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M PAYMENTS: MIRACLE OR MIRAGE?

Advances in technology.
We've seen them come, we've seen them….well, not always go, but often fail to deliver on the golden promises that were made for them.

Remember how those new-fangled ATMs were going to do away with the need for costly branch networks? Doesn't look like it – not when Spain, home of some of the most advanced holes-in-the wall anywhere, is also one of the most over-branched countries in the world. (There's a branch for roughly every 1000 Spaniards, about six times the provision in the UK).

Similarly, the Internet was also going to spell the end of bricks and mortar banking. But for every successful First Direct, there are failures like Egg, NetBank and other pioneers of stand-alone online banking. After an exciting start, Egg faltered and was eventually sold to more conventional operators, while in the US, NetBank fell foul of regulators who eventually closed it down.

The result? So far from being knocked for six, branch banking is in rude health: in the US, for example, there are now 22% more branches than there were in 2000. [i]

True, m banking isn't the same as m payments: it does a different job, and is often managed in a different part of the bank. But there are instructive parallels for m payments to be drawn from the impact m banking is having on the real world.

In this light, how are we to interpret the sound and fury around m payments? Is this going to be the technical advance that really does do away with physical cards? Or is it another case of the excitable making an unholy alliance with the salesmen to pitch the latest product?

Let's take a look at the facts.
And here we hit the first problem: estimates of just how big the m market is can raise eyebrows. To take just one example, a recent UK study suggested that m payment sales for 2012 would reach as much as 12% of all online retail volume.[ii] Surprising in itself, that out-turn would imply an astonishing 2900% increase from the corresponding level a bare two years ago. Accordingly, this note focuses on the US, home of the biggest players and probably the best documented.

As recently as this past April, the head of Accenture's North American payments practice was telling *American Banker* "When the iPhone 5 hits and it comes with NFC – at that point in time it's going to be a very fast slope that everybody slides down."[iii] Well, iPhone 5 came without NFC, so maybe that fast slope is further away than he thought.

Similar disappointment came with the announcement in September by Isis that it was to delay its first big test in the US of a mobile-payments service[iv]. Isis gave no reason for the delay, one of several it has had to announce in the two years of its existence. And Isis isn't a couple of nerds dreaming in a garage: it's a joint venture of AT&T, T-Mobile and Verizon Wireless.

The fact is that in the US, which in this regard at least is probably ahead of Europe, m payments have been slow to take off.

When looking at real world usage, it's helpful to distinguish between m payments in general, and m payments at POS. Gartner reckons that m payments in the US will hit $171 bn this year[v]. By contrast, September 2012 research from Javelin Strategy puts the figure at $20 bn[vi] while its June 2012 study[vii] forecasts that m payments at POS, a lowly $363 mn in 2011 will grow to $1.4 bn by 2017. , US debit, credit and charge card volumes exceeded $3.5 trillion…[viii]

New products, new entrants…

Possibly the most ballyhooed new product has been Google Wallet: tellingly, though, Google declines to release any figures around usage. Maybe that's because its Wallet is only available on a limited number of the phones sold by Sprint, which ranks no higher than number three in the mobile telecoms market.

Not far behind Google in noise level, though quite different in function, is Square, essentially a card reader which plugs into an iPhone. Clearly aimed at small merchants who don't want conventional POS terminals, during a recent fund-raising round its boss, ex-Twitter founder Jack Dorsey, claimed Square is processing payments at an annual clip of $8 bn. However, he also claimed that the business is about to expand internationally which, since the reader is based on mag stripe technology, seems slightly odd[ix].

The mag stripe deficiency is true also of the PayPal mobile wallet. Often touted by enthusiasts as the world's biggest bank, PayPal's 230 mn accounts worldwide[x] probably earn it the title, though rather more than half of these are inactive, and it certainly doesn't do all that banks do. What's not in doubt is that it processes a lot of transactions: a worldwide volume for 2011 of $118 billion. Of this, a significant and growing proportion is coming from m payments: PayPal's parent EBay is now forecasting a US total of $10 bn, up from $4 bn in 2011.[xi]

But to stake a claim outside the US, Square, PayPal and the like have to break out of the mag stripe ghetto. The EMV challenge has been taken up by businesses like mPowa, a UK competitor to Square, whose devices are based on Chip and PIN, and which has just announced a deal with First National Bank of South Africa. A launch with a British retail bank is also said to be in the works[xii].

Further complexity comes from the tensions around charges which inevitably exist between merchants and the card industry. Stateside in particular, the debate is growing rancorous as lobbyists turn up the heat to secure advantage for their principals. Predictably, the new entrants are zestfully exploiting these sharp disputes, positioning themselves as the retailer's champion against the predatory banking establishment. That's as may be. Which of the payments players truly has the merchant's interests at heart – let alone the consumer's – is a very moot point at this time.

So far, what we are seeing is an act of faith: established actors and new entrants jostling with each other to launch the hardware and software, and to build the partnerships necessary to create the crucial infrastructure.

Looking for a game-changer

In reality, the hardware and software are the easy bits. The toughest thing is to persuade customers and merchants to change payment behaviours whose security and convenience have served them well for half a century. What is needed is a game-changer, an iTunes equivalent: an app that transforms what both sides get from a purchase transaction, adding so much true value to today's security and convenience that there is reason to abandon the habits of a lifetime. Once that tidal wave begins to break, both customers and merchants will eagerly adopt the change, choosing from whatever emerging partnership of communications, payments infrastructure and technology providers best suits their needs. The hope of the existing financial players is that, unlike iTunes and the record companies, the new app won't leave the payments business gutted.

The new entrants, of course, very much hope this will happen, leaving them in control of a huge, growing and profitable industry.

Where do the card schemes fit?

Interestingly, in all of this turmoil, the payment networks may be least at risk. In the first place, they offer security: it may be quite a while before even the biggest telcos, let alone completely new entrants, earn the trust of consumers and merchants. Secondly, the worldwide pipelines they operate are so sophisticated and reliable, so expensive to replicate, that any player with ambitions to serve other than a niche or regional market will have to work with one or all of them. It's telling that Isis, for example, which had originally planned to build its own payment network, has now partnered with Visa and MasterCard. In fact, we could see a repeat of the situation decades ago when domestic-only payment cards eventually had to migrate to the international networks.

Additionally, compared with the issuers, the networks have much less capital invested in plastic: for them, a payment is a payment, no matter how it happens. Underlining the point, the Isis alliance shows that, responding to a changing world, Visa and MasterCard are now quite willing to work with non-bank partners.

But the card schemes aren't the only players who are ready to rewrite the rules of the game. Maybe the biggest challenge to today's business model will come from merchants. Short term, the big retailers want to slash card charges. But in the long term, there's evidence that they would be willing to bypass the banks and build their own payments capabilities: in the US, the Merchant Consumer Exchange, a consortium of large retailers, aims to set up an m payments infrastructure that will represent merchants and customers – but not, by implication, the banks. And how else are we to read Wal-Mart's move with American Express into the payments world?

Here's an attempt at a high level summary of the opportunities and risks faced by each of the main sets of players:

	CONSUMERS	MERCHANTS	ISSUERS	NETWORKS	TELCOS	NEW ENTRANTS
Opportunity	Not yet clear	▪ Short term: Not yet clear ▪ Long term: Build an alternative payments structure, bypassing the banks	▪ Primary: Stay in the game ▪ Secondary: Avoid need to issue plastic and support paper billing	Device agnostic?	▪ More devices ▪ More traffic ▪ New revenue source	New revenue source
Risk	Security	Cost	▪ Disintermediation ▪ Transition costs	Cost	Cost	Cost

So, the big question: Where's the iTunes for m payments?

If we look globally for answers, it's clear that the emerging world has found one. In markets like East Africa, m payments are booming. Why? Because they fulfil a need – particularly for easy, safe P2P payments – which the existing infrastructure can't. Kenya's M-PESA, of course, is the poster child, and its performance is astonishing: 15m subscribers, used by 70% of the adult population – around 25% of Kenya's GNP flows through it[xiii] Building on its success, imitators are popping up wherever there's an infrastructure gap.

But in the developed world, the fact is that no-one knows what the m payments iTunes will be: so all the establishment players are hedging their bets – a strategic investment here, a take-over there. Even from time to time, an actual launch: this side of the water, Barclaycard is doing good work, following up on the prediction of Antony Jenkins, then its CEO, now running the whole bank, that in the future customers would use plastic out of nostalgia rather than necessity. Hence its recent launch of apps for m payments, P2P m transfers and m banking.

Our bet?
We believe that the tipping point will come in the area of recognition and reward – adding a whole extra layer of value to enrich the basic purchase transaction for both customer and merchant. Could Passbook, now available for retro-fit on iPhone 4, be a starting bid from Apple? Seasoned industry observer Ron Mazursky takes the view that the folks from Cupertino will hook the value-rich app on to whatever payments mode (NFC? The cloud?) emerges as a winner.

Let's circle back to our headline question. M payments aren't a miracle – not yet, anyway. Nor a mirage, either. Rather, we echo a very ancient formulation: "I believe: help me in my unbelief".

With thanks to Ron Mazursky and David True for their valuable insights.

[i] The Economist, International Banking Report, May 2012

[ii] http://www.imrg.org/ImrgWebsite/User/Pages/Press%20Releases-IMRG.aspx

[iii] http://www.americanbanker.com/magazine/122_4/mobile-payments-banks-merchants-1047519-1.html

[iv] Wall Street Journal: Mobile Payments Fail To Gain Traction, 26 Sep 2012

[v] http://www.gartner.com/it/page.jsp?id=2028315

[vi] https://www.javelinstrategy.com/brochure/263

[vii] http://www.cutimes.com/2012/06/07/cash-dethroned-by-cards

[viii] http://www.paymentssource.com/statistics/

[ix] http://www.theregister.co.uk/2012/09/18/square_cash/

[x] www.paypal.com/cgi-bin/webscr?cmd=_display-country-functionality-outside

[xi] https://www.paypal-media.com/about

[xii] http://www.telegraph.co.uk/technology/news/9579309/British-Square-rival-Powa-signs-bank-deal-for-mobile-payments.html”

[xiii] The Economist, 25 August 2012