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The reinvention of card payments.

Responding to innovation: where will the impact be?

Finextra

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01

Ramped-up expectations

Payment innovation has proliferated and this, coupled with the pandemic's digitisation drive, is spurring card issuers to reinvent themselves and assess what the impact of the latest trends will be. With the mushrooming options for consumers and merchants, it is challenging for issuers to navigate this landscape and know, with certainty, what the future will hold. It is crucial they get it right, however, since payments for banks and non-banks alike are a key touchpoint with the customer; they are the 'in' to a long-lasting - and profitable - relationship.

Issuers must adapt to the increased expectations of the customers, which have shifted since the pandemic. Buying behaviour fundamentally changed once lockdowns went into effect, with in-person purchases plummeting and online sales skyrocketing. McKinsey notes, for example, that in April 2020 there were no new car sales in India and tourism in Thailand plummeted to zero in the same month. The payments industry, the consultancy notes, responded with measures such as waiving fees. Meanwhile, e-commerce boomed and according to McKinsey the proportion of consumer items bought online nearly doubled, and there has been an accompanying drive by banks to support small and medium enterprises (SMEs) sell and accept payments online. One such example is Singapore's OCBC Bank, which launched SMEs Go Digital, a package that offered a free subscription to e-commerce provider Shopify.

During the pandemic, many were spurred to go digital and embrace e-commerce, and they are now unlikely to return to their pre-pandemic ways. And in the physical world, the use of contactless payments was given a boost when concerns over hygiene prompted many to abandon cash. The pandemic gave the impetus that many needed to make the switch to contactless, and limits were increased. In the UK, for example, at the start of the pandemic, the contactless limit was raised from £30 to £45 and the limit was bumped up further in mid-October 2021 to £100.

The contactless trend is set to continue. McKinsey notes that in Asia, 70% to 80% of those who tried contactless for the first time during the pandemic are likely to continue using it. In Asia, The Future of Payments in Asia report continues, contactless is more likely to take off in developed markets in Asia, whereas QR codes are expected to take off in emerging markets. It adds that QR codes along with digital wallets are expected to become the new normal.

These trends, of course, are an acceleration of a shift that was already underway. The dwindling of cash has long been documented, along with the steady increase in electronic payments. According to Capgemini's World Payments Report 2021, non-cash transactions are growing at an estimated compound annual growth rate (CAGR) of 18.6% between 2020 and 2025. The number of transactions is expected to hit 1.8 trillion by 2025. In fact, according to Capgemini, this figure could be reached as soon as 2022.

And for issuers keeping track of the various payment forms, there is growth expected across the many types in the years to come. E-commerce has an estimated CAGR of 20% for the same period; mobile payments a CAGR of 30% through to 2027, and digital wallets approximately 15% to 2026, according to Capgemini. Asia-Pacific has been highlighted as seeing the most growth, with the region accounting for half of the total of non-cash transactions by 2025, with a CAGR to that year of 28%. Also, Capgemini states, digital wallets, buy now pay later, biometrics and cryptocurrencies are trends that are likely to drive non-cash growth. The report also notes how business-to-business (B2B) payments are changing, with commercial clients demanding digital solutions such as being able to access and reconcile payments virtually, while working from home. And businesses want to payments to be easy for their customers, which Germany's Aareal Bank Group has done through its B2B platform. Capgemini notes how the Aereal Exchange & Payment Platform, which is typically used by property and housing companies, now has PayPal as an option, which means that tenants – the end-users – can pay their rent via PayPal, which is a convenient alternative to some traditional payment options.

02

Beyond the card

Next-generation payments aside, issuers need to consider what cards actually mean for their business. For years, the industry has developed propositions that were built around the physical card, and now issuers must rethink how physical or virtual they need to be.

Physical payment cards are now impacted by sustainability issues and the mega trend of environmental, social and governance (ESG) concerns. In recent years, there has been more focus on environmentally-friendly alternatives to the traditional plastic cards. Mastercard, for example, has created a directory of sustainable materials, and more than 60 issuers have programmes that use cards made from either recycled, recyclable or bio-sourced materials. In addition, the payments network has created a scheme whereby cards carry a stamp to indicate whether they have been made from sustainable materials.

The type of card an individual carries can be a status symbol of sorts. While there is a broad trend of digitisation – and a move away from the physical card altogether – there is still a role for the traditional form factor. Some issuers have opted to treat the card with the same reverence as an Apple product – in beautiful, quality packaging – to be unveiled in an 'unboxing' by social media influencers. Rather than traditional advertising campaigns, some issuers have opted to pay financial influencers to pose with the latest payment card. FNBO [First National Bank of Omaha] is one such example that did this with its Evergreen credit card launch in April 2021.

While digitally-savvy banks have adopted this trend of posing with the physical card on social media, there is no need for their customers to wait for the card to arrive before they can start spending. Neobank Mox in Hong Kong, for example, almost instantly issues virtual card details to new customers so they can spend online, or add them into their digital wallet, straight away. Although the plastic is no longer necessary in many cases, such as the use of PayPal, ApplePay or SamsungPay in Europe, the concept of the card still forms the basis of digital wallets. This is also the case in Asia, where the likes of Alipay, GrabPay and SeaMoney have been growing massively.

Paying via a digital wallet or tapping a contactless card has never been easier. There are still some concerns, however, about security. Biometrics is one way to overcome this, and some smartphones already require a fingerprint to unlock the phone. Some issuers have even introduced a fingerprint pad onto the actual payment card to read biometric data to authenticate payments. For example, in the UK Natwest in 2019 issued a biometric payment card and more recently, in January 2021, BNP Paribas launched a biometric payment card.

Biometrics could ultimately move beyond the card and be used to identify the customer so they don't need any kind of physical item to make a payment. A scan of the face, or the retina, for instance, could be enough to link an individual to their account and be used to confirm the payment is genuine. Imagine being able to walk into a shop, pick up some items and walk out again, all without having to touch anything to do with a payment. Face recognition may be a bit too Big Brother for some, but such ideas pave the way for the next-generation payments solutions.

The ultimate goal of many who are innovating in this space is for the payment to go unnoticed, and to be invisible. This idea has been trialled by the likes of Amazon, with its Amazon Go, 'Just Walk Out' concept that was launched at a grocery store in Seattle in January 2018, and since launched elsewhere in the US and as Amazon Fresh in the UK. At around the same time in China, a similar concept was launched by BingoBox, a convenience store where items are tagged with RFID [radio frequency identification] and sensors detect when they have been removed. Customers scan a QR code on entry and pay via their mobile digital wallet.

03

Adapting to new types of credit

Beyond the various forms that card accounts are now taking, there are also changes in how credit is now extended to cardholders. While credit cards have long offered credit on a revolving basis, the buy now pay later (BNPL) trend is now sweeping the industry - with some going as far to claim that it threatens the existence of credit cards.

BNPL is not new - Capgemini notes that it has been making inroads since the mid-2010s – and the concept of paying for goods in instalments is not new for customers who have been offered hire purchase at the point of sale when buying white goods, or furniture, for example. BNPL is attractive to both merchants and consumers as it makes online sales more likely, and it is convenient for shoppers. Gen Z customers – those typically born between 1997 and 2012 – are attracted to BNPL by its ease of use and apparent cost benefits of not paying interest, according to Capgemini.

Although BNPL is not a new invention, it has become increasingly popular in recent months. Technology insights platform, CB Insights notes that although BNPL still represents a small portion of overall spending on payment cards, it is at an inflection point. It projects that on a global basis, the industry is expected to grow by 10 to 15 times its current volume, reaching $1trn in annual gross merchandise volume. Also, the research estimates that the revenue opportunity for BNPL is currently $680m and it could be a $1.1bn revenue market by 2025.

The big names like Klarna, AfterPay and Affirm are already established in the BNPL space, and others have also been adopting the trend. Conventional issuers have been getting on board, for example, with American Express's Plan it, JPMorgan Chase's My Chase Plan, and Citi's Flex Pay. And in July 2021, in Southeast Asia, Grab partnered with Adyen to offer BNPL through the GrabPay wallet. And Mastercard has also invested in Pine Labs - a merchant commerce platform - to bring the pay later solution to market in a number of Asian markets. And in September 2021, Mastercard announced that it was launching its BNPL programme Mastercard Instalments in the US, Australia and the UK.

Other non-banks have also been getting in on the act. Stripe, for example, has partnered with Klarna, Quadpay and Four so that it is possible for merchants using Stripe to offer those services. And in a mega deal that was valued at $29bn, Square announced in August 2021 that it would be buying BNPL provider Afterpay.

Boston Consulting Group (BCG) notes that competition is heating up in the BNPL space, which in turn is attracting the attention of regulators. Also, consumer groups have started to express concern about the apparent lack of regulation of the sector, the late-payment penalties, and how such easy credit could push people into unmanageable levels of debt. However, other research indicates that the users of BNPL do have the capacity to successfully manage this kind of debt. CB Insights, for instance, found that while there have been concerns about over-indebtedness, for many, BNPL is their only kind of borrowing of this nature and many don't even have a credit card. For those linking the pay later option to their debit card, 80% had enough money in their current account to cover the full purchase price of the goods they were buying, according to CB Insights.

04

Opening up new possibilities

Advancements in cloud technology, the use of APIs [application programming interfaces] and open ecosystems have opened up the options of what is possible for issuers. It has also lowered the barriers to entry as smaller players can partner with niche companies to offer relatively cost effective and agile solutions. In this new world of embedded finance, non-bank players can offer payment services just like the incumbent issuers.

Capgemini argues that we are now in the era of Payments 4.X, where industry players need to embrace the use of data, shared infrastructure, platform business models and embedded finance - all of which need to be adapted to give a superior customer experience.

For the nimble players that have embraced this way of doing things, they can launch new solutions quickly. BCG notes that next-generation card processors, for example, have an API-first approach so their services can be linked into others relatively easily, thus increasing their speed to market.

The ecosystem provides a platform model – which functions in a similar way to an app store – and enables banks to connect with technology vendors and fintech providers. Meanwhile, decentralised finance is a growing trend, which – because it is powered by blockchain – has the potential to do away with intermediaries and banks altogether.

05
Bitcoin and beyond

The uses of blockchain and distributed ledger technology are proactively being explored by the industry. For now, however, the most attention in the crypto space has been on Bitcoin as an asset class. Some corporates, for example, have been considering Bitcoin as a hedge against inflation. Interest was piqued in Bitcoin at the beginning of 2021 when it was reported that carmaker Tesla had invested $1.5bn in Bitcoin, which had reportedly gained $1bn in value in just 10 weeks. Other companies, such as Microstrategy and Square have also invested in Bitcoin.

Bitcoin has also been moving into the mainstream. In September 2021, it was made legal tender, and an official currency along with the US dollar, in El Salvador. Some of the benefits touted were that it would help financial inclusion and there would be no fees for overseas workers sending home remittances. Also, by giving an alternative to the US dollar, the country is less tied to the monetary policies of the United States.

There is, however, still concern about the volatility of Bitcoin, and its drop in value is noticeable when it needs to be exchanged into another currency. For example, a shopkeeper accepting payments in Bitcoin may find the payments they receive are worth less than what they paid in dollars for their stock.

The volatility concerns have prevented Bitcoin from being adopted more widely. This is where stablecoins come in, an alternative form of digital money that is backed by a fiat currency to smooth out the volatility. They are also powered by blockchain so they carry the same benefits of cross-border payments being quicker and cheaper.

According to McKinsey, $3trn was transacted in the first half of 2021 in stablecoins such as USD Coin (commonly known as USDC) and Tether. And big-name brands are already getting involved in stablecoins. Visa, for example, in March 2021 announced that it was the first major payments network to settle transactions in USDC.

And Facebook, which has been working on launching its own currency for a number of years, has now announced a pilot, albeit with an existing stablecoin. In October 2021, Novi - as it is now called - announced that it would be conducting a pilot in the United States and Guatemala with the

Paxos stablecoin. The company announced that it would start rolling out a small pilot of the Novi digital wallet app to show that it is operationally ready and serving its customers well. The wallet, the statement said, is targeting the unbanked and will help people send and receive money cross-border and with no fees. In principle, sending money this way should be as simple as sending a message on WhatsApp.

This announcement comes in the context of central banks also exploring the potential of digital currencies. Capgemini notes that central bank digital currencies (CBDCs) are gaining momentum and could offer an alternative to private cryptocurrencies. And with the currency being issued by the central bank, this would function as a digital alternative cash, giving the central bank - through the use of smart contracts - the ability to control the money supply in accordance with its monetary policy.

Central banks around the world have been investigating the use of CBDCs. And in October 2021, the finance ministers of the Group of Seven (G7) countries announced an agreement on the principles by which CBDCs should be developed, which covered areas such as cybersecurity, energy efficiency, privacy, financial inclusion and tackling illicit finance.

China is so far considered to be leading the way with CBDCs and has been developing its e-CNY. In July 2021, the People's Bank of China - the country's central bank - published a progress report and said that the digital currency was ready for cross-border use.

With these developments, it remains to be seen what impact this will have on the cards industry and on issuers. McKinsey, however, in The Future of Payments in Asia report argues that if CBDCs do go ahead to a full launch, they are more likely to strengthen, rather than replace, the use of existing digital wallets.

06
Considerations for issuers

Issuers need to constantly monitor the payments landscape for developments to keep pace with the changes, as well as consider what they mean for the future. There is a lot to digest, and it can be challenging to assess with certainty what the impact these innovations will have on cards payments.

To stay ahead of the BNPL trend, BCG suggests that issuers consider developing their own pay-later programmes. If they have a dominant market position, they could do this themselves, or if they are a smaller player, they could partner with a BNPL fintech player instead. This move could help issuers compete with their peers, and also slow down the growth of the pure-play BNPL providers.

With the move toward ecosystems, and the increased use of APIs, there is more opportunity for issuers to partner with other providers. In embracing the next-generation payments, the partnership model is the most effective, and realistic, way for them to stay relevant and release solutions at pace. This means they can be nimble and adapt each time a use case presents itself, rather than relying on partners for issuing a co-brand loyalty programme, for example. BCG suggests that when issuers offer loyalty programmes, they should differentiate and focus on novel experiences[1] . Also, BCG notes that by focusing on their use of data, issuers can offer quicker approval rates. With smarter analytics, issuers would be able to do a more accurate credit risk assessment, which in turn means they could cast a wider net of potential customers, even those without credit histories.

The opportunities are endless, and there are myriad possibilities for issuers to explore in how to reinvent themselves. In navigating this innovation, and assessing where the greatest impact will be, issuers should not lose sight of their customers and how to provide them with better experiences.

[1] https://web-assets.bcg.com/58/30/e7773b6a4c29b79b3673ab21ef66/bcg-global-payments-2021-report-all-in-for-growth-oct-2021-r.pdf

07 About

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For more information:
Contact **getinfo@fisglobal.com** or visit **www.fisglobal.com**

Finextra Research Ltd
77 Shaftesbury Avenue
London,
W1D 5DU
United Kingdom

Telephone
+44 (0)20 3100 3670

Email
contact@finextra.com

Web
www.finextra.com