CELENT

In Conversation With earthport

Where is the Value in Payments?

Gareth Lodge, Celent
Neil Burton, Earthport

© CELENT

OLIVER WYMAN

Value is a concept that means different things for different people in the value chain. Understanding each perspective is vital.

Consumers

For *consumers*, under most circumstances, payments should be like an international airline flight – in other words, unremarkable. Nobody wakes up in the morning and wants to buy a payment. And every consumer is looking for a bargain, so they should also be 'free' – priced into whatever product the consumer is buying. Often they are bundled into the banking relationship, although this is not the case in every country. For suppliers of payments services there is considerable risk – brand risk for example, as consumers are quick to complain should something go wrong, if salaries or payroll fail to arrive on time.

The value is largely in providing convenient, accurate and timely information. Consumers have been conditioned to pay for services delivered via mobile phones; leaving mobile network operators a simple profit opportunity from providing advices and statements, whilst avoiding the significant costs and regulatory overhead associated with the payments industry.

In contrast with domestic payments, consumers expect to pay for international payments services. Fees are high, typically up to 10% of the value of a transfer and it may be cheaper to post a parcel than to make an international funds transfer. For a bank, the costs are also high; the penalties which may be imposed for failing to meet international regulatory requirements are so big that the business case for banks – probably the only group which could reduce fees to an acceptable level – is weak at best.

Furthermore, unlike domestic payments, international payments are not commoditised; banks make considerable margins on high value transfers (usually for corporates and high net worth individuals) which they are reluctant to cannibalise. As a result, many of the suppliers who specialize in such payments differentiate on price. Whilst banks may not commoditise the product, others are beginning to do so.

Corporates

For *corporates*, value arises in a number of ways. Treasurers want to know how much money they have, where it is, whether it’s safe and what they can do with it. Though surveys often place faster payments as a priority, deeper questioning reveals that certainty is of more value, at least for lower value transactions. The ability to predict outcomes, by value and in time is important; and the ability to reconcile receivables with invoices is recognized as probably the single greatest benefit to corporates worldwide. Online merchants want to collect payments from their customers cost effectively and without recourse; solving this challenge is amongst the top transactional requirements in e-commerce. Unsurprisingly, the latter is the fastest growing segment in payments today.

Banks

For *banks*, payments represent up to 25% of revenue and 30% of costs. Yet banks are strangely schizophrenic; the payments business is relegated to the ‘back office’, out of sight. Almost all available investment is needed to maintain compliance with the growing sea of regulations and the necessary technical systems and processes to maintain a service which doesn’t provide competitive advantage. Beyond that, investment cases almost always centre on reducing costs, which compromises opportunities to fund innovation.

Unsurprisingly, pressure for change is growing fast. The internet has transformed international trade, connecting buyers and sellers across borders. It has also catalysed the emergence of new business models for which the economics are very different. Though incumbent providers in any industry will always attempt to preserve old business models indefinitely, adoption of business innovation can only be postponed.

The domestic clearings systems, the most efficient and cost effective components of the payments industry, benefit from massive economies of scale. When combined with internet technology, results produce a payments architecture which is more efficient, more transparent and lower cost.

Time to reflect?

Prior to significant new investment, assumptions long held in the payments industry should be revisited, including:

- Has the market changed enough to warrant a different approach?
- Are alternative sourcing strategies available, delivering value faster than traditional build, buy or outsource?
- Do alternative models offer different cost and service characteristics, such as better customer satisfaction and lower per transaction costs?
- Are payments a back office function, or a viral marketing opportunity to sell financial products to a wide audience?
- Where is the value – in the transaction fee, or in the opportunity to interact with the customer?

Coupled with the massive economic forces at work in 2012, the next decade will see huge innovation in payments.

Gareth Lodge
Senior Analyst
glodge@celent.com
+44 7753 614647

Neil Burton
Director, Product Strategy
neil.burton@earthport.com
+44 7802 790663

Read the complete series of ‘In Conversion With' vision papers