zensar

The Payments Industry Revolution

Abandoning 'Small Change' for Big Bets

Q2 FY22

An RPG Company

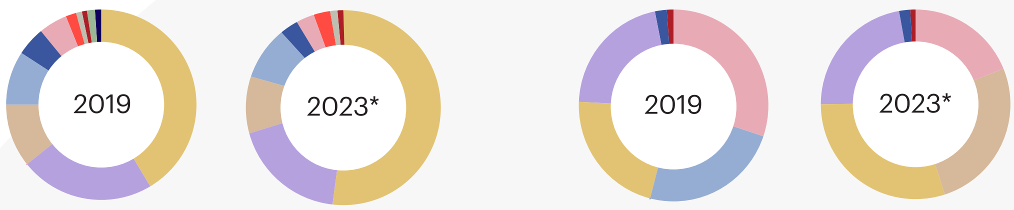
zensar

The payments industry is on an aggressive path of innovation. Its motto appears to be "faster, simpler, cheaper." In India, customers pay street-side vegetable vendors using QR codes; in Turkey, commuters pay for bus travel cards using an SMS. In China, patrons of fast-food eateries are paying using facial recognition. In the US, buyers pay for medicines, groceries, and white goods by tapping their smartphones at a payment terminal. This trend is powering cashless transactions that are forecasted to grow from $1tn in 2020 to $3tn in 2030. Going cashless is now an urgent priority for every business. Add innovations such as buy now, pay later (BNPL), post-pay, pre-pay, digital wallets, and crypto, and it is easy to see how the payments industry is catalyzing the digital economy.

GLOBAL E-COM AND POS PAYMENT METHODS

Global eCom payment methods

Global POS payment methods



	2019	2023*		2019	2023*		2019	2023*
Digital/Mobile Wallet	41.8%	52.2%	Cash	41.8%	52.2%	Buy Now Pay Later	41.8%	52.2%
Credit Card	24.2%	18.8%	Debit Card	41.8%	52.2%	Post Pay	41.8%	52.2%
Debit Card	24.2%	18.8%	Digital/Mobile Wallet	41.8%	52.2%	Pre-paid Card	41.8%	52.2%
Bank Transfer	24.2%	18.8%	Credit Card	41.8%	52.2%	PrePay	41.8%	52.2%
Charge & Deferred Debit Card	24.2%	18.8%	Charge Card	41.8%	52.2%	Other	41.8%	52.2%
Cash on Delivery	24.2%	18.8%	Pre-paid Card	41.8%	52.2%			

Distilling the trends provides us with a way of making sense of the unstoppable change sweeping the payments landscape. In this article, we will talk about six emerging trends that are shaping the payments industry:

- Digital products innovation
- Everything real-time (aka RTP)
- The B2B battle of BigTechs vs banks
- CBDC and cryptocurrencies at crossroads
- Making cross-border payments ubiquitous
- The cyber fraud challenge

Economies, world over have begun to crystallize its payment landscape of the future. Admittedly, there are subtle differences between regions, but a single thread binds them: instant, real-time payments (RTP). Every business wants to improve cash flow management and bring visibility into payments, both of which are enabled by RTP. An examination of the regional trends provides context for the broader innovations that are underway:

United States of America

Non-financial big techs (such as Google and Amazon), retailers, grocers, and manufacturers are embracing embedded finance options. Retailers, for example, are partnering with banks and FinTechs to offer BNPL options to customers at checkout. A leading study shows where this trend is headed - by 2030, says the study, non-financial institutions will process 73 percent of consumer payments. Equally important is that big techs are briskly expanding into the SMB segment and B2B e-commerce with partnerships for virtual cards and invoicing automation. From the perspective of traditional financial services providers, the playing field is being un-leveled at an alarming pace. And finally, the US is all set to meet customer expectations with its FedNow service, which is expected to increase RTP volumes 5x by 2024.

Europe and UK

The payments industry in Europe and UK is moving to ISO 20022. This is the emerging global standard for payment messaging, offering straight-through processing that lowers the need for manual intervention. Simultaneously, Payment Service Directive 2 (PSD2) ensures that third-party non-banking providers have access to bank infrastructure, leading to improved competition and innovation around new payment methods. Meanwhile, RTPs will be enabled by the UK's new payments architecture (NPA) program. The NPA will be live by 2025 and will support multiple payment products such as instant payments, bulk payments, multi-payments, and priority payments.

South Africa

A marketplace model will enable incumbent banks in South Africa to offer low-cost and industry-specific solutions for broader customer outreach. An API-based Rapid Payments Program (RPP) is being developed that will make it possible to send money to a mobile phone or an email address in real-time without the need to know the recipient's banking details. The first live transactions are likely to occur by the end of Q2 2022.

Asia

Most of the cutting-edge developments in contactless payments using biometrics, NFC, QR, mobile wallets, etc., can be attributed to Asia. Mobile wallets alone will have 2.6 billion users in the APAC region by 2025. A key contributing factor is that debit and credit card penetration is lower in Asia than in Europe or the US. Asia is teeming with FinTechs such as AliPay, WeChat Pay, PayTM, OVO, ShopeePay, LinkAja, LINE Pay, Kakao Pay, and GrabPay. Many of these providers have added a layer of social media, marketplaces, and financial products to their payment systems. These are innovations the rest of the world is yet to adopt. In a bid to catch up, it is safe to assume traditional payment providers will partner with fast-moving startups. Meanwhile, RTPs are already a reality in Asia — India is a global leader in RTPs, with 41 million transactions per day, closely followed by China. The next advancement, naturally, will be cross-border RTPs.

Many changes in the payments space have been accelerated by the COVID-19 pandemic. Interestingly, there is an additional driver for change: digital payment innovators are acquiring customers rapidly and are outshining traditional financial services providers. The success of the new breed of non-banking players has brought pressure on incumbent banks to act and counter the challenge.

Fortunately, the latest developments around payments technology hold a deep appeal for the industry. Among the irresistible draws is that adopting new standards will enable richer data to be carried in payment messages, unlocking further innovation; the trend of embedded payments will unlock more opportunities for collaboration; open banking is already heralding the rise of new services; and shared technology stacks will eliminate the scourge of siloed development.

No one can accurately predict how the payments landscape will unfold. Predictions will go awry because customer behavior is volatile. Today, customers want to pay from any device or application (such as a messenger). They want to pay from anywhere and over any channel. Soon they will be paying for gas and parking using integrated payment systems in their cars, without touching anything, much like how toll is paid. They are already demanding to freely use fiat currency, crypto, or digital currency. Tomorrow, many will want to transfer NFTs.

Although the payments space is witnessing extraordinary evolution, almost bordering on chaos, six emerging trends are shaping the industry. These provide us with a clear view of the most immediate opportunities and challenges in payments:

1 Digital products innovation

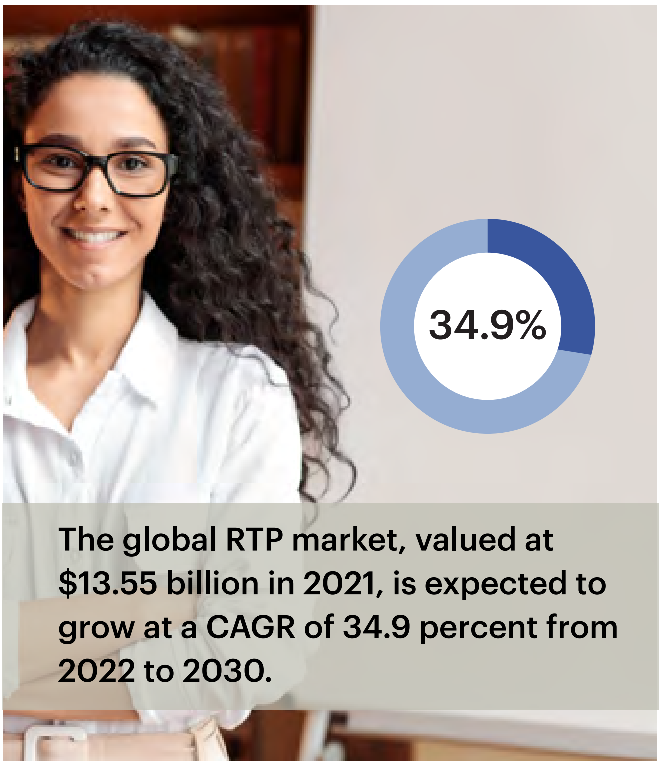
Product innovation is being led by the proliferation of digital wallets and the rise of the BNPL model. Digital wallets (like Google Pay, Venmo, and Apple Pay) store money and simplify online transactions by eliminating the need to repeatedly fill in debit or credit card details.

Digital wallets will account for more than half of all e-commerce payments worldwide by 2024. BNPL leaders (like Afterpay, Affirm, and PayPal) will process $650B-$1T in transactions by 2025. From Mastercard to Visa and Standard Chartered, every major services provider is lining up partnerships with smaller payment tech organizations to innovate. They are creating checkout-free shopping using digital wallets and overlaying it with geofencing or experimenting with voice-activated payments that combine authentication and authorization.

The innovations around digital payments signal the need for traditional providers to re-invent themselves while working on improving their propensity for cross-industry collaboration.

2 Everything real-time (aka RTP)

RTP is an all-pervasive trend, cutting across geos and industries. The number of RTP transactions in 2020 stood at more than 70.3 billion, with a surge of 41 percent observed during the COVID-19 pandemic.



The global RTP market, valued at $13.55 billion in 2021, is expected to grow at a CAGR of 34.9 percent from 2022 to 2030.

In 2020, RTP infrastructure existed in less than 30 percent of the world's nations. This is set to see a dramatic change.

While zero lag time in settling transactions will continue to drive adoption, there are several ways RTP trumps traditional payment systems. RTP technology offers convenience and control combined with security. In addition, it betters conventional payment systems that have a one-way flow of communications, from the payer to the payee. RTP enables two-way communication. Data related to initiation, transfer, confirmation, and settlement are exchanged along with the transaction.

Not surprisingly, every type of financial service provider is moving to RTP. FinTechs like Modern Treasury, Dwolla, and Orum are bundling it with value-added services; tech companies like Facebook, Amazon, and WeChat are making it default to their offerings; networks and processors like VISA, Mastercard, and AmEx are adopting it to stay relevant; and RTP has been critical to SWIFT for the last few years. The most significant impact of RTP will be on clearinghouse volumes. Their volumes will flatten. Central banks will, as a consequence, have to replace their paper and batch-based processes with new clearinghouses for RTP.

3 The B2B battle of BigTechs vs banks

After building their dominance in the P2P digital wallets segment, BigTechs are moving to capture the B2B small and medium businesses (SMB) segment. Traditional banking has been unsuccessful at creating affordable products for the complex SMB segment, leaving it open for BigTechs to offer B2B e-commerce, virtual cards, and automated invoicing solutions. BigTechs will make their offerings strong by integrating payments into their solutions, lowering processing costs, providing visibility into transactions, and eliminating payment delays.

The interest that BigTechs are displaying in SMBs is already visible: Apple has acquired Mobeewave to tap the potential of the software point-of-sales (SoftPOS) market; Amazon's mobile app for SMBs (Pay for Business) provides merchants the means to manage their day-to-day transactions while simplifying digital payments; Meta (Facebook) has partnered with Supplier Success to offer next-day liquidity to US-based suppliers at a minimal cost.

The SMB-fueled trend is growing, and regulators may be forced to put guard rails on BigTech's M&A activities to discourage monopolistic behavior. To sidestep this, Big Techs will target B2B marketplaces that do not compete with banks, resulting in a win-win. In the immediate to short term, the need to churn out innovative solutions and stay on the right side of regulators will foster collaborations between banks (especially the smaller tier 2 banks) and BigTechs.

4 CBDC and cryptocurrencies at crossroads

Virtual currency is becoming a reality faster than predicted. Nine nations have launched their Central Bank Digital Currency (CBDC), a digital form of their fiat currency. Last year, with the launch of eNaira, Nigeria became the latest nation to opt for CBDC. The hands of central banks are being forced by the rise of private cryptocurrencies and the risk of monetary instability that crypto represents. Adding to the pressure is the preference for cashless transactions that customers are demonstrating. This explains why today, 87 countries (representing over 90 percent of global GDP) are exploring their own CBDC.

The action around digital currencies has become hectic. While these are early deployments, they emphasize the remarkable opportunities waiting to be exploited. Some examples provide insights into the opportunities: JPMorgan's JPM Coin is used by large institutional clients and is solving issues that have been the bane of traditional cross-border payments. JPM Coins smoothen the transfer of cross-border funds. Citi Bank has a digital assets group that assists clients to invest in CBDCs. China released a new digital yuan app that is being used in 23 pilot cities across China. The app is designed for small but high-frequency retail transactions. Over the next few years, digital currencies will see broader adoption and transform the face of the payments industry.

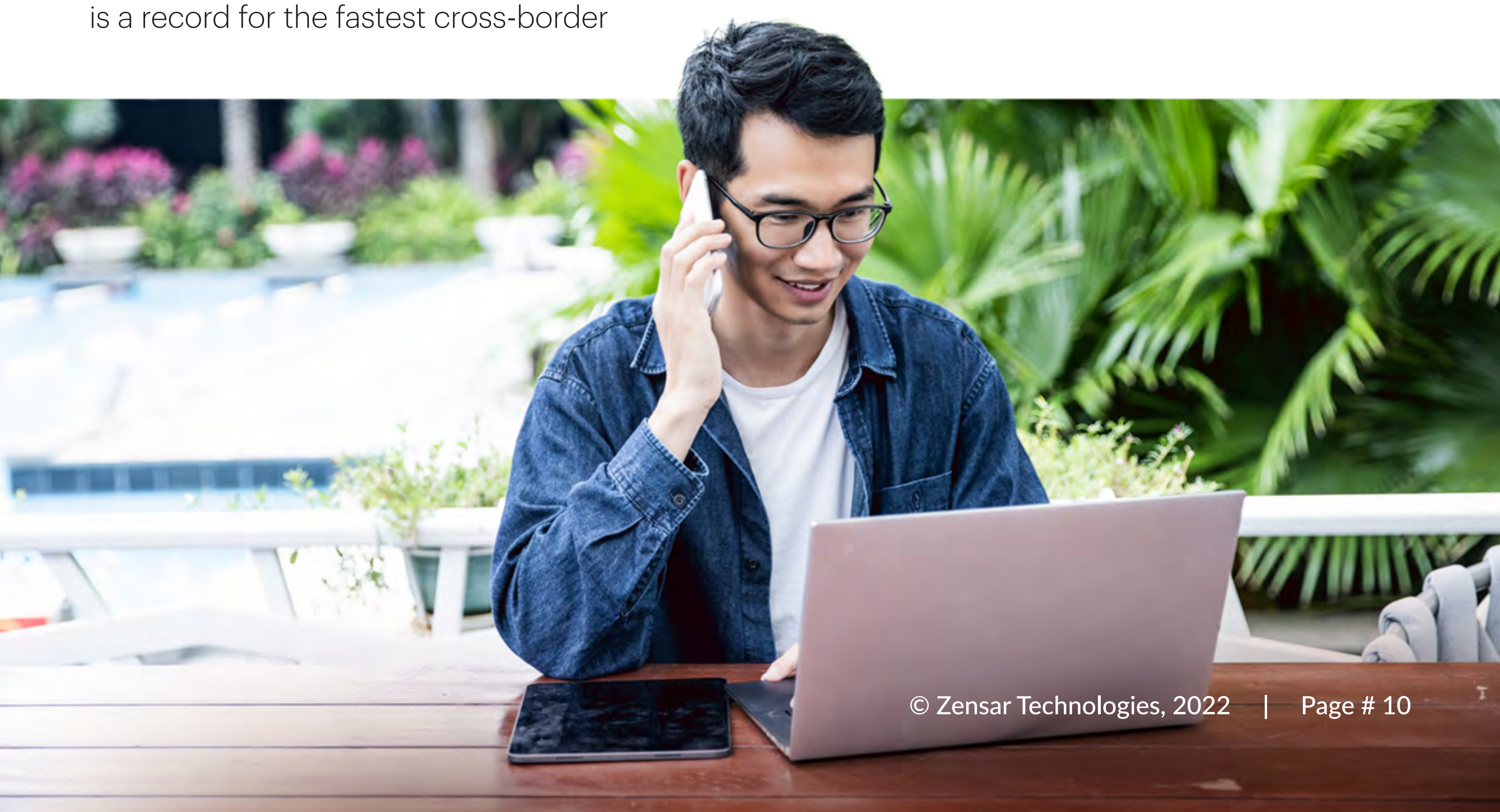
CBDCs will find more users than private cryptocurrencies. Although CBDCs will affect privacy, their adoption will be fueled by the backing of the governments that issue them. Businesses will adopt CBDCs for the faster transaction velocity and the centralized monitoring and reporting they offer. However, to succeed globally, central banks across nations will have to agree on common minimum principles regarding CBDC structures. Financial analysts will keenly watch these developments over the next five years.

5 Making cross-border payments ubiquitous

PayPal's 2021 Borderless Commerce Report says, "This is a unique moment in time when merchants can diversify their business model and tap into cross-border growth. As consumers became more comfortable shopping online, they started shopping globally more often, and this trend will accelerate further." The report found that 22 percent of consumers surveyed became more comfortable with cross-border shopping since the pandemic. At $156 trillion by the end of 2022, the global cross-border payments opportunity is enormous.

FinTechs like Wise, Ripple Labs, and Rapyd are cashing in on the opportunity. Their solutions are faster and cheaper, giving them an edge over traditional banks. The competition is forcing new collaborations — that are also highly successful — in the cross-border payments space. A pilot between SWIFT and UK Faster Payments saw a payment from Australia to a UK beneficiary credited and confirmed in 36 seconds. This is a record for the fastest cross-border payment. Singapore and Thailand recently linked their respective national RTP systems, PayNow and PromptPay, allowing registered users to instantly transfer funds using only a mobile phone number. The service displays exchange rates and fees before the transfer and promises to be affordable.

Making cross-border payments simpler, better, and faster has been a long-pending demand of businesses. FinTechs are doing this by leveraging collaborations and bundling value-added services such as corporate expense management, account receivables, and payables management with their cross-border payment offerings. Common minimum principles regarding CBDC structures across nations will lead to more efficient cross-currency and cross-border payments. For every cross-border payment provider, the goal will be to make sure there is no difference between the domestic settlement system and a cross-border one.



6 The cyber fraud challenge

The COVID-19 pandemic accelerated the adoption of new digital payment methods, but it also increased the incidents of takeover fraud from 34 percent in 2019 to 54 percent in 2020. Forecasts suggest that by 2030 when payment card volumes are expected to hit $79.14 trillion, the payments industry will lose an estimated $49.32 billion to fraud. BNPL-related incidents such as synthetic identity fraud, account takeover, and chargeback fraud are adding to fraud volumes. Naturally, cybersecurity has become a top priority for payment providers.

The rising threat to cybersecurity has led to a flurry of activity. Banks and FinTechs are investing in automation, advanced analytics, and rules-based fraud management to build consumer confidence. Some of the leading solutions being deployed include risk scoring tools, mule account modeling tools, and machine learning-based tools. Regulators, too, are implementing data protection frameworks to curb fraud in the payments space.

In the coming months, several intelligent digital identity processes will be used to fight payments fraud. These will include facial recognition, fingerprint biometrics, voice biometrics, signature recognition, and keystroke biometrics. Investments in this space will be important, with industry collaboration equally critical in combating new-age security and fraud threats.

The future is now

After decades of frustratingly small and incremental changes, the payments industry is primed for a major revolution. The velocity of change is already unprecedented. The intersection of various technologies is making it possible for the industry to deliver blockbuster solutions. This is the right time for payment providers to experiment, think velocity, and boldly step into a customer-focused future.

After decades of frustratingly small and incremental changes, the payments industry is primed for a major revolution. The ubiquitous and embedded, cross industry nature of payments business makes the change emerge from any nook and corner be it the fintechs, insuretechs, healthtech, retail tech etc. The velocity of change is already unprecedented. The intersection of various digital & cloud technologies is making it possible for the industry to deliver blockbuster solutions. This is the right time for BFS institutions, payment service providers to experiment, innovate, think velocity, and boldly step into a customer-focused future.

Authors

Ashutosh Sharma
Global Head, Banking
BFS Industry Solutions Group

Shivam Vashishtha
Senior Business Consultant
BFS Industry Solutions Group

This article is published by Zensar BFS Industry Solutions Group (BFS-ISG). The BFS-ISG team focuses on delivering client advisory & implementation services, building domain-based frameworks & solutions, domain product competency and Industry thought leadership in the Banking & Financial Services space. The group proactively works to understand and preempt the industry dynamics, and regularly publishes viewpoints about key business and technology trends shaping the future of the financial services industry.