Flashpoints in digital payments

The emerging threats and opportunities in the post-COVID landscape

Payments disruption is accelerating in the wake of the COVID-19 pandemic, but the pace of change is uneven across countries and product segments.

The leading banks of the future will respond today with speed and agility to defend and expand market share, based on a deep understanding of these emerging dynamics. The Accenture Payments Disruptability Index identifies the forces at work in each market and predicts the disruptive threats and opportunities of the future.

Payments disruption is here to stay

Disruption in payments has been a fact of life for banks for the past 20 years, and it shows no signs of abating anytime soon. Indeed, as consumer behavior and business sentiment shift as a result of the pandemic, the scale of disruption is likely to grow dramatically and the tempo of change will pick up in the months to come.

Across the world, regulatory developments such as the EU's revised Payment Services Directive (PSD2) and Interchange Fee Regulation, and the UK's Financial Conduct Authority fintech regulatory sandboxes are reshaping the competitive landscape. When paired with the accelerated move to e-commerce and contactless payments at this time of physical distancing, these regulatory developments may hasten the substitution of cards and other traditional instruments with alternative payment solutions.

Big tech companies, fintechs, challenger banks and other non-bank entrants, meanwhile, are driving market disruption too by offering customers — especially consumers — better user experiences and lower prices. This may have started with the substitution of physical cards with digital wallets, but the appetite of merchants and consumers for radically new alternatives to traditional payment options is growing.

A total of 2.7 trillion transactions are expected to shift from cash to cards, interbank payments, and alternative payments instruments in the next decade, representing a $300 billion opportunity for payments providers.

Consumers and businesses are increasingly attracted to payment experiences that offer more control and lower costs, from request-to-pay solutions displacing direct debits, to services like Klarna that minimize upfront payments and return control of cashflow to users. Embedded payment experiences too are on the rise as non-financial services providers like Starbucks, interfaces like voice recognition and Internet of Things devices like smart appliances offer new ways to pay.

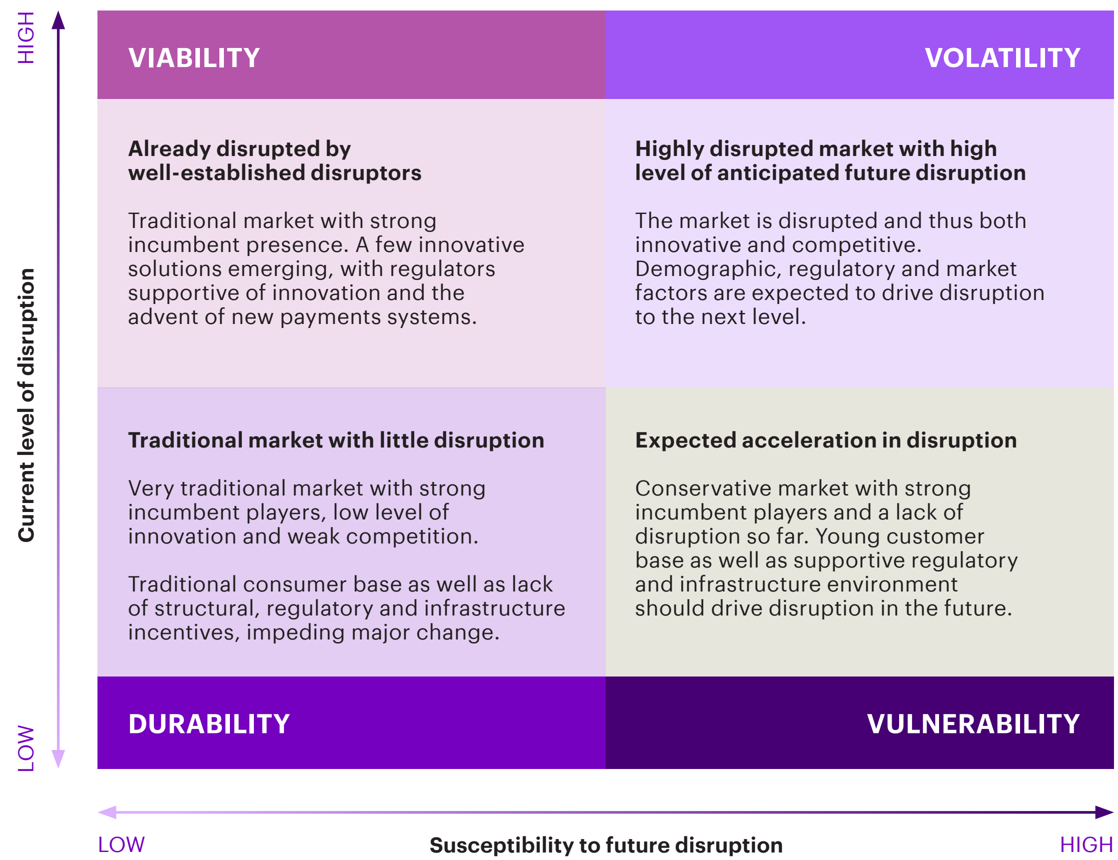
The continued displacement of cash and checks over the next three years, helped along by customers' adoption of digital shopping and their desire to avoid contact with physical infrastructure and objects, will open even more opportunities for disruption in payments. This movement is already underway: e-commerce as a share of GDP is expected to grow 15 percent in China, 22 percent in Sweden, and 114 percent in Nigeria in 2020.[1] A total of 2.7 trillion transactions, worth US$48 trillion, are expected to shift from cash to cards, interbank payments, and alternative payments instruments in the next decade, representing a $300 billion opportunity for payments providers.[2]

But even though the speed of payments disruption is increasing, the level and rate of this disruption are uneven across different markets and payments instruments. Challengers are targeting the segments with higher margins and lower barriers to entry — and banks are scrambling to respond. This comes at a time when banks are already feeling the competitive heat, with many seeing payments revenues contract during the COVID outbreak as a result of lower transaction volumes.

The Payments Disruptability Index

With the **Payments Disruptability** Index, Accenture provides banks with insights that help them capture new opportunities and avoid getting left behind. Since each product and each territory is on a unique path, a one-size-fits-all approach will not work for banks looking to maintain or expand their positions as payments leaders. Instead, the market leaders of the future will tailor their responses to the level of disruption a country or product is currently experiencing, and its susceptibility to future disruption.

Figure 1. The Payments Disruptability Index arranges markets and products into four stages of disruption



Dimensions of disruption

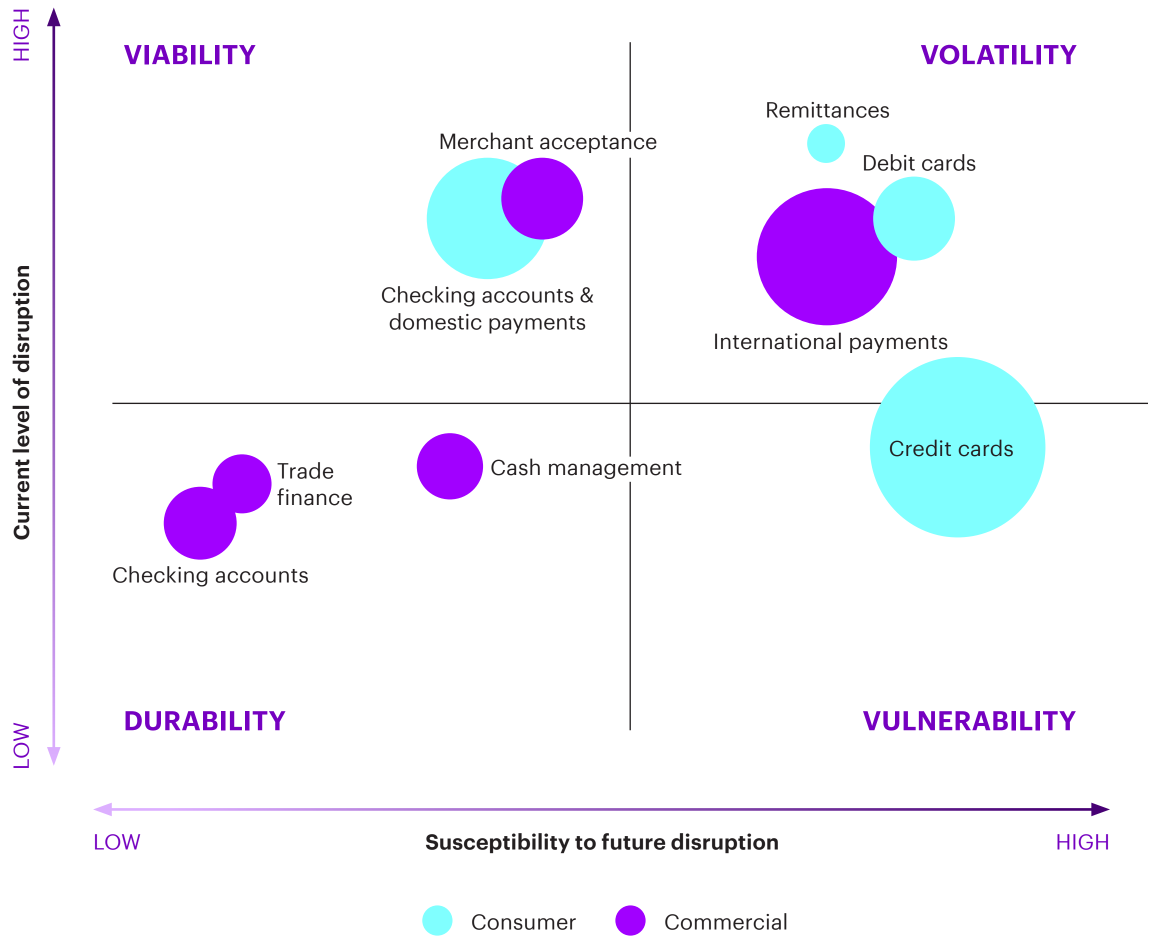
Payments instrument and territory

How disruption is unfolding in different segments of the payments market

The Payments Disruptability Index reveals that disruptors have already had an impact on remittances, international payments, merchant acceptance and debit cards and that the credit card segment has the highest susceptibility to future disruption among those analyzed. The current level of disruption by segment, as well as the susceptibility to future disruption, are illustrated in Figure 2.

Figure 2. Payments disruption by product

Note: the size of the circles indicates the relative value of transactions handled by each payments product.



Durability
Little or no disruption

Commercial checking accounts, cash management and trade finance remain in the durability stage of disruption. Banks have, so far, fended off challengers seeking to disrupt these markets with products such as blockchain in trade finance. Unlike retail e-commerce, trade finance has yet to be digitized. Many transactions are still predominantly paper-based, and until they are digitized there is limited scope for digitizing the payment process. Incumbents' strong customer relationships are another factor impeding disruption.

Some banks are proactively adding innovative solutions to their corporate product portfolios. For example, BBVA Compass offers real-time digital reconciliation services to help corporate clients streamline their back-office operations.[3] Some banks are also using artificial intelligence and robotic technologies to forecast cash positions based on transaction history.[4]

Banks have historically benefitted from the complexity of this market, which makes the barriers to entry higher for disruptive competitors. This explains why there is more disruption in the lower end of the small- and medium-enterprise B2B payments market, where basic remittance platforms like AliPay are gaining momentum. However, the complexity gap is narrowing and banks cannot count on it to ward off new entrants forever.

Vulnerability

Susceptible to future disruption

Credit cards are the segment with the highest susceptibility to future disruption. Disruptors are challenging traditional models with credit at point of sale (POS) products that offer payments in installments. This more transparent alternative to cards is finding favor among younger and more cautious consumers. Also, compression of interchange in many markets is making it harder to fund the generous reward and cashback programs that can make credit cards so attractive to consumers.

Volatility

Highly disrupted, with more disruption to come

Debit cards, remittances, and international payments are examples of segments that have already seen significant disruption yet remain susceptible to more in the future. Stored-value accounts, account-to-account (A2A) payments, and mobile wallets from big techs and fintech players are growing at the expense of debit cards, for instance.

These solutions are attractive to consumers because of their user-friendliness—they eliminate the requirement to insert a long card number to make a payment or remove the need for a card. PayPal was a pioneer with stored-value accounts, while Klarna developed the A2A solution in Sweden. These alternative payments methods clearly displace card transactions and many banks were quick to respond. In Sweden they joined forces to launch Swish, whose market share is steadily increasing. In the Netherlands, they also got together to launch the A2A solution iDEAL, which accounts for the majority of consumer e-commerce transactions in the country. Further disruption is likely to be driven by open banking and by PSD2 regulation and similar regulations around the world.

Viability

Already disrupted and starting to stabilize

Merchant acquiring, checking accounts and domestic payments are instances of product categories that have already been heavily disrupted in some markets and now show signs of moving towards stability.

Non-bank players have achieved global market share of around 60-70 percent[5] in merchant acquiring because many banks shed this business to focus on markets they considered to be more core and strategic. Non-bank players built scale and developed the segment by offering value-added services like automatic renewal of card details for subscriptions.

One of the leaders, Adyen, expanded its value chain by offering payment gateway, risk management, processing and settlement services to merchants. Adyen's EBITDA grew, on average, by 60 percent a year between 2015 and 2019.[6] Even though Adyen focuses on e-commerce, its share of the traditional credit card acquiring business grew from 2.9 percent to 5 percent[7] during this time.

Credit cards

Next in line to be disrupted?

Credit cards have long been a preferred payments instrument in many markets, particularly in North America where issuers offer attractive rewards to their customers. Until now, these reward systems have proved effective in locking in customers and preventing new entrants from making much of an impact. As a result, disruption in this flagship part of the retail payments business has mostly taken the form of the replacement of the physical card with a digital wallet.

But the underlying card clearing and settlement rail has remained largely untouched. This is changing fast as POS credit solutions gain traction — they have already achieved market penetration of 30 percent in Sweden, 21 percent in Germany and 15 percent in the US because of easier accessibility and use as well as lower costs for consumers. Some of the leaders even offer zero percent interest rates.[8]

Challengers like Affirm, Klarna and Afterpay have steadily made inroads into developed markets by offering 'buy now, pay later' solutions that appeal to younger consumers or interest-averse customers. Until now, however, most banks have been resistant to the idea of working with these players — forcing them to turn to retail partnerships instead.

Affirm has partnered with over 3,000 merchants in the US, including Walmart, to offer shoppers payments in installments at POS — online and in-store.[9] Affirm's loan volume reached $2 billion in 2018,[10] but the company expects to receive a significant boost from the ongoing pandemic as more consumers explore different options for shopping on credit.[11]

Credit card disruption may accelerate as a result of the pandemic. Traditional credit card rewards (travel insurance, price guarantees) are less attractive during a time of restricted movement and economic uncertainty. This is forcing banks to look at more flexible reward schemes, such as American Express's Pay with Points, which lets customers redeem points for shopping, dining and entertainment.

Yet the rewards card issuers use to retain customers already look unsustainable in the longer term. Accenture's calculations, based on annual reports from six major credit card issuers in the US, indicate that US banks spent $47 billion on rewards in 2019, up from $38 billion in 2017. The average rewards ratio spiked from 1.29 percent in 2017 to 1.37 percent in 2019, while the interchange rate remained stable at 1.82 percent in the same period.

More incumbents are now looking at the POS credit opportunity — including American Express (Pay It, Plan It), Citi (Citi Flex Pay) and JPMorgan Chase (My Chase Plan).[12] With My Chase Plan,[13] customers can repay the purchase over a chosen period of time with a set monthly fee rather than paying interest on card debt.[14]

The aim is to offer consumers an attractive alternative to POS financing and recapture some of the $250 billion JPMorgan's customers have outstanding with other lenders.

Remittances and international payments

Scaling for profitability

This segment has gone through several waves of disruption, starting with players like Western Union and MoneyGram and continuing with fintechs like WorldRemit and TransferWise. Demand for these products is high and competition is fierce. Some players are operating at low margins (TransferWise's net profit margin in 2019 was 5.8 percent) or even at a loss (WorldRemit with a net profit margin of -52 percent in 2018) as they seek to scale and build market share.

Remittances were traditionally a high-margin, low-volume business for banks, accounting for just 3 percent of their consumer payments revenues.[15] The average global remittance fee is 5 percent, compared to just 0.37 percent for debit card interchange.[16] Because retail banks focus primarily on domestic business, they had little motivation to innovate in this non-core business. This created a gap for the challengers to exploit.

Incumbents hoping to reposition and regain market share in this segment are looking to fintechs to augment their full-service banking offering. Santander, for example, offers customers the ability to make quick international money transfers using its One Pay FX service which was developed with Ripple.[17]

To move outside of its own customer base Santander recently also launched a standalone, co-branded money transfer app called PagoFX. The intention is to offer the best of both worlds — the security and trust of a bank solution, combined with the user experience, convenience and price competitiveness of a modern fintech solution.[18]

Disruption unfolds in different ways in each country

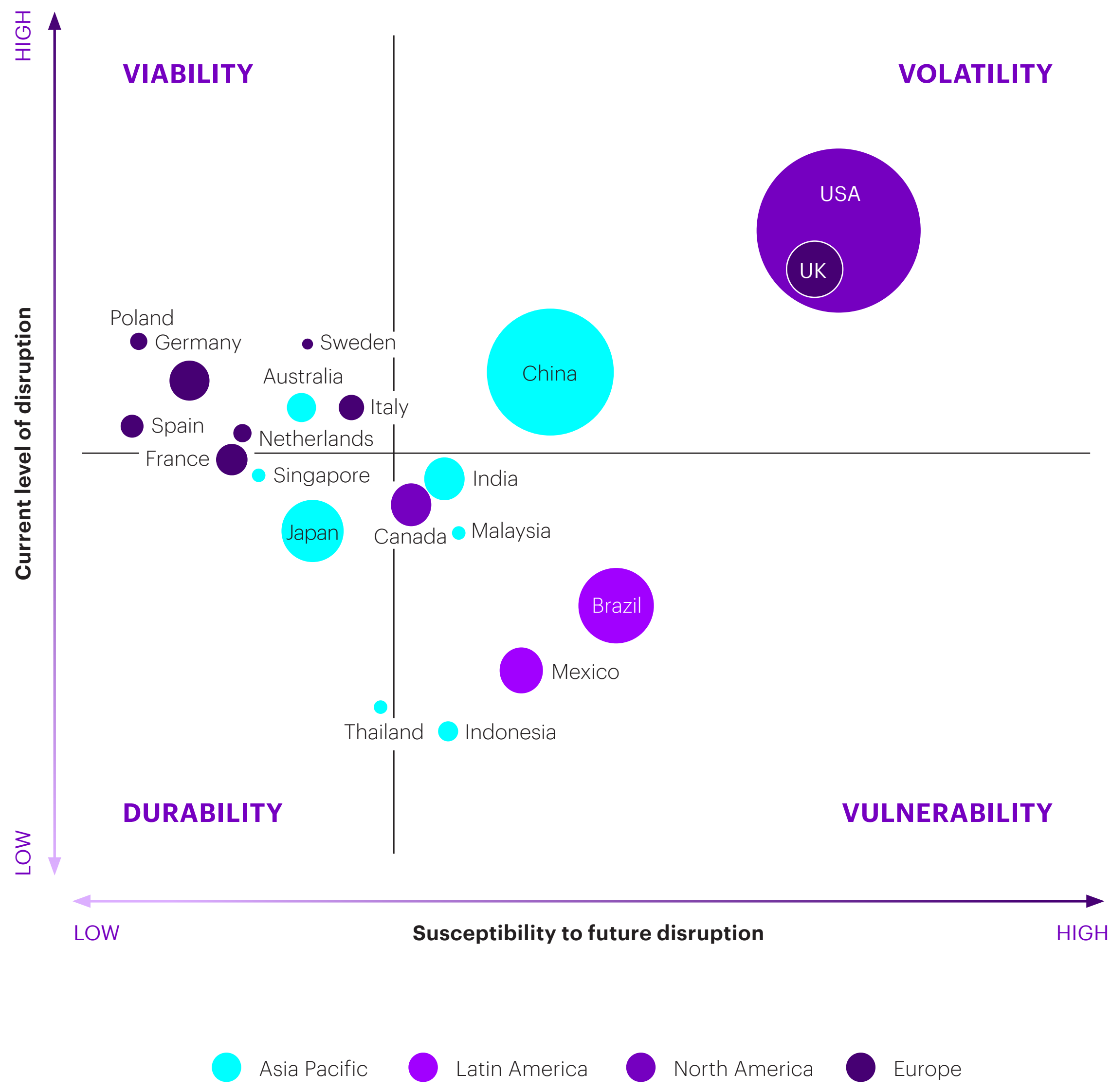
One of the insights provided by the Index is a quantified view of the level of disruption by country. It finds that current disruption and susceptibility to future disruption are highest in the US, closely followed by the UK. In contrast to Europe, where disruption is supported by regulations (such as PSD2), it is mainly driven by market forces in the US.

To date, fintech hubs like San Francisco and New York have attracted around $29 billion in disclosed fintech investments in payments since 2014.[19] The sheer scale of the market and payments investments on the part of bigtech companies like Apple and Amazon are also driving disruption. But a lack of regulatory support and of direct access to payments systems presents significant barriers to the thorough transformation of payments in the US.

The UK's high volatility is partly explained by London's strong, well-funded innovation ecosystem, which has enticed neobanks and fintechs to set up shop. Revolut, for example, has raised more than $800 million in funding to date. Fintechs in London are estimated to have raised almost $4.5 billion since the beginning of 2016.[20] There is also a favorable regulatory environment, with the Financial Conduct Authority driving initiatives like open banking and sandboxes.

Figure 3. Payments disruption by market

Note: the size of the circles indicates the relative value of transactions in each country.



Emerging markets

Vulnerable to disruption

By contrast to the US and UK, low penetration of credit cards contributed to a conducive environment for disruption in China. This created the opportunity for bigtech to leapfrog cards with convenient mobile payments solutions designed for e-commerce — for example, Alibaba's Alipay. Young, tech-savvy consumers soon started using these mobile solutions in-store as well, and banks have yet to respond effectively.

The result is that mobile wallets are rapidly displacing cash and card payments in China — by 2019, nearly 76 percent of transactions originated from mobile wallets, up from around 12 percent in 2014. Consumer payments in China are thus thoroughly disrupted by and saturated with digital wallets, with people already using mobile apps and QR codes to pay at robotic restaurants and unmanned stores.[21] The effectiveness of QR code payments is now causing that technology to ripple out into the rest of Asia and also Latin America.

Further disruption in China will depend, among other factors, on fintech investments, which amount to only a quarter of the US investments for the period from 2014 to the first half of 2020.[22] The next waves of innovation are likely to break in merchant acquiring (Tong Dun, 4Paradigm), corporate payments, software-as-a-service solutions for e-commerce (Jushuitan) and e-invoicing (XForcePlus, Cloud Helios) — the areas that are attracting the largest fintech investment at this time.

Outside of China, many emerging markets are vulnerable to disruption, or are volatile, because most have younger populations and more unbanked people who are ideal adopters of disruptive solutions. In India — which had around 190 million unbanked people in 2017[23] — more payments are already made via mobile wallets (9.8 percent of the total) than by card (4.7 percent).[24]

Europe's mature markets

Rapidly settling into viability

Some European markets have already been heavily disrupted and have little prospect of further disruption. In many of these countries, banks moved early to ward off disruptive threats. Banks in Sweden, Germany and Poland worked together to offer innovative online account-to-account payment solutions (respectively Swish, Giropay and BLIK). They were successful in consolidating their market position and staving off disruptors. For example, BLIK reached 60 percent market share in e-commerce in Poland in April 2020.[25]

These countries are not major fintech hubs, partly explaining why they have rapidly settled into viability. Along with lower customer readiness — due to higher median population ages — this means these markets offer less fertile conditions for disruption. Customer openness to innovative payment solutions tends to be lower in markets with ageing populations, like Germany and Japan.

In Germany, only 0.14% of all transactions are done via mobile wallet.[26]

E-wallet adoption in the US and the Netherlands

The US and the Netherlands are contrasting examples of the dynamics when banks are slow versus quick to act. E-wallet players like PayPal — offering alternatives to cards that were perceived as safer and more convenient by both buyers and sellers — could quickly gain share in markets where banks had not addressed the drawbacks of cards.

In the Netherlands, e-wallets have never been more than a marginal player (5 percent market share in online payments[27]). Dutch banks were early in identifying the need for an online payments method that was more user-friendly, more secure and more cost efficient than the solutions that were common at the time. By contrast, PayPal is estimated to have about 30 percent market share in the US online retail, travel, and entertainment and media sectors.[28]

Before 2005, the major banks in the Netherlands tried to develop their own online payment solutions separately and concluded their own contracts with online merchants.[29] They realized this was inefficient and cooperated to create the iDEAL consortium and payment method for online commerce. iDEAL's market share amounted to 60 percent in 2019, indicating the ability for coordinated bank action to dominate a specific payments market.[30]

COVID-19:
Accelerating and deepening disruption

The COVID-19 pandemic means that payments disruption is even more of a burning priority for banks than it was just a year ago. The coronavirus outbreak has, in many markets, hastened the transition to a new, more digital payments world. Italy, for example, achieved five years' worth of progress towards a more digital society (one that uses more non-cash payments) in the first month of the pandemic alone.[31]

Many banks moved swiftly to support customers with alternative payments channels and options as the virus upended life and triggered nationwide economic shutdowns. The market leaders will be evaluating how permanent the changes in customer behavior are and looking to leverage the investments they made in the early stages of the pandemic to drive future growth.

There will be some reversion when the pandemic is over. However, new customer habits typically take hold in as little as 70-90 days, so we think a lot of the behavioral change in payments will stick. COVID-19 is accelerating payments disruption in two ways:

1. **Consumers are using less cash to avoid physical contact:**
   In the UK, ATM withdrawals dropped by 50 percent in the second half of March.[32] Some 55 percent of those surveyed globally by Accenture said they had increased their usage of contactless payments — with almost 9 in 10 expecting to maintain a higher level of usage after the pandemic.[33] Contactless isn't confined to traditional cards — consumers are willing to pay with mobile wallets like Apple Pay using fingerprint or facial recognition authentication.

2. **Consumers are more cost- and risk-aware:**
   Consumers and businesses are looking for ways to manage costs in an uncertain economy. Accenture data shows that close to 9 in 10 consumers think they will permanently become more cost-conscious shoppers.[34] They will be likely to look for ways to cut spending on payment fees. PayPal data suggests that sending remittances through mobile is, on average, half the cost of using traditional remittance services.[35]

   Enterprises are also becoming more risk-aware. Domestic and cross-border real-time transactions via modernized infrastructure and implementation of blockchain could help to mitigate liquidity and counterparty risks. Businesses will monitor counterparty risk more closely, implying a demand for instant payments that are easier to track — for instance, the international transfer services offered by TransferWise.

Susceptibility to disruption from non-bank payments will increase during the pandemic across payments instruments that are already contactless, widely used for e-commerce payments, under cost pressure and underpinned by real-time technology.

COVID-19 is likely to accelerate disruption in countries where all or most of the following conditions are met: bigtechs are actively present; there is a higher adoption of e-commerce; open banking and fintech sandbox regulations are in place; there is a higher proportion of early adopters or youth among the population; cash has a higher share in the payments mix; and banks do not own the mobile payments infrastructure. Examples are China, Indonesia, the UK, the US and Thailand.

Three plays for the future

Defend the core, augment core products, partner with fintechs

To defend and expand their payments market share, leading banks will adapt their innovation strategies across product segments and territories. A high-margin, low-volume product like remittances requires a different approach to a low-margin, high-volume core product like debit cards. Market nuances such as consumer preferences, national payments systems and regulation also need to be considered.

Here are three approaches to innovation that banks may use to defend or grow their positions as payments leaders — thereby ensuring long-term growth and profitability.

1. Defend the core and reach scale

In markets where margins are low and barriers to entry are high, it can be prohibitively complex and expensive for any single player to build enough scale on its own to bring disruptive solutions to market. In conditions where innovation requires changing parts of the market infrastructure, it may make sense for banks to cooperate via vehicles such as open industry consortiums.

For example, recent implementations of national real-time payments platforms (over 30 have gone live since 2016[36]) encouraged banks to collaborate and develop payment apps (e.g. Swish in Sweden, PayNow in Singapore). Offered by many banks, they could reach scale quickly — in Singapore the value of transactions grew tenfold between April 2018 and 2019.[37]

Based on Accenture's Global Payments Revenue Model, banks' largest consumer payments products by revenue are credit cards (59 percent) and debit cards (12 percent), while remittances make up only around 3 percent.[38] These are areas where consumers and banks alike may benefit when institutions work together to offer interoperable and scalable platforms.

2. Augment core products with new customer experiences

For products or segments that don't rely on new infrastructure adoption and that haven't yet been disrupted, product experience innovation might be the optimal option. By innovating here, banks can differentiate established products against those of their peers and ensure relevance in the eyes of customers. Consider the example of Barclaycard, which launched the first contactless cards in the UK in 2007 as part of a deal won with the consortium that runs the Oyster transport card system.

This gave it the exclusive rights to place Oyster on its Visa cards for the next three years. Ten years on, contactless cards have become a basic requirement. But it doesn't have to stop there. Forward-looking banks are already looking to add biometric authentication solutions to their contactless cards.[39]

3. Partner with fintechs on innovative products

Banks should look to fintechs or other specialized players when they want to upgrade their core offering with innovative products. This could apply both to non-core products such as remittances and to core traditional products where new competitors are offering appealing alternatives.

Commonwealth Bank of Australia, for example, partnered with Klarna when the fintech launched in-market. This enables the bank to address the growing demand for alternative payment solutions in Australia and enhance the customer experience in the banking app. The partnership combines the bank's customer network, merchant relationships and existing digital technology with Klarna's innovative payments technology and integrated shopping experience.

Defining a role in the future payments ecosystem

No part of the payments ecosystem will escape the effects of the pandemic. It is accelerating disruptive trends that were in play, amplifying challenges that banks were already wrestling with, and shifting the consumer and business landscape in ways that are profound and not yet completely understood. Whereas some larger companies might respond to a sudden drop in revenue by cutting innovation, tomorrow's payments leaders are more forward-looking. They understand that the unique conditions of the pandemic and the global downturn could pave the way for accelerated adoption of innovative payments propositions.

If the recent history of payments disruption teaches us anything, it is that the winners are the banks that are proactive about deciding where and how they want to win. Now is the time for banks to define what role they want to play in the future payments ecosystem — before someone else decides it for them. Leaders of the future are deciding what they want to defend, which opportunities to attack and what they're willing to let go. Having a clear approach to innovation to unlock new opportunities will enable and position them to realize their ambition to become future payments leaders.

How Accenture can help

Accenture Payment Services offers a unique combination of deep payments industry expertise, robust technology capabilities, innovative thinking and unsurpassed global outsourcing delivery experience. In addition to our payments consulting expertise, we have access to specialist teams in technology, finance and risk, and workforce and talent management.

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About the Payments Disruptability Index

To construct the Index, Accenture collected and analyzed data within five pillars:

1. The presence and penetration of disruptors
2. The performance of traditional players
3. Customer readiness
4. The innovation ecosystem
5. Regulation and infrastructure

Based on these inputs, we calculated scores for each segment or market, indicating both the current level of disruption it is experiencing as well as its susceptibility to future disruption. Using these scores, we then grouped the respective segments and markets into four distinct stages of disruption: Durability, Vulnerability, Volatility, and Viability.

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