Disruption across the industry a global theme

Around the world, new entrants (including start-ups and nontraditional players) are entering the payments industry. The new technologies and ideas they bring have the potential to ignite greater innovation across the industry and challenge established participants. While the full impact of this disruption will play out over many years, 2016 will see significant changes to the status quo.

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Global Payments Overview

Each country around the world has unique cultural, political, and economic conditions that impact the domestic payments industry. As a result, each country is at a different level of payments development. In some countries, traditional payment methods like cash and checks remain popular, whereas in others new electronic payment methods now account for the majority of transactions. However, regardless of payments development, one clear theme has spread across virtually the entire payments industry. This is the fundamental shift to electronic payment methods.

The growing number of noncash transactions comes as the method by which consumers pay for goods and services changes. Payment cards already are consumers’ preferred electronic payment method. According to the “2015 World Payments Report” from Capgemini and Royal Bank of Scotland (RBS), payment cards accounted for 62.8% of all noncash transactions in 2013. Mercator Advisory Group believes that this share will continue to rise throughout 2016 as issuers commit to technologies like contactless payments and mobile wallets to enhance the overall cardholder experience.

Card payments are not the only electronic payment type causing the decline of traditional payment methods, however. Direct debits and credit transfers using real-time payment systems and traditional ACH infrastructure are on the rise. The success of real-time payment systems like United Kingdom’s Faster Payments system is driving greater international deployment of these systems, and as the number of potential payment applications of these systems increases, so too will the number of transactions carried over their rails.

Despite the shift to electronic payment methods, the continued importance of cash and checks in many markets cannot be overlooked. These traditional payment types (particularly cash) are still important to the vast underbanked and unbanked population around the world. A November 2015 report by Accenture and CARE International UK finds that financial inclusion can be a viable business strategy and estimates that today the global opportunity is $380 billion. In light of that report’s finding that only 23% of banks have a strategy around financial inclusion, serving the financial needs of the unbanked and underbanked could help banks sustain growth long into the future and minimize disruption from alternative service providers.

This 2016 Outlook by Mercator Advisory Group’s Global Payments Advisory Service focuses on the various ways the global banking payments industry is being disrupted and the impact this major global theme for 2016 is likely to have on the industry. In particular, this 2016 Outlook focuses on the easing of regulatory barriers, the rise of contactless payments, and opportunities that real-time payment systems create for the industry.
Disruption of the Status Quo

“In change is the law of life. And those who look only to the past or the present are certain to miss the future.”
— John F. Kennedy, 1963

In general people do not like change. Academic studies have shown that at a fundamental level people have a very reliable and tangible preference for things that have been around longer. Consumers are more likely to change their spouse than to change their primary checking account provider. However, there are indications that this mindset might be shifting. At least the broader international payments and retail banking industry is being pushed to think more abstractly about the future of the business as a wave of new entrants to the market, including nontraditional service providers, actively challenge established service providers for customers and the revenue they generate.

But disruption means more than challenges to market share. New and reconfigured technologies and ideas that are being acquired or released by established service providers are making the customer experience in payments and banking more seamless and user friendly for both consumers and businesses. Disruption today is therefore as much about creating better and more innovative services that change the way traditional transactions take place as it is about winning market share. Consequently, participants in the broader international payments and retail banking industries that are content to rest on their laurels or simply manage the evolving landscape risk missing out on future opportunities that could bring significant success.

Spurring disruption are many factors—new technologies, the reinvention of existing technologies, regulatory easing, and economic improvement, to name a few. While an entire report could be devoted to detailing the impact of each of these factors, this 2016 Outlook focuses on just two, since these will play a role in the broader disruption set to occur across the industry in 2016 and beyond. The two are regulatory easing and the reinvention of existing technologies, specifically contactless payments and real-time payment systems.

Regulatory Changes

Around the world, governments and regulatory bodies are exploring means to reduce the regulatory obstacles that prevent greater competition in the market. In many countries, steps have already been taken to reduce these barriers to growth. For example in the U.K., capital requirements and a more streamlined process of applying for banking licenses have resulted in the proliferation of new physical and digital financial institutions looking to disrupt the long-stagnant market, which until recently had not issued a new banking license in over 100 years. (For more information on the U.K. retail banking environment, see the Mercator Advisory Group Viewpoint titled A (Potential) Revolution in Retail Banking Competition: U.K. Case Study, and research report titled 2015 U.K. Debit Rewards Landscape Review, both released in May 2015.)
The regulatory changes have the effects of forcing new entrants to sustain their momentum in order to win over customers and forcing established service providers to reconsider their position and invest in improving banking and payment products and services for the new digital age. However, regulatory changes are not always positive; they can have a negative disruptive impact as well. For example new entrants into the payments and retail banking space are not necessarily held to the same heavy regulations (like capital requirements, etc.) placed on established players. The resulting uneven playing field is a source of growing frustration to traditional service providers because the additional cost in regulatory compliance can affect the cost of direct-to-consumer products.

The absence or easing of regulatory obstacles for new entrants is not the only way that regulation is likely to disrupt the broader payments and retail banking space. For example, 2016 will see the impact of interchange regulation in Europe take full effect. With interchange revenue from the growing number of debit and credit transactions significantly capped in the European Union and in the United States (for debit), the ability of financial institutions to fund new and innovative products and services will be strained. However, regulations capping potential revenue may discourage future market entry by new or nontraditional players, thus creating a regulatory paradox in which regulators are simultaneously making new competition in markets around the world both more and less difficult for established service providers. In 2016 and the years ahead, one can expect this situation to persist and expect international payment regulations to grow in the guise of promoting additional competition.

**Contactless Payments**

The technology powering contactless payments has existed for years, used most commonly as a payment method for transit fares, but in 2015, contactless payments using Near Field Communication (NFC) technology truly started to gain adoption in a number of markets around the world. The primary driver of the growing volume of contactless payments is the increasing availability of contactless-enabled point-of-sale (POS) terminals and contactless-enabled cards. Over the long run though, as consumers worldwide increasingly turn to their mobile devices for banking and payment functions, contactless payments will likely migrate from cards to mobile payment systems like Apple Pay.

Even though smartphones and other mobile devices may become the dominant form factor for payments in the years ahead, at present contactless debit, credit, and prepaid cards are quickly becoming popular among consumers in markets where their issuance is high, notably in some European markets as well as Australia and Canada. In the U.K. alone, more than £2.5 billion ($3.83 billion) was spent by consumers using contactless cards in the first half of 2015 according to the UK Cards Association. Furthermore, the monthly spend on contactless cards is rising. For example, the Association reports that the monthly contactless spend in January 2015 was £287 million ($439 million), which rose to £567 million ($867 million) in June 2015.

In Australia, the RFI Group’s Global Payments Evaluation Study released in May 2015 found that two-thirds of Australians are now aware they own a contactless payment card and 53% have made a contactless transaction, statistics that make Australia one of the world’s top contactless markets. In Canada, the consumer use of contactless payments is not as high, but the country’s relatively recent transition to the EMV standard has resulted
in a broad EMV acceptance network, which should serve as a strong foundation for future contactless card issuance and transaction growth. According to multiple sources, in 2014 75% of POS terminals in Canada were already contactless enabled. With these robust foundations in place, it should not come as a surprise that Apple announced in an October 2015 investor relations call that these two countries would be the next two international destinations to support Apple Pay after the United Kingdom.

Mercator Advisory Group expects a sharp increase in issuance of contactless payment cards and deployment of contactless-enabled POS terminals globally in 2016. We also expect contactless card use to outpace contactless mobile payments in selected markets due to consumers’ greater familiarity with contactless cards there and the still emerging status of mobile payments. Adoption of mobile payments is hampered by the fact that the value proposition of using mobile payments has not yet matured to the same level as contactless cards and is unlikely to reach that level within the next year. But beyond 2016, the foundation laid by widespread use of contactless cards will benefit mobile payment systems and help them gain consumer traction around the world. And in the years ahead, consumer adoption of mobile payments will escalate quickly. (For more information on contactless payments in Europe, see the Mercator Advisory Group Viewpoint titled The Impact of Contactless Cards on the U.K.’s Mobile Payments Future and the research report titled 2015 European Contactless Card Payments Landscape, released in September and October 2015 respectively.)

**Real-Time Payments**

The first real-time payment system was launched in Japan in 1973. While that system, the Zengin system, has been a success (and has been upgraded six times since 1973), it was not until recently that real-time payment systems became a major global focus in the payments industry. Today at least 16 real-time payment networks are in operation globally. Definitions vary, but there is strong global momentum that could result in a quick rise in this number.

The industry momentum and demand for more cost-effective and efficient transactions by consumers, businesses, and other participants in the payments value chain is leading the creation of real-time payments systems despite the significant financial investment necessary to implement them. Real-time networks have the potential to drastically alter the way consumers, government organizations, and businesses small and large make payments and interact with financial institutions. The convenience and other benefits to the end users are clear.

The October 2015 announcement that U.K.-based Vocalink, operator of the U.K. national real-time payment scheme, would work with The Clearinghouse on a new real-time system highlights positive action being taken in the market. The United States is among the countries most interested in implementing a domestic real-time payment network. At least seven other countries are either actively designing or planning potential systems. These countries include Australia and Finland, the Netherlands, Norway, Portugal, and Spain, as well as the broader European Union, which is considering implementing a pan-European solution. As the real-time payments infrastructure becomes more critical to the ability to launch the next generation of payment and banking products, expect more announcements of impending real-time systems in 2016 from some of these countries and others.
(For more information on global real-time payment developments, see the Mercator Advisory Group research note titled *Seizing the Opportunity of a U.S. Real-Time Network*, released in October 2015.)

Conclusions

Disruption comes in many forms. Across the broader payments industry, disruption is coming not only from new entrants and nontraditional service providers but also from the development and reconfiguration of technologies. While some of the disruption will prove challenging to incumbents, it also provides an opportunity for established service providers to embrace change and develop strategies that will lead to sustainability over the long run.

While payment cards and traditional payment instruments like cash will remain significant components of the payments mix in 2016 and the years ahead, it is clear that a new generation of payment technologies will increasingly influence the way the industry evolves. This next generation of payment technologies will not be isolated to mature payment markets. These technologies offer emerging markets the opportunity to meet or exceed the capacities of legacy systems and thus launch new products that will appeal to consumers who are “banked” and the vast unbanked population.

In 2016, Mercator Advisory Group expects that the types of disruption described in this Outlook as well as new types yet unknown will impact the global payments industry and change the dynamics of the current payments landscape.
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