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The value of a payment

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Introduction: What is the value of a payment?

Payments are seen as a cornerstone of new digital economies, creating unique customer experiences, stimulating economic growth, addressing financial inclusion and establishing new digital ecosystems and partnerships. The value of a payment has surpassed the notional value that comes from a payment transaction to encompass broader value creation for each of the unique stakeholders within the payments value chain.

The traditional payments landscape and value chain have been disrupted and, as noted in the first article in our Payments Trends Series, entitled 'Convergence of Payments', we observed that the payments industry is swiftly undergoing a paradigm shift as a result of digital convergence. This radical shift is underpinned by global megatrends such as rising customer expectations, mobile and internet penetration, infrastructure modernisation, changing regulations, emerging technologies and new competition.

Growth in digital payments is further accelerating during the COVID-19 pandemic out of necessity, particularly at the institutional level. These conditions have created the perfect catalyst for change that we believe will perpetuate the growth of digital payments for years to come.

In this article, we delve into the value of a payment as it has transformed, from a traditional medium used to complete an exchange of goods or services, into a cornerstone of the new digital economy.

For many companies offering digital products or services, the payments experience, although essential, needs to be invisible and complement the end-to-end customer experience and journey. The notion of 'invisible payments' is exemplified by leading companies such as Amazon, Uber and Apple (via its App Store) that have made the payment experience so seamless that it is rarely noticed by customers when they make a purchase — encouraging more repeats and ultimately leading to greater customer stickiness.

The value of a payment goes beyond the actual transaction. It lies in the definition of value itself. The true value of a payment is dependent on the customer, bank, service provider or regulator assessing the payment.

Conventional wisdom suggests that the value of a payment is the value exchanged for the services or goods offered. Therefore, the more payment transactions processed, the more money is made. Payments has predominantly been a game of scale. It still is, however the context has changed. The traditional way to pay has been disrupted, progressing payments beyond the conventional model into a new paradigm. The new opportunity lies within the context of a payment. Payments provide insights into managing your business better, understanding your customers more deeply and operating in a more efficient, effective and innovative manner.

The value of a payment lies within the richness of the data that it provides. Rich data messaging standards such as ISO 20022 can now provide more information in each payment message that is sent. The same level of hyper-personalisation in social media for a user can also be achieved in financial services via payments. This is where the value can be unlocked.

In the financial services industry, the transactional data provided by digital payments is extremely valuable. It enables additional context and insights to the user, whether it be a corporate or retail client, or a reliable merchant who is eligible for loans and additional products. These insights have enabled banks and non-traditional financing players to sell additional services, products or loans to existing customers. With more digital financial services providers in the market, many small and medium enterprises have better access to capital to fuel their growth.

In developing countries such as South Africa, thriving but subscale informal businesses stand to benefit most from more accessible forms of capital. The SMME market in developing countries serves as a goods hub to communities for essential services. The value for SMMEs in this context goes beyond access to finance and more into enabling them to unlock the potential inherent within the entire value chain — from supplier to consumer, enabling them to buy stock in a safe and reliable manner, transact with customers and understand the needs of their customers, which in turn creates growth for the merchant and the community as a whole. This is the crux of the value of a payment — the unlocking of ecosystems to create greater benefit to all players involved. This goes beyond just the actual transaction.

Newer entrants such as Square — a US financial services, merchant services aggregator and mobile payments company — provide a case study of how tackling such issues can unlock great value. Square started as a payments service provider that enabled small to medium-sized enterprises (SMEs) to receive digital payments. The company leveraged the growing payment transaction data of its customer base to develop alternative but robust risk modules to enable it to extend loans to SMEs that meet specific transactional profiles. Square's strategic pivot has proven to be hugely successful, with similar innovations in the retail space helping to propel the company to become more valuable than established institutions such as Goldman Sachs — which it achieved in September 2020.

The examples highlighted above provide a glimpse of the potential that comes with the transformation of the value of a payment. We see payments providing more robust levels of context for customers, businesses and government institutions to make better decisions and run their operations more efficiently. In essence, payments have become a strategic priority for organisations that are serious about being relevant in the payments ecosystem and broader digital economy.

How does value creation change with digital payments?

In similar fashion to the way in which the value of a payment is transforming, value creation has also shifted across the payments ecosystem. While our observations focus on the payment ecosystem and the immediate value created by digital payments, the themes and learnings distilled will apply across many industries, albeit to different degrees.

Key Takeaway #1: Frictionless payments are no longer enough

The first and most pronounced observation is the relegation of frictionless payments into the realm of table stakes and the increased emphasis on holistic value creation for the customer.

Many companies emphasise the need to make the payment experience as seamless as possible in order to convert potential purchases into actual sales. Indeed, early adopters saw a boost in sales as a result of reducing friction for customers checking out — Amazon and Apple being the quintessential examples of this trend.

Frictionless payments have now become essential for many companies competing in the new digital economy. International card schemes such as Visa and Mastercard have introduced contactless payments (i.e. tap to pay) while PayPal enables one-click checkout options for their customers and merchants. With such levels of convenience so easily available, simply having a frictionless payments experience is no longer a differentiator when every real competitor has it, the table stakes have changed. Newer forms of regulation such as the EU's Revised Payment Services Directive (PSD2) are also increasingly requiring strong authentication for many payments, which puts some friction back into the experience.

To differentiate themselves in the market, companies are now increasingly focused on developing better products and services while incorporating seamless payments into a holistic end-to-end customer experience. Uber, mostly known for its ride hailing and food delivery services, deliberately relegates the payments experience into the background so customers can focus on their core intention for interacting with the app — getting to their destination or simply enjoying their meal. Other household names such as Airbnb, Amazon, Apple, Facebook, LINE, Meituan and WeChat have also incorporated elements of this approach with equal success. The value is seen in the experience and evolution thereof — but knowing what works today does not necessarily mean this will ensure value tomorrow.

Key takeaway #2: Rise of Payment-as-a-Service and the entrenchment of banks

Our second observation stems from the results of the latest rounds of acquisitions by payment intermediaries. Some of the biggest players such as ACI Worldwide, FIS, Fiserv, Mastercard and Visa are now creating value by offering a multitude of payment solutions, least-cost routing options and value-added services that can flexibly cater to the needs of small merchants and global multinational companies alike.

An emerging model from this new flexibility is Payment-as-a-Service (PaaS). This model allows merchants and other participants in the payments ecosystem to use local, regional and global payment options simply by interacting with a single interface. The complexities associated with clearing funds is handled behind the PaaS layer by the service provider. The value is in the removal of complexities, improved processes and differentiated experiences. The banks now have platform solutions that are integrated into their core banking systems via application programming interfaces (APIs) from PaaS providers. The platform offers a seamless experience like no other and the bank has the benefit or value of outsourcing to technology providers and thus saves on excessive legacy system expenditure and maintenance.

Building on the growth of PaaS, platform integrators take the value equation a step further and provide value-added services on top of their payment solutions for a more holistic service offering. An example of such a platform integrator is Adyen, which has added automated marketplace onboarding and know your customer (KYC) services to its payment service offering. The value creation once again becomes exponential to the parties involved — the bank, the PaaS provider and ultimately the customer. All of this is enabled through the rich data messaging that accompanies the payment transaction and thus, in essence, minimises the risk and provides more known factors into the equation.

The intermediary layer is set to continue the path of further consolidation with a concentrated group of providers perpetuating the PaaS model. The PaaS model in turn will continue to innovate with more comprehensive solutions further strengthening the value proposition of PaaS providers in a virtuous cycle of growth.

In tandem with the rise of PaaS providers in the ecosystem, banks have become more firmly grounded as the ultimate store of value owners. Banks ensure regulatory and financial compliance, and in most cases are owners of the underlying clearing 'rails' that make it possible to move funds from one institution to the other. As the level of digital payments activity continues to grow, compliance with anti-money laundering (AML) legislation and KYC and fraud management requirements continue to be scrutinised by regulators to ensure that customers are protected. This is where banks typically excel — as some of the most leveraged institutions in the world — and have formed partnerships with intermediaries to further embed and enhance value creation in the payments ecosystem.

In the next paper in our Payments Trends Series, we will explore in greater detail the different models of 'co-opetition' between banks and intermediaries that have led to the creation of more diverse payments ecosystems.

Key takeaway #3: Use of contextual data leading to changing risk models

The third observation is the growing focus on access, use and management of payments data across the payments ecosystem. Payments data, when combined with other identifiers, provides a deeper level of context for organisations. Contextualised payments as a by-product of digital payments growth is regarded as both valuable in and of itself and a means for further value creation.

Newer merchant service providers such as PayPal are leveraging the payment transaction data libraries of their merchant customer base to offer loans and generate new value pools. This playbook for value creation is now being adopted in an increasing number of markets. Kopo Kopo, for example, is a Kenya-based service provider that offers merchant digital payment acceptance points. In essence, Kopo Kopo provides merchants with a way to accept payments other than cash — such as credit card and account-based payments. Above and beyond this service, Kopo Kopo provides unsecured, instant credit lines to its acquired merchants based on historical payments data.

The availability of contextual data afforded by digital payment transactions is paving the way for alternative credit risk models for consumer finance. Newer entrants in credit lending are leveraging unconventional consumer information such as location data (geolocation-tagged payments), utility payments, spending category habits and velocity of payments with conventional sources such as credit score reports to predict the creditworthiness of consumers. Given enough transactions and time, more sophisticated providers of credit can even sift for invoice payment transactions to establish the creditworthiness of small merchants.

The growing abundance of data within payments is enabling greater transparency and discovery of more creditworthy businesses to offer loans to. With greater access to credit, these businesses can scale up to employ more people, leading to greater contributions in tax revenue and consumption within an economy. A virtuous cycle.

In the near future, such alternative credit models will become more mainstream as conventional lenders adapt to an environment where data is more openly shared and accumulated.

What will the role of payments be in the economy of the future?

Payments will continue to play a crucial role in our everyday lives. As the digital economy expands, payments will be a key enabler of digital financial services. The scope and scale of financial services will be more than just a movement of the transaction value, it becomes a value equation where payment transaction + insights + trust = value creation within the value chain. The transaction is invisible, the interface, the platform of interaction is the crux to it all. If the interface offers an intuitive experience that is personal and relevant, the user will return again. This leads to trust being added to the equation and is where leveraging and integrating data creates endless opportunities for a multitude of systems.

Trust is a critical component that must not be underestimated.

In future, payments will play a bigger role in facilitating financial inclusion and create a digital economy in which once-excluded citizens are able to operate and be integrated. Financial inclusion is a basic human right and broader inclusion into a digital ecosystem comes with additional benefits, and less risk than that associated with cash in hand — particularly in a society where personal safety is a major issue. Additionally, the value to a country is the inclusion of a new market and thus growth of the formal market subsequently being a catalyst for greater economic growth.

By driving economic growth and value for everyone, everywhere, these advances can create greater overall value in the ecosystem. A critical factor to enable interaction and inclusion into this digital financial ecosystem is accessibility. This is particularly relevant in developing countries where network and device availability are crucial.

To enable broader access to digital financial services, there is a need for greater levels of diversity in the types of service providers within the formal payments sector. Open banking is driving the inclusion of many non-banks into the formal payments ecosystem. Non-banks typically have greater reach to the financially excluded or underserved by means of non-traditional banking and financing services such as e-wallets and loans.

These players may also have a key role to play in expanding the formal economy. Digital payments create the opportunity for low-income consumers and SMEs to become integrated into the formal economy. They can provide users with easier and cheaper access to their money and financial data, saving them high transaction and cash costs, and providing them with easier access to credit, thus further enhancing the value and trust equation.

Digital payments have been evolving over the past decade with rapid acceleration in digital offerings available to consumers. From physical credit cards to prepaid debit cards and now with electronic payment services such as PayPal, Payoneer, Google and Amazon Pay having proliferated across the world, it is only a matter of time before digital payments make physical paper money obsolete. In countries such as Sweden, paying with cash is becoming increasingly difficult with most transactions being digital. It is anticipated that the country will be cashless by 2023.

Beyond the horizon, several countries such as China are also exploring the concept of central bank digital currencies — a digital payment token that is issued and fully backed by a central bank and is legal tender.

Every action has a reaction and, with the growth of digital payments becoming exponential, there is the risk that those not already in the ecosystem will be left behind. Banks, governments, non-traditional financial service providers and financial technology firms must work together to enable this transition to a digital value-creating financial services ecosystem to further enhance their social licence, to build trust and to make sure that the most vulnerable are protected.

What are some of the most successful stories of digital payments transforming the payments industry?

Square makes it possible for merchants to accept digital payments anywhere with only the use of a mobile phone, demonstrating the emergence of digital payments and transformed point of sale (PoS) payments across the world. Between January and July 2020, 31% of businesses in the UK went digital (cashless) from a previous 8% at the start of the year. This shows an increase in digital payments of 288%.[1]

Adyen, a Dutch payments company that focuses on enabling businesses to accept digital and local payment methods through its payments platform, has increased the volume of all its transactions by 55% in just two years. This is another example of the shift in market share and massive growth in the digital payments industry. In 2019 alone, the company showed a 51% increase in processed volume.[2]

Revolut and TransferWise are involved in the processing of international payments and have outperformed the cost structures of banks when it comes to digital payments. Revolut has shown an enormous increase in transaction volume since 2015, with an increase in transaction volume from £150m in 2015 to £65bn in 2019.[3] TransferWise showed 70% growth in its annual revenue in 2020, from £179m in 2019 to £302,6m in 2020.[4]

Flutterwave is a fast-growing payments company in Africa, aiming to transform payments for businesses across the continent and the rest of the world. In addition to announcing a partnership with WorldPay FIS in 2019, it has shown significant growth with the number of businesses on the platform growing from 1,000 in May 2020 to 5,000 in July 2020, to over 20,000 now. The company has also processed more than $8bn in transaction value since launching in 2016.[5]

1 “Square Data Shows Rise of Cashless and Digital Payments Across the UK.” Finextra Research. Last modified August 20, 2020. https://www.finextra.com/pressarticle/83775/square-data-shows-rise-of-cashless-and-digital-payments-across-the-uk

2 “Top Financial Services Cybersecurity and Data Breaches.” FinTech Magazine - Financial Technology (FinTech) Platform. Last modified April 1, 2020. https://www.fintechmagazine.com/venture-capital/top-financial-services-cybersecurity-and-data-breaches

3 “Revolut Revenue and Usage Statistics (2020).” Business of Apps. Last modified September 11, 2020. https://www.businessofapps.com/data/revolut-statistics/

4 “TransferWise Reports Accelerating Revenue Growth to 70% in Its March, 2020 Fiscal Year – TechCrunch.” TechCrunch. Last modified September 22, 2020. https://techcrunch.com/2020/09/22/transferwise-reports-accelerating-revenue-growth-to-70-in-its-march-2020-fiscal-year/

5 "HOW FLUTTERWAVE SAVED 2020 FOR ITS COMMUNITY." Forbes Africa. Last modified January 12, 2021. https://www.forbesafrica.com/brand-voice/2021/01/08/how-flutterwave-saved-2020-for-its-community/.

What are the implications for incumbent banks to consider in order to win in this new environment?

Incumbent banks will need to critically examine the role they wish to play and how they can create value in the new payments ecosystem. Taking into account the evolution of their individual markets, some banks might be better positioned to build their own thriving ecosystem through the liberal use of APIs while others may benefit from forming strategic partnerships with more established digital platform providers.

In an environment abundant with contextual payments, banks will need to change how they approach risk in lending. Conventional credit risk models will have to be relooked and augmented in order to compete with new credit providers that are more adept at using alternative data sources such as digital payment transactions.

Banks should also leverage their position as custodians of the financial system more aggressively to capture value in the digital payments ecosystem. As some of the most leveraged and regulated businesses in the world, banks are natural specialists in safeguarding the money of customers and adhering to complex compliance requirements (e.g. KYC, AML) imposed by financial regulators.

As banks will ultimately be liable if something happens to the underlying store of value, it is important for incumbents to maintain their brand positions around trust, privacy and cyber security resilience. This presents unique opportunities for banks to take advantage of the rising PaaS trend and the platforms introduced by digital entrants such as Uber and Facebook that are extending into payments.

Summary and conclusion

As the perception of value for payments continues to transform, we should brace ourselves for more rapid innovation. Serious players within the payments ecosystem will have to keep up with changing customer expectations, regulatory changes, technology advancements and persistent innovations by new entrants together with greater societal purpose for financial inclusion of the previously excluded and underserved customers.

The value of a payment has evolved and it is important to know that:

- To stay relevant, never mind successful, payment providers have to be agile and anticipate change at all times — what is a differentiator today will become table stakes tomorrow.
- Frictionless payments are no longer enough. The focus of value creation has shifted once again towards quality products and services for the customer — on top of a curated end-to-end experience.
- PaaS is fast becoming the model of choice for payment intermediaries while banks continue to become more entrenched as the ultimate store of value owners — responsible for ensuring regulatory compliance at all times to safeguard customers and protect their money.
- Contextualised payments will redefine conventional credit risk models to open new value pools, promote greater access to capital and enable deeper levels of digital financial enablement.
- Value is built on trust as the foundational element in a digital ecosystem and, if you have already established trusted relationships, these are phenomenal foundations for growth.

We hope you have enjoyed reading this second part of our Payments Trends Series. In the next edition, we will explore some of the emerging players in the payments ecosystem and their business models in greater detail.

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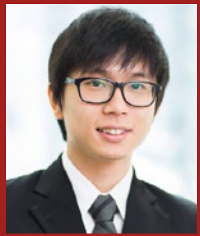

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