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Strategic imperatives for payments service providers

For years, payment service providers (PSPs), the companies that facilitate electronic payments, derived substantial and reliable revenue from processing payments. However, these companies, which include banks, non-bank acquirers, and some financial technology (fintech) providers, now confront narrower margins as payment processing and money movement become cheaper. To preserve their revenue and market share, PSPs need to rethink their business model, and take advantage of their customer relationships to offer more diversified services that meet the changing needs of consumers and businesses.

To appreciate the magnitude of the threat PSPs face and their urgency to adapt, it is critical to understand the sea change in the payments space in a relatively short period of time. Global payment networks like Visa, Mastercard, and SWIFT, once the backbone of money movement, are facing increasing competition from local and regional players. Domestic infrastructures—such as instant payment systems like Sarie in Saudi Arabia and Aani in the UAE, or domestic card scheme like Mada and Jaywan, and local digital wallets like stc pay (now bank), Barq, and Hala in Saudi Arabia, or e& money and du Pay in the UAE—provide faster payments tailored to local needs with strong regulatory support. These payments mechanisms meet consumer demand more effectively at lower cost than traditional networks. **Real-time payment** grew 42% year-over-year in 2023, reaching 266 billion transactions, with projections to reach 575 billion transactions by **2028**. On the other hand, domestic digital wallets have built strong customer bases. For example, we calculate that digital wallets in Saudi Arabia, a cheap domestic payment method, have attracted over 15 million users by 2024.

Moreover, these low-cost payment providers are no longer confined within national borders—further squeezing the margins in crossborder payments. For example, UAE merchants can accept payments solutions such as WeChat and Alipay from China. Increasingly they are interlinked and so provide the convenient “glocal” (global and local) solutions that customers favor. The BIS Innovation Hub’s Project Nexus also supports the interoperability of domestic instant payment systems, driving cost efficiencies in cross-border payments. Standards like ISO 20022, expected to cover 80% of global high-value payments by 2025, is part of this change. **Distributed Ledger Technology** (DLT), an emerging technology, could facilitate a further shift. Regulatory initiatives like open banking, and cooperation frameworks such as the G20’s Roadmap for Enhancing Cross-border Payments, are pushing for lower costs and greater accessibility, further encouraging the use of alternative payment rails.

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When a bank has oriented its culture toward innovation and committed the right resources, a venture studio can produce assets that go beyond incremental product upgrades to include disruptive, market-shaping innovation.

In response, PSPs take advantage of their customer relationships, their knowledge of their customers, and their strong regulatory compliance, to seek new avenues for growth in three ways.

1. **First,** PSPs can position themselves as one-stop shops for all specialized payment services, including alternative payment methods (APMs), payment orchestration, and anti-fraud solutions. **By integrating APMs**, PSPs can cater to customers' diverse payment preferences, and cover emerging technologies such as central bank digital currencies, which some 94% of central banks were involved with at the end of 2003. Meanwhile, payment orchestration ensures efficient routing of transactions, reducing costs and enhancing speed, and anti-fraud solutions bolster transaction security, building trust, and protecting customer assets.
2. **Second,** PSPs should offer a broader range of services beyond payments. By analyzing data and insights from payment interactions, PSPs can underwrite loans for thin-file customers, broadening financial inclusion and opening new avenues for lending. Additionally, PSPs can offer business and personal financial management tools that enhance efficiency through forecasting, budgeting, and personalized financial recommendations.
3. **Third,** PSPs should offer a wide range of services in areas closely related to payments given the central position they play in the operations of their customers. By establishing strategic partnerships, PSPs could become curators of a vast ecosystem of solutions that small- and medium-sized enterprises (SMEs) could use to digitally transform their businesses, enabling them to manage finances, inventory, and sales from a single platform. PSPs could also appeal to larger enterprises by facilitating treasury and cash management in enterprise resource planning (ERP) integrations which connect core business processes like finance, inventory, and sales into a single platform, thereby streamlining operations.

Accounting is an example of this new suite of offerings generation. A PSP could partner with an accounting solution provider to integrate accounting with payments to create a solution with significant efficiencies. Or the PSP could develop industry specific solutions, such as order management systems for restaurants or retail. Further, PSPs could use open banking and application programming interfaces (APIs) to integrate third-party fintech solutions to offer a comprehensive suite of tools.

PSPs have an opportunity to seize the initiative and expand the services they offer and diversify their revenue streams. They have the customer relationships, a knowledge of customer needs, and strong regulatory practices. Now is the time to seize the opportunity.

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