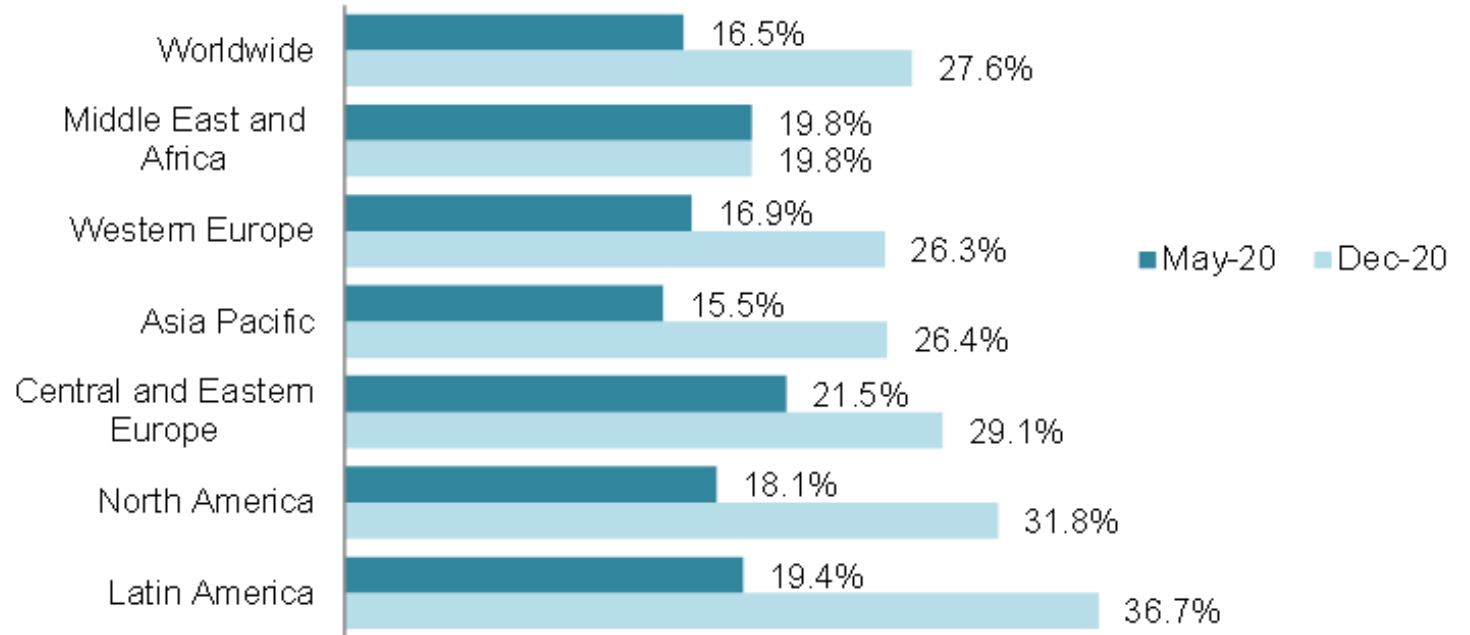
The result is a complex and cumbersome global payments ecosystem

6 Disruptive Trends in Payments

Trend #1: The shift to digital accelerates

- The principal drivers of digital payments volume growth are:
 - Conversion of cash into digital payments
 - Digitalization of commerce
 - Opening of new acceptance points
- The Covid-19 pandemic in 2020 has accelerated the shift to digital

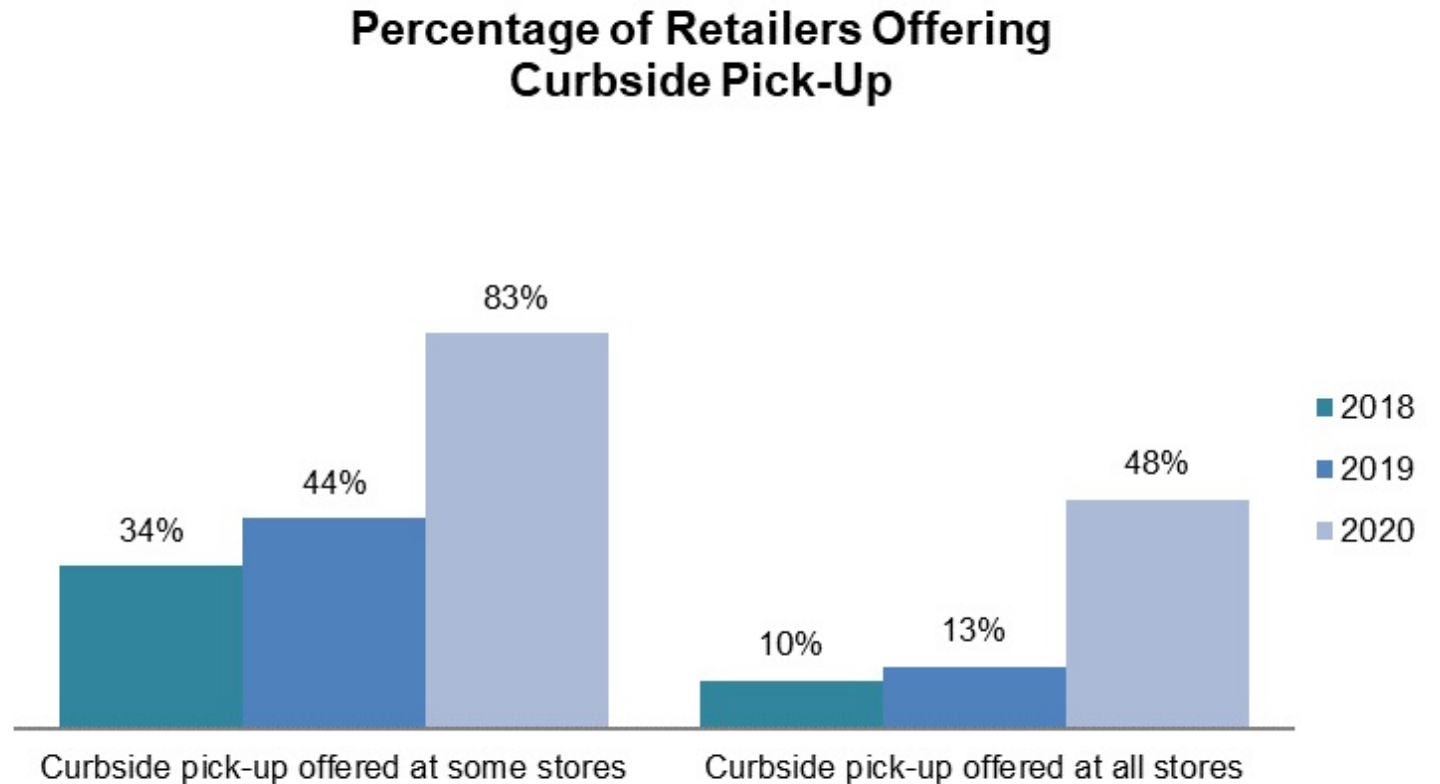
Retail E-commerce Sales Growth Worldwide and by Region, 2020



Source: eMarketer

Consumers and businesses have embraced new ways to shop and pay

- Purchases traditionally made in stores, like groceries, shifted significantly toward online ordering and delivery or curbside pickup during the pandemic
- Buy Now Pay Later usage has grown dramatically, up over 100% so far in 2021
- QR Codes have gained wider acceptance at restaurants and points of sale

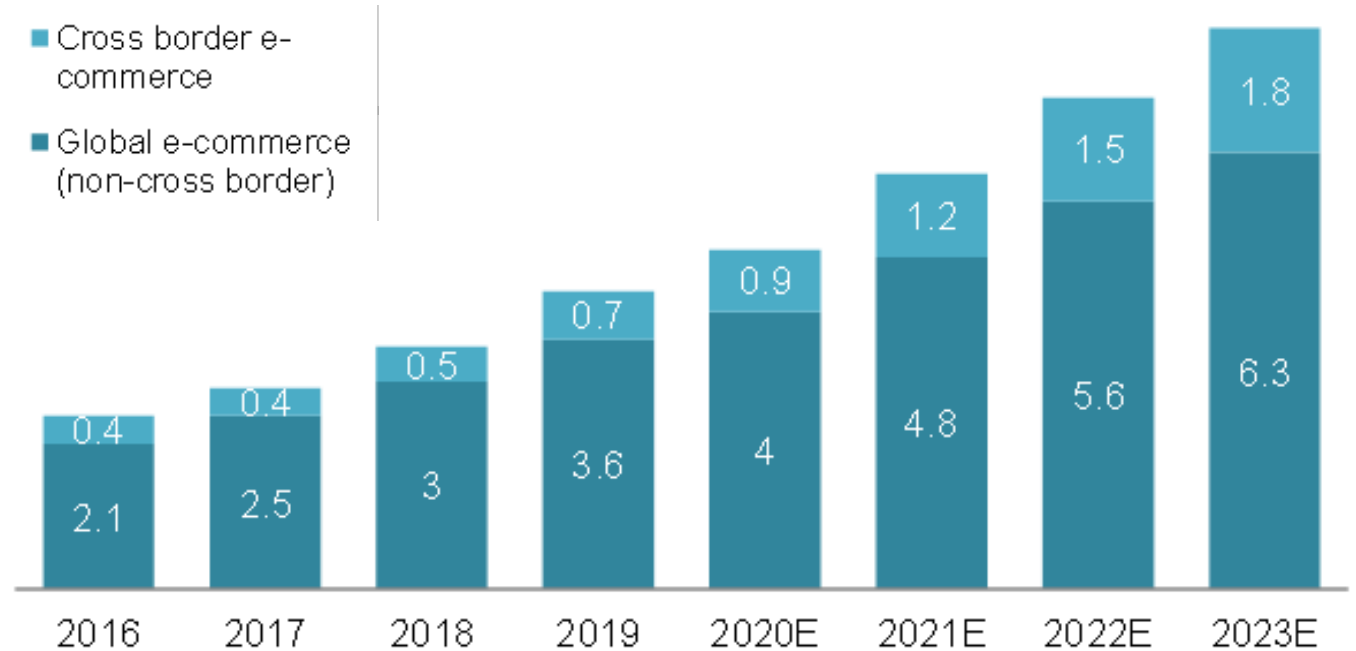


Source: UKG survey of 302 US retailers, Sept 2020

Trend #2: Commerce is becoming borderless

- Cross-border B2C e-commerce grew by nearly 27% to nearly US\$1 trillion annually by 2020
- According to a study by Visa, 87% of global merchants see cross-border sales as critical to their long-term success
- Merchants must also reckon with an expansion of their international B2B supply chain involving suppliers and downstream partners

Global Cross-Border B2C E-/M-Commerce Growth, 2015 to e2020 (\$US Trillion)



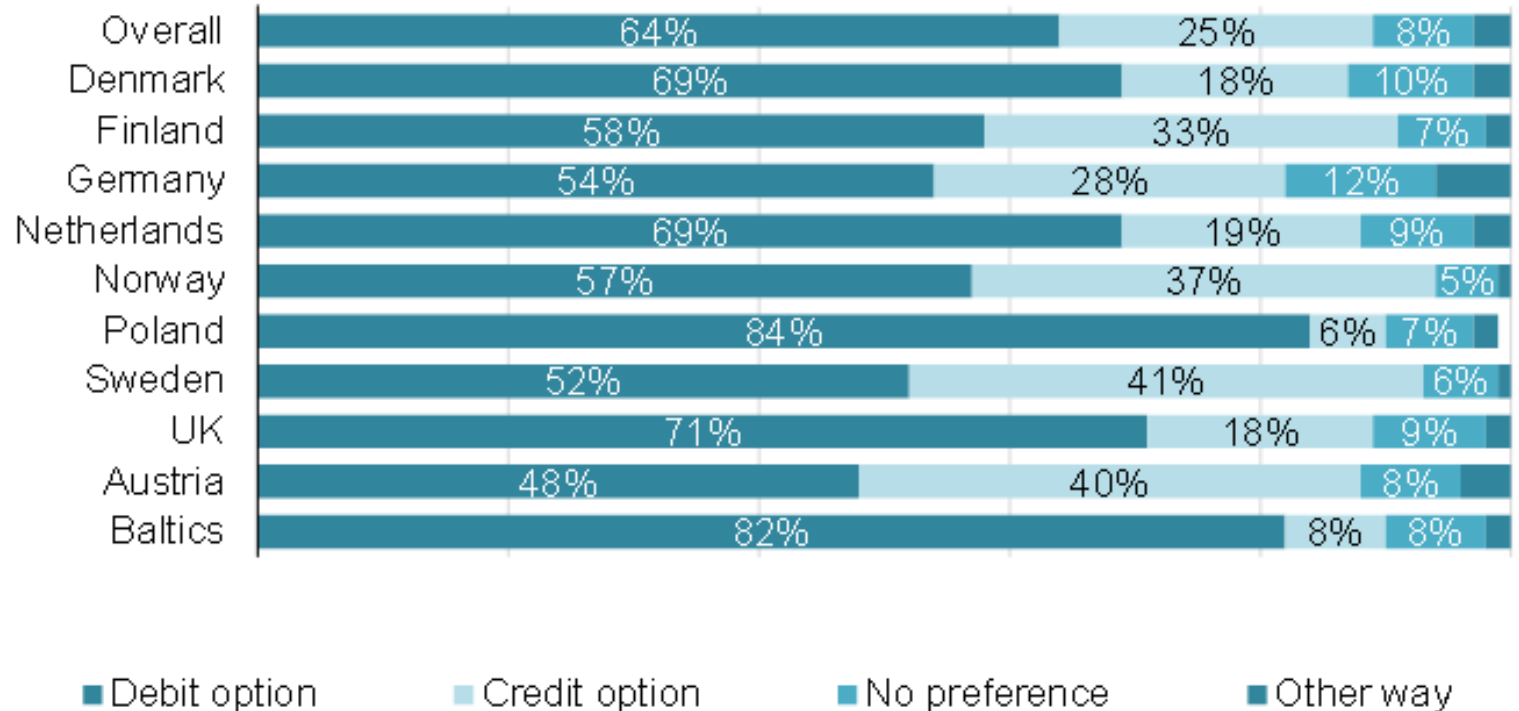
Source: Aite-Novarica Group

Trend #3: “Alternative” (non-card) payment methods (APMs) claim an increasing share of e-commerce payment volume

- By 2023, APMs are expected to account for more than half of online payments volume.
- This trend away from cards to APMs is driven by consumer demand for convenience, trust, and speed, and the needs of online merchants to drive conversion and reduce risk.
- Instant (real-time) payments are rolled-out globally, driving innovation in APMs
- European consumers prefer to “pay now” rather than “pay later”

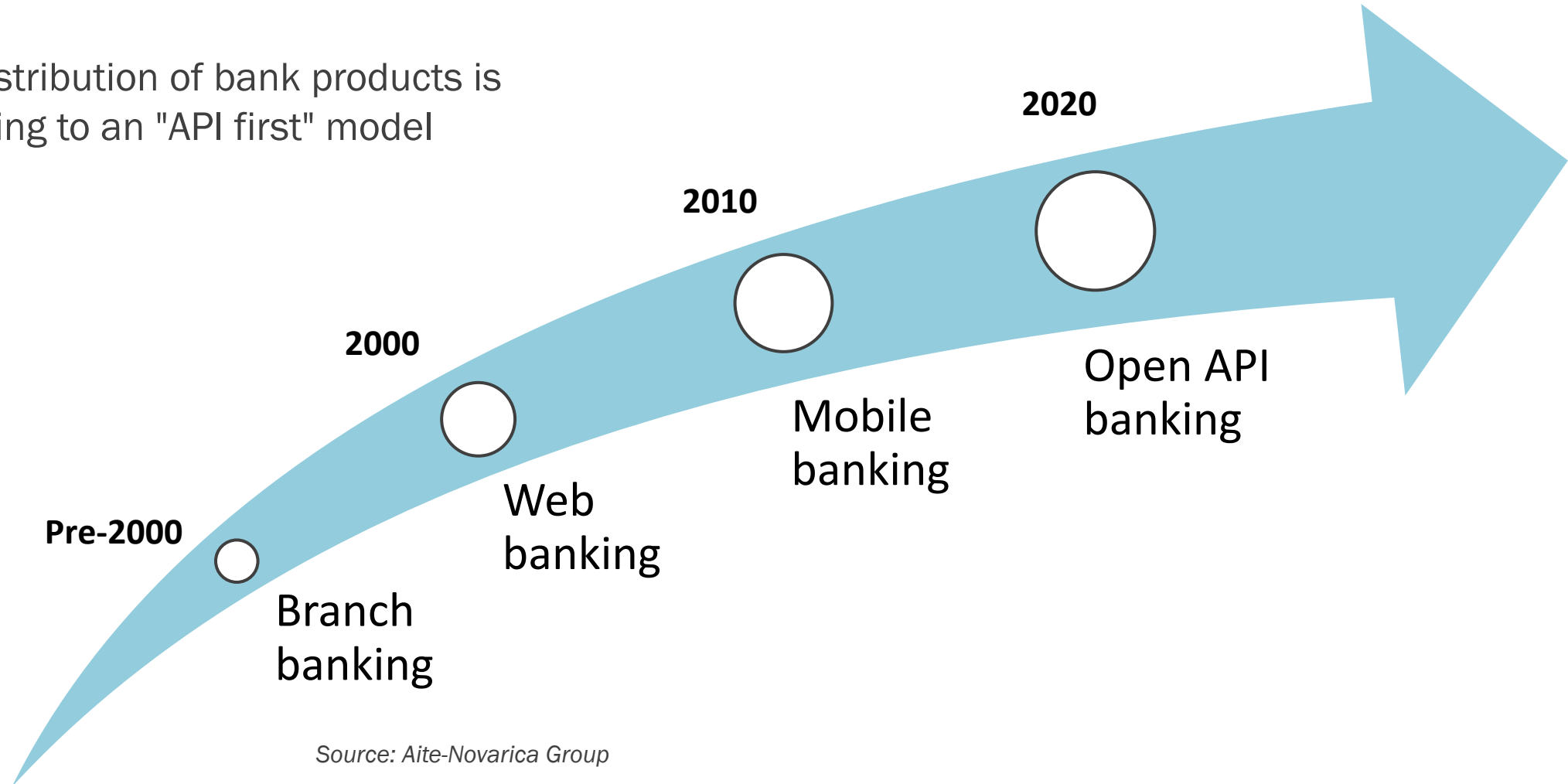
How Do You Prefer to Pay Online? (N=10,031)

Source: Trustly research



Trend #4: Open (API) banking is the next step in the evolution of digital banking

The distribution of bank products is changing to an "API first" model

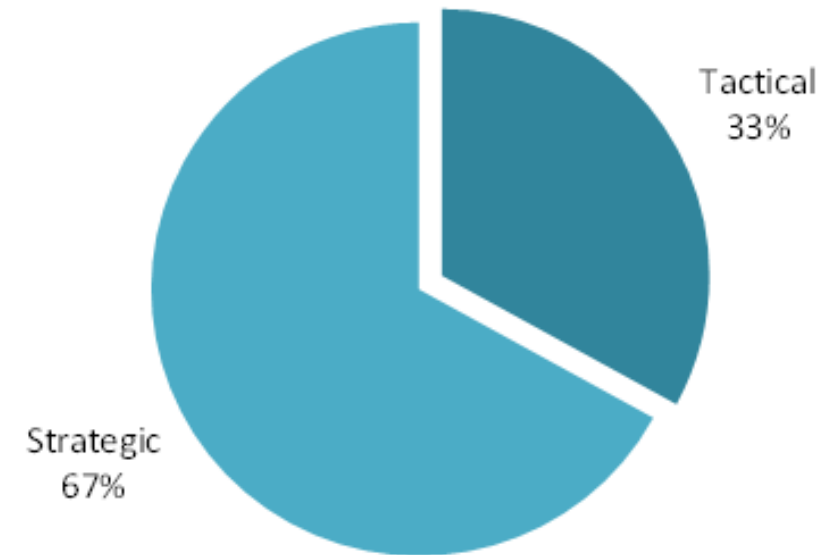


Source: Aite-Novarica Group

Open (banking) payments could emerge as a major payment method

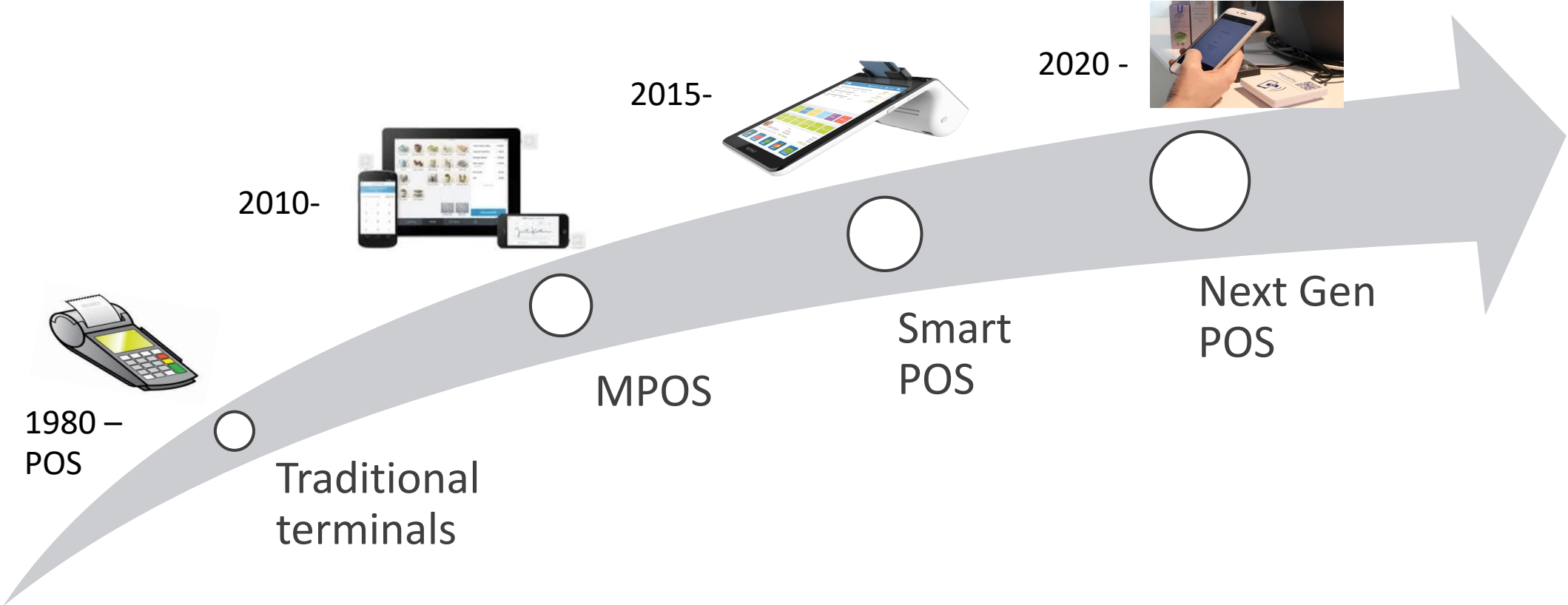
- In Europe, payment initiation services (PIS) will enable banks and other PSPs to offer open (banking) payment solutions to their corporate and SME clients
- Open payments are expected to take an increasing share of European payment volume as a result of trends in client demand, the availability of instant payment infrastructure, and regulatory support
- Open payment use cases can help companies to provide better payment experiences
- However, lack of API standardization inhibits the adoption of open payments at scale

Q: What is your primary motivation for adopting PIS? Is it a strategic move, i.e., to grow revenue share in noncard payments, or more of a tactical choice against cannibalization of existing revenue? (N-15)



Source: Aite Group interviews of 15 banks, PSPs, and payment solution providers in Europe, January to March 2020

Trend #5 The POS payment terminal space is being transformed

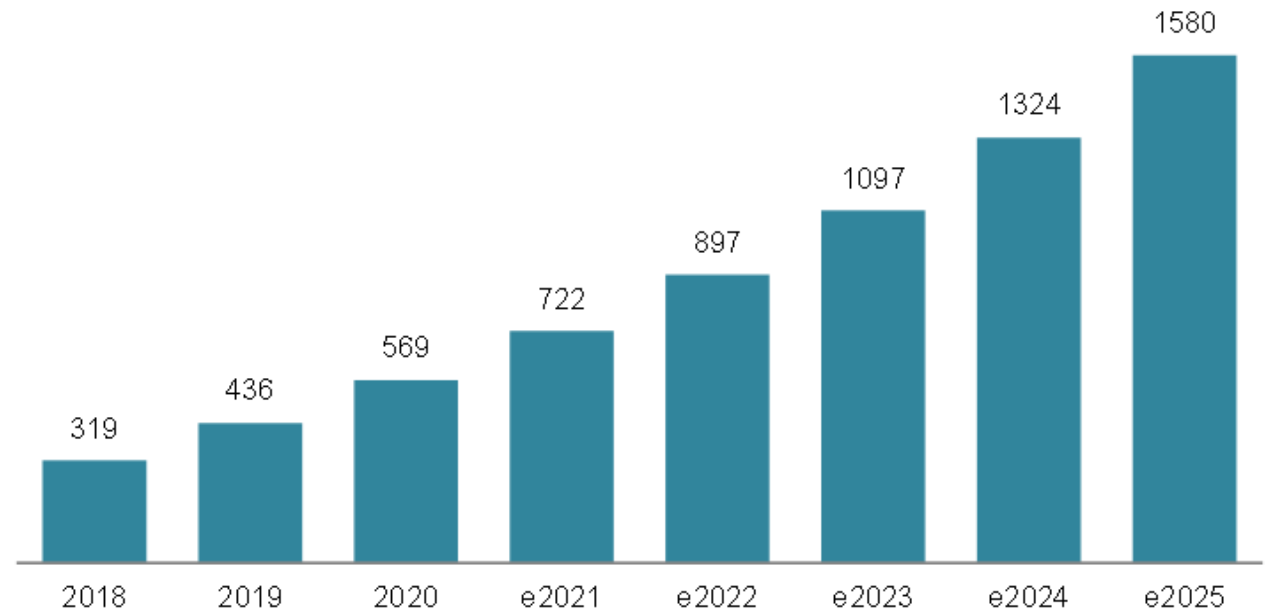


Source: Aite-Novarica Group

Trend #6 Businesses take payments in-house

- Marketplaces and other two-sided platforms (e.g., peer-to-peer, on-demand services, crowdfunding) are offering payment services directly to the large communities of merchants aggregated on their platforms, disintermediating traditional acquirers from direct merchant relationships.
- Software vendors (ISVs) operating SaaS platforms also increasingly take payments in-house, becoming payment facilitators (payfac-s) for their SMB clients.
- The payfac model has the potential to disrupt the payments value chain.

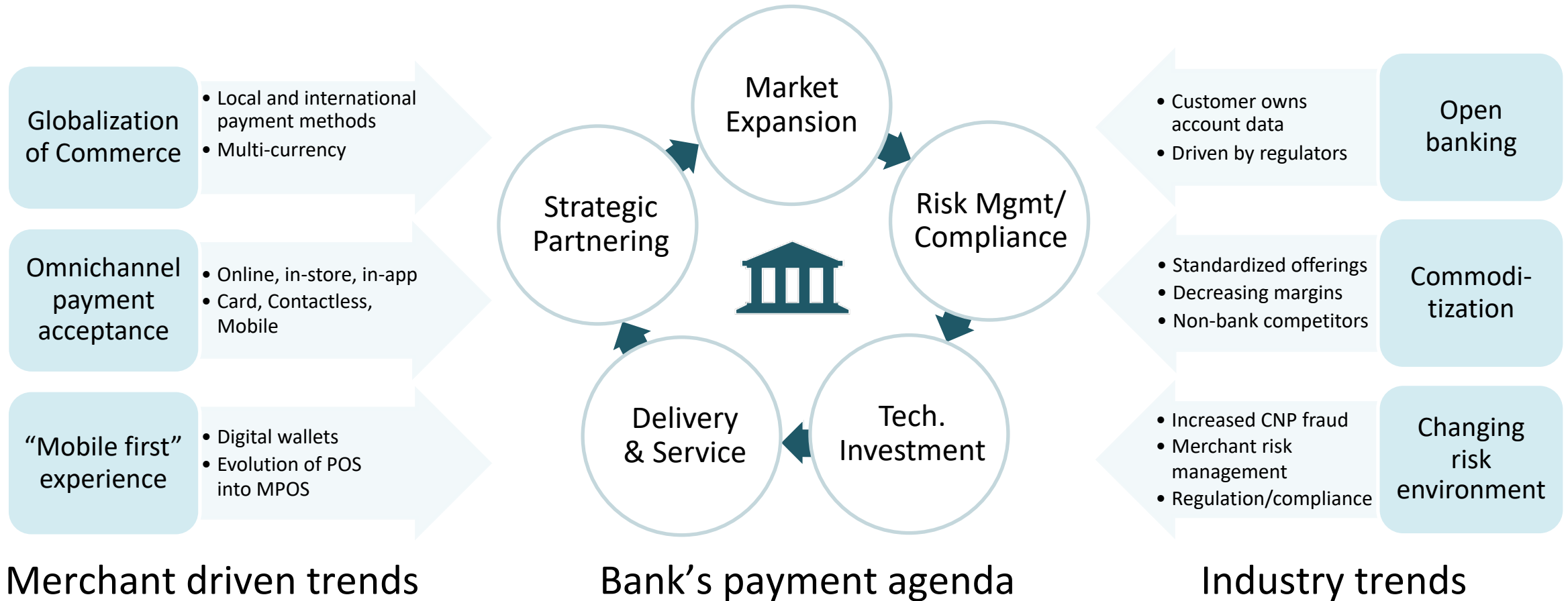
Global PayFac GPV excluding the largest companies (PayPal, Square, Shopify, Stripe). GPV in US\$ billions



Source: AZ Payments Group

Bank Response: Transformation of Payments

The combined forces of changes in client demand and disruptive industry trends urge banks to invest in the modernization of their payments platforms

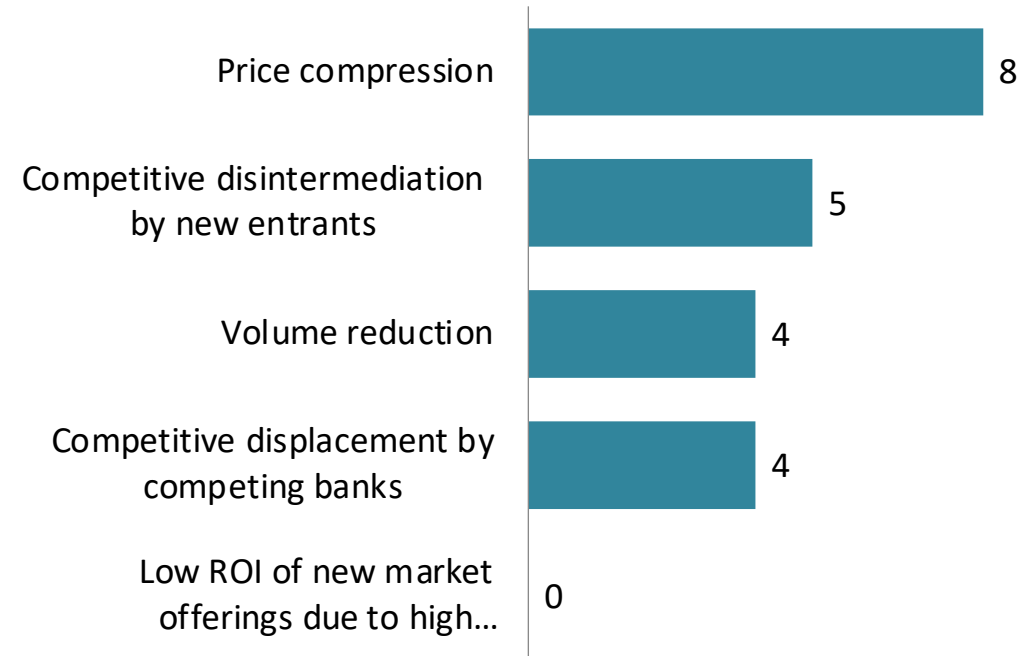


Source: Aite-Novarica Group

Price compression is the greatest revenue threat

- Banks indicate that price compression is their greatest revenue threat.
- Many retail payment services are becoming commodities, with price as the main distinguishing factor.
- Competition from new entrants as well as peers leads to price compression, leading banks to seek new markets and customer segments to increase scale and sustain growth and profitability.
- To succeed, banks should focus on value-added services rather than sheer transaction volume.

Q. What is your greatest revenue threat?
(N=21)

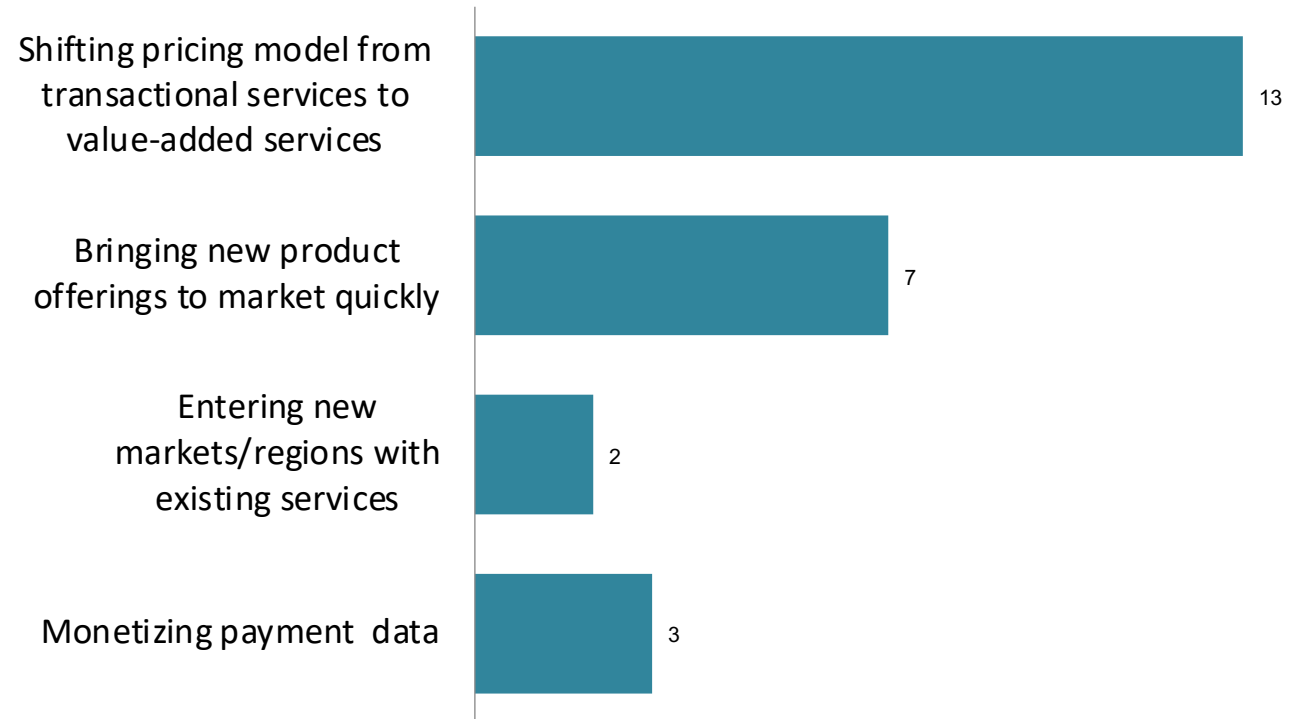


Source: Aite-Novarica Group interviews with 21 top tier retail banks, August – October 2020

Banks are shifting their business models to value-added services rather than focusing on sheer transaction volume

- Nearly two out of three banks said that they are looking to shift their pricing model from a focus on transactional services to a focus on value-added services.
- Monetizing payment data is mentioned as a potential large opportunity for banks, but compliance with data protection legislation and fear of reputational damage makes it difficult for banks to monetize the opportunity, particularly in Europe.

Q. What is your greatest revenue opportunity?
(Select all that apply; N=21)

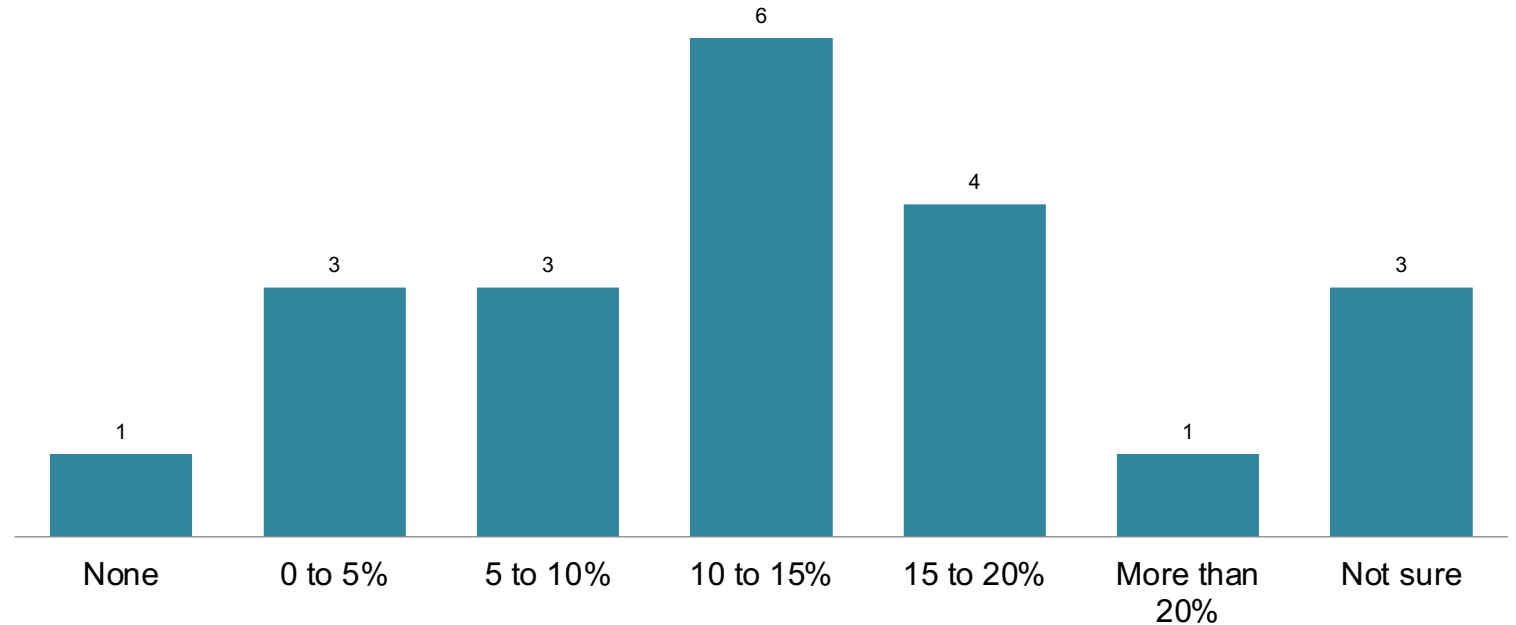


Source: Aite-Novarica Group interviews with 21 top tier retail banks, August – October 2020

Impact of competitive challenges

- Many banks foresee a significant impact on revenue if their banks do not adapt and invest in payments.
- Competition from new entrants, in particular big tech, is considered the main threat.
- The median for the responses on this sample is a revenue at risk for retail banks of 10-15% of retail bank payments revenue, or US\$ 100-150 billion globally.

Q. Over the next 3 years, what percentage of retail payments revenues do you believe will be at risk from competitive challenges? (N=21)



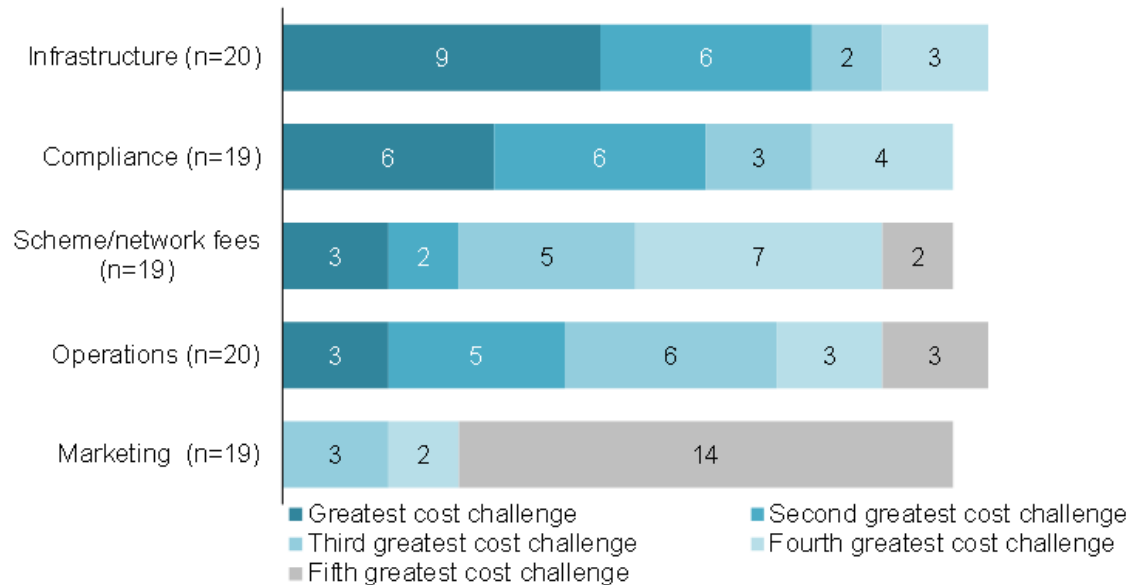
Source: Aite-Novarica Group interviews with 21 top tier retail banks, August – October 2020

Banks are moving to the cloud to be more agile and reduce cost

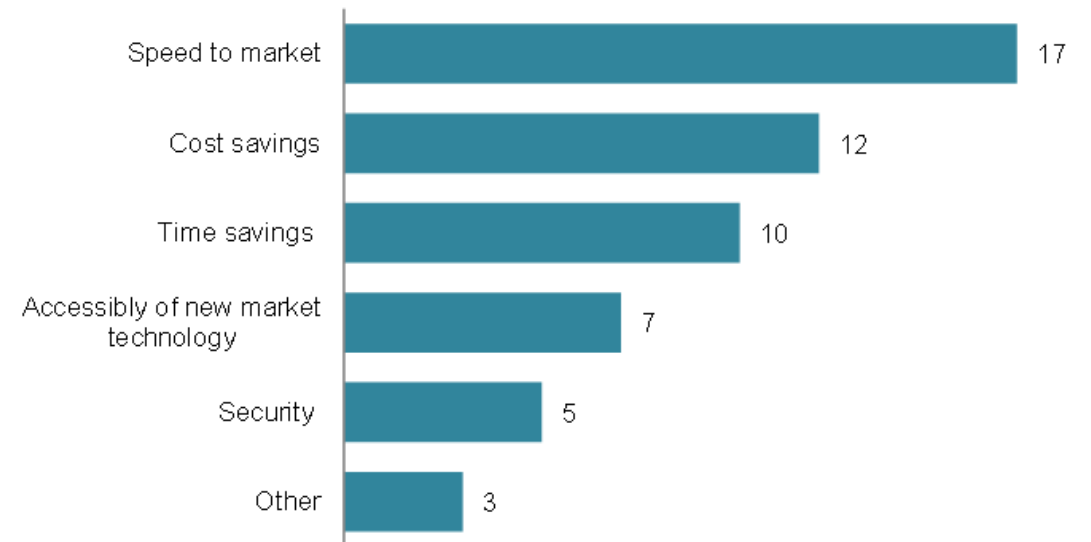
Banks see investments in infrastructure and the cost of compliance as the main challenges

Cloud technology enables banks to run a more cost-efficient operating model

Q. Please rank your greatest cost challenge.



Q. What are the expected benefits of cloud technology? (Select all that apply; N=20)

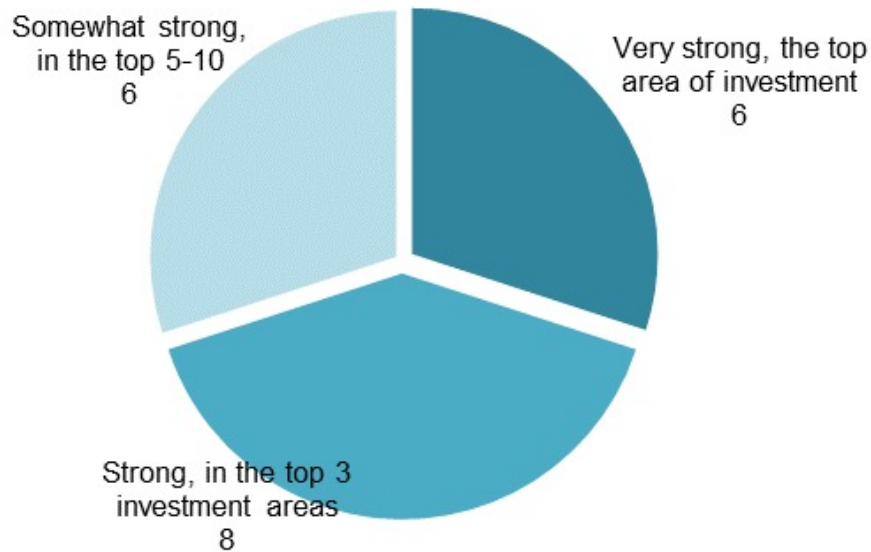


Source: Aite-Novarica Group interviews with 21 top tier retail banks, August – October 2020

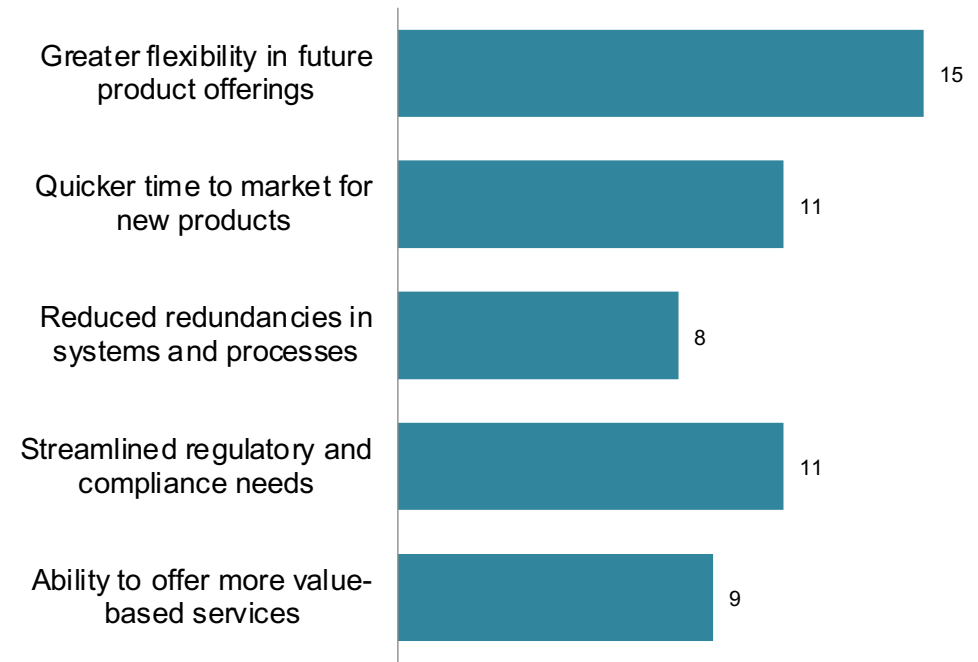
Payment modernization is a strong priority

Payment modernization is a strong priority for banks to become more agile in their product delivery, reduce time-to-market, and streamline legacy processes.

Q. How strong is the priority of payments modernization in your organisation against other investments? (N=20)

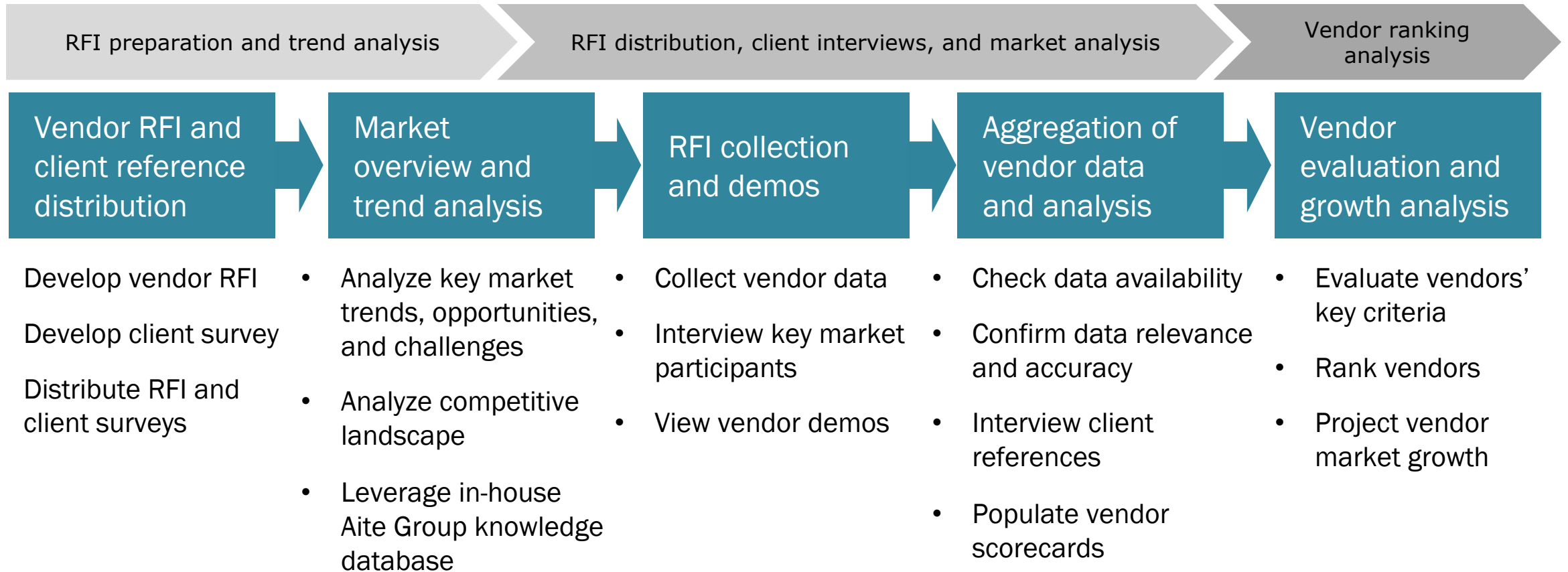


Q. What are the positive outcomes for modernization of payments in your organization? (Select all that apply; N=21)



Source: Aite-Novarica Group interviews with 21 top tier retail banks, August – October 2020

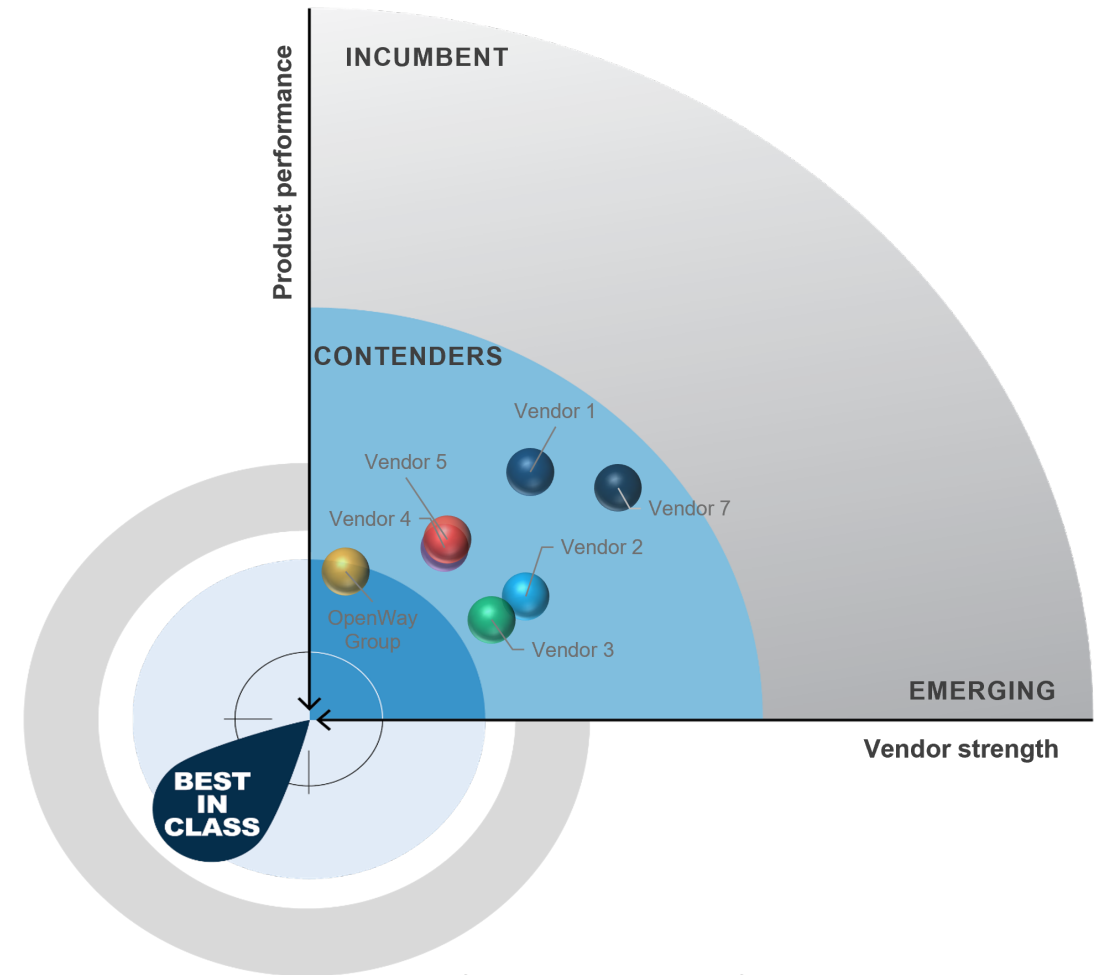
Aite-Novarica Group developed an assessment of seven technology vendors that provide solutions for issuing and acquiring processing to retail banks



Source: Aite-Novarica Group

Modern platforms win

- OpenWay Group obtained the highest score in terms of ratings from the evaluation, but other vendors were close in terms of overall strength.
- Overall, there was not much differentiation among the participating companies in terms of feature/functionality.
- The primary differentiation was found in the architecture that is used (whether it's a legacy platform or state-of-the-art), client service, and vendor's geographic reach/vision/company culture.
- Customer service was found to be a key differentiator. Make sure that the vendor's key performance indicators related to customer service meet the company's needs.



Source: Aite-Novarica Group

Conclusions

Conclusions

- **The payments space is very dynamic as a result of accelerated digitalization of commerce,** empowered customers requiring immediate and frictionless service, the disruption of age-old value chains and business models, and regulatory actions
- **Lack of standardization leads to fragmentation and complexity in the market.** Intermediaries such as fintechs and payment networks are developing global platforms to mitigate this risk and bridge inefficiencies
- **Banks should invest in payments modernization to protect their market share against new competitors and develop new business.** Continuing on a business-as-usual scenario is not a viable option and will expose banks to a significant risk (10-15%) of loss of revenue
- **Banks should consider moving from a transactional pricing model to a model that is focused on value-added services**
- **Technology vendors in the payments space should provide flexible, cloud-based solutions to banks to support them on their modernization journey.**

Additional Information

Retail Banking & Payments practice provides clients with ongoing insights focused on the business, technology, and regulatory challenges affecting consumer banking services and retail payments of all kinds. The practice serves a wide range of market participants, from global universal banks to community banks and credit unions as well as alternative financial services providers, card processors and network providers, merchants, technology vendors, and professional services firms.

Contact Presenter



Ron van Wezel

rvanwezel@aite-novarica.com

+31 6 3629 6515

inquiry@aite-novarica.com

+1 833-668-2742

www.aite-novarica.com

About Aite-Novarica Group

Aite-Novarica Group is an advisory firm providing mission-critical insights on technology, regulations, markets, and operations to hundreds of banks, insurers, payments providers, and investment firms—as well as the technology and service providers that support them.

Comprising former senior technology, strategy, and operations executives as well as experienced researchers and consultants, our experts provide actionable advice to our client base, leveraging deep insights developed via our extensive network of clients and other industry contacts.

The quality of our research, insights, and advice is driven by our core values: independence, objectivity, curiosity, and integrity.

Our goal is to be a trusted advisor to our clients by using our data, experience, and proven best practices to help them make better, faster, and more lasting decisions.

Contact

Aite-Novarica Group
280 Summer Street, 6th Floor
Boston, MA 02210

833-668-2742

info@aite-novarica.com

More information at
www.aite-novarica.com



The logo for Aite Novarica features the word "Aite" in a dark blue font with three small orange dots above the letter 'e'. The word "Novarica" is in a larger, dark blue font. The background consists of a central white band with a faint, light-colored network pattern, flanked by blue and yellow textured borders.

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