DOUBLE TROUBLE

It's usual to start a new year with optimism. But a review of the big trends in payments, and financial services in general, suggests there are real causes for concern. This note picks out two worries, one longer term, one very close upon us.

Let's start with existential threat #1 – one whose full effect may only be felt in 10 years or so.

TECHNOLOGY: ALLY OR ENEMY?

You don't have to buy all the babble about the "Internet of Things" and its cousins in the ranks of stratospherically-priced solutions seeking a problem to be generally positive about technology.

These days, most of us see IT as a powerful ally: increasing productivity, enabling communications, driving down costs, making connections that previously were unthinkable. All true. But there's another side as well, that is only now beginning to emerge: technology as the destroyer of jobs. And, in consequence, the impoverishment of an entire previously productive class of workers.

Take travel as just one example. Not so very long ago, business travel was arranged by a highly-skilled group of staff who had to be masters of geography, airlines, timetables, classes of travel, and able to navigate their way accurately through a truly Byzantine structure for fare calculation. The advent of computerised reservations systems put them out of work virtually overnight – together with their counterparts in airlines, tour operators, cruise companies… a whole class of talented employees whose hard-earned skills had suddenly become worthless. (As a side-bar, a recent survey of business travellers identifies using online reservations "tools" as a major source of stress – but that's another story).

Or compare Eastman Kodak, founded in 1880, with Instagram, only 18 months old when Facebook bought it in 2012 for around $1 bn. At its peak, Kodak employed over 145,000 people, and indirectly provided jobs for many thousands more. It filed for bankruptcy a few months before Instagram was sold. At that point, Instagram had 130 million customers, but employed 16 staff.

It's a picture repeated in factories, banks, and back offices of all kinds around the world. And now we learn of expert systems that will do a better job of diagnosis than your doctor, pilot a plane better than a human, predict weather better than a meteorologist. All very wonderful of course. But what happens to those people's jobs and incomes?

A recent study argued that "Jobs are at high risk of being automated in 47% of the categories into which work is usually sorted. That includes accountancy, legal work, technical writing, and a lot of other white collar occupations."[1] According to Larry Summers, a former US treasury secretary, only one in 20 American men between 25 and 54 wasn't working in the 1960s. Extrapolating recent employment trends, Mr Summers suggests that in 10 years, the number could be one in seven.

Does it matter that the only jobs that may be available for our children and their children are ones involving personal care or high level creativity, technology performing all the tasks in between? At an individual level, surely it must matter: not everyone is suited to work in the caring professions, not all of us can be a Rothko or a Jamie Dimon.

[1] Frey and Osborne, quoted in *The Economist* 18 January 2014, p 22

But there is a commercial dimension, too. Just from a financial services perspective alone, payments, savings, loans, insurance products all depend on masses of individuals with an income – the working and middle classes, in other words. What if that group is in structural decline? Because, according to economist Branko Milanovic, data from household surveys show that from 1998 to 2008 real incomes of the poorest 50% in the US grew by just 23%. By contrast, incomes of the top 1% of Americans grew by 113% - which other studies say may be an underestimate.[2] At best , static customer numbers, many of them under financial pressure, alongside a small, hugely wealthy élite. What are the long term implications for universal banks, broadscale card issuers, acquirers, processors, the payment schemes?

The answer isn't at all clear. But it feels like a conversation that someone should be having….

So now let's take a look at what you might call a clear and present danger: existential threat #2

BYE BYE INTERCHANGE?

This series of notes has enlarged before (see "Blowing Smoke" in August of last year, for example) on the not-so-straightforward motives of the legislators and business groups pressing for a reduction in interchange.

But make no mistake: interchange is permanently on its way down – and maybe out. The travails of the US following Dodd-Frank are well-known. But an extreme example of the future may be found in Poland, a rapidly-growing economy which is relatively new to using cards. By 1 July, Government legislation will have brought interchange on debit (much the most-used format) down from 1.6% to 0.5%, a rate that in fact will apply to credit also.

A painful enough change in itself, you may think, given the financial models usually associated with these two card formats. But there's more to come: the EU is now proposing a further fall. Broadly speaking, it aims to introduce legislation capping interchange for consumer cards at 0.2% for debit and 0.3% for credit cards, across domestic and cross-border transactions in Europe.

As to Who Benefits, the Commission's statement is worth quoting in full:

"Consumers would benefit from

- better protection and security;
- increased competition and greater choice of payment providers;
- full transparency on the fees charged by banks to retailers (that are passed on to consumers).

Retailers would also benefit from lower charges (interchange fees) and enjoy full transparency on the fees charged to them by banks

Payment institutions would benefit from

- a modernised legal framework
- legal clarity on a number of difficult issues (such as interchange fees)
- common technical standards and interoperability.
- greater ease of doing business throughout the EU."[3]

[2] Quoted in the *Wall Street Journal*, 22 January 2014, p18
[3] http://ec.europa.eu/internal_market/payments/docs/framework/130724_citizens-summary_en.pdf

Splendid stuff – and worth saving somewhere just to check in a few years' time how the outcome matched up with the promises.

The reasoning here is becoming increasingly clear: interchange should simply cover processing costs – and there are voices saying that even that is too much: why should there be any charge at all?

It's been said before, and it's worth saying again: the payments industry has made a terrible job of explaining to the public and the regulators just what a fantastic job cards do. World-spanning, hugely reliable, innovative, competitive……there's immense value here. And we've allowed it to become commoditised.

So what to do? Maybe there's a case for an annual fee. But it would have to be supported by clear customer value over and above a plain vanilla payment capability. How this could be made attractive to a middle income market isn't clear. Maybe the card simply becomes an element in a package of charged-for banking services. But either way, it looks like the golden age of card profitability is drawing to a close.

It seems a shame to start the year off on a rather downbeat note. Maybe there'll be good news to report next month….

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Background

- With more than 20 years of experience in the payment card industry, Roy was previously with American Express, where as VP and General Manager, he launched the highly successful commercial card business in the UK, going on to lead product rollout across EMEA and latterly Latin America/Caribbean.
- As a consultant, Roy works with banking and payment card clients around the world, identifying and advising on best practices in customer marketing and relationship management. He has also undertaken assignments in media, utilities, airlines and retail.
- He has developed and audited coalition and bank loyalty programmes in the UK, Ireland, the Netherlands, Spain, Canada, Dubai, Kuwait, Australia, Singapore, Spain, Israel, Turkey, Saudi Arabia, Brazil, Chile, Venezuela and Mexico.
- Roy has also advised on airline FF programmes, and has been the rewards lead in the MasterCard Advisors pool.
- He speaks fluent Spanish, reasonable French and is the author of *Marketing Planning for Financial Services* (Gower Publishing). He has a B. Com, holds an MA in Management Studies and is a Fellow of the RSA.
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