

# INNOVATION IN RETAIL PAYMENTS

---

26 May 2009



# ***Consumers are not driving innovation in payments in most industrialised countries***

---

- A high percentage of consumers are banked
- Consumers have lots of choice in payment methods
  - Similar numbers of options by payment channel are seen in most developed markets
- There is no overt demand
  - Except in mass transit
- They perceive no major gaps

# ***Australian consumers are not driving innovation in payments***

---

- A high percentage of consumers are banked
- Consumers have lots of choice in payment methods
  - Similar numbers of options by payment channel are seen in most developed markets
- There is no overt demand
  - Except in mass transit
- They perceive no major gaps
  
- But take care:
  - Consumers don't know what's possible
  - As Henry Ford said

***“If I'd asked people what they wanted, they'd have said a faster horse”***

# *Innovation in cars*

---

**Cars have not fundamentally changed in nearly 100 years**

- **4 wheels**
- **Internal combustion engine**
- **Steering wheel**
- **Braking system**
- **Gearbox**



# *Innovation in cars*

---

**Cars have not fundamentally changed in nearly 100 years**

- 4 wheels
- Internal combustion engine
- Steering wheel
- Braking system
- Gearbox



**But there have been lots of changes**

- Fuel injection
- Electronic ignition
- ABS brakes
- Pneumatic tyres
- Hydraulic suspension



## ***Hence there are different types of innovation***

---

- **Systemic vs Product innovation**
  - Systemic changes require collaborative efforts
- **Continuous improvement vs Step change**
  - Incremental changes are more easily understood & adopted
- **Repackaging vs Value Proposition innovation**
  - B of A's "Keep the change" debit card program changed the VP
- **Imitators vs Innovators**
  - Copying ideas from elsewhere can still be original in your market

***and categorisation can be a matter of perception***

# *What is innovation?*

---

- We defined innovation as “creating value by doing things differently”, with

$$\text{Value} = \frac{\text{Benefits}}{\text{Cost}}$$

- Different people or market segments can see different value in something that costs the same amount, because they perceive a different package of benefits
- International examples where value was created as an outcome of changes to products, services or systems >>

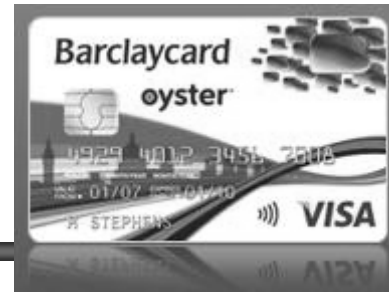
# ***China UnionPay – National network for China***



- **Driven by the government, CUP established in 2002 to unify the electronic payments network in China**
  - **Previously a Beijing card would not work in Shanghai**
- **Within 2-3 years, the CUP network had interconnected all POS terminals, ATM's, the international payment schemes and the financial institutions**
- **Improved inter-operability and acceptance made widespread card issuance viable for FI's and provided consumer convenience**
- **Proponents argue that one central network provides cost efficiencies; detractors that the lack of competition does the reverse**
  - **However it has avoided duplication of infrastructure**
- **Innovation realised through:**
  - **Government support**
  - **Collaboration / coordination among industry players**

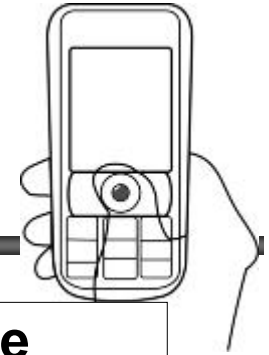


# ***Oyster Card – Transport for London***



- Introduced as a reloadable contactless prepaid card in 2003
  - Barclaycard licensed to place Oyster onto its Visa credit card in '06
- Covers buses, underground, light rail & some trains
- Barclaycard version “OnePulse” has 3 applications
  - Oyster for transit; Chip & PIN credit card; contactless credit card
- 27m Oyster and 1m OnePulse cards issued since '03
  - 38m journeys per week & over 1000 OnePulse contactless merchants
- Innovation realised through:
  - Meeting consumer demand for convenient transit payments
  - Meeting TFL’s need for speed & efficiency;  
40 gate movements per minute vs 25
  - Collaboration (adding Barclaycard)
  - Process of continuous improvement

# ***Wizzit Bank – Mobile banking & payments in South Africa***



- **Established in 2002 to provide a low cost, comprehensive banking service to the country's 16m unbanked adults**
  - **Service launched in 2005 using the mobile phone as the channel**
- **Uses USSD rather than SMS (G-Cash & M-PESA)**
  - **Does not require a new SIM card; uses PIN for security**
- **\$4 to open account, then low cost pay-by-transaction service**
  - **No monthly fees, minimum balance or minimum use**
- **Load at Post Office or ABSA Bank branches**
  - **Can link to MC debit card, providing ATM & POS functionality**
- **Innovation realised through:**
  - **Not disenfranchising any of the key players**
  - **Satisfying demand of the unbanked population**

"G WIZZ"  
my bank in my pocket



# **Moneybookers – Online payments in Europe**



- **Became Europe's first regulated electronic money (e-money) issuer in 2003, under the EC's Electronic Money Directive**
- **Focussed on simplicity, cost competitiveness & security**
- **Online merchants have adopted Moneybookers service**
  - **30,000 merchants as at '08, including eBay, and 6.2m users**
  - **Processed €2.9 billion in payments last year**
- **Users upload funds to a virtual account, which can be used to purchase goods/services and pay anyone with an email address**
- **Cost competitive: 1% of value, with a maximum of €0.50; plus 1.75% forex margin if applicable**
- **More than 60 local payment linkages/options are offered**
- **Innovation realised through:**
  - **Regulation when the European Commission (EC) issued its Electronic Money Directive in October 2000**
  - **Addressing demand for simplicity, cost competitiveness and security**

# ***Drivers of innovation (1)***

---

## **■ Consumer / Merchant demand**

- **Historically large merchants have been drivers of change**
  - Increased speed, convenience, consumer loyalty, hence lower costs & higher revenue
- **Consumers have had little direct influence**
  - But their choice of payment method is driven by the 6 C's #

## **■ Technological advancements**

- **New technological capability facilitates innovation**
- **Technology adoption tends to be part of broader strategies**

## **■ Level of security**

- **Confidentiality is one of the 6 C's**
- **Innovative payment systems face a challenge to convince consumers they are secure & trustworthy**

# ***Drivers of innovation (2)***

---

## **■ Industry framework**

- **Government has a role to play in ensuring innovation & efficiency are driven into the payment network**
- **Industry coordination is required for innovation shared across all players**

## **■ Competition / Market share**

- **In mature markets, maintaining a competitive advantage is key to acquiring & retaining customers**
- **Many players seek a first mover advantage using innovations**

## **■ Profit**

- **Clear financial incentives spur innovation**
- **The “business case” is King**

# *The drivers are also shaped by a number of factors encouraging or impeding innovation*

---

- **Market structure**
  - **Network effect**
  - **Market size**
  - **Managerial scope**
  - **Government structure**
- **Infrastructure**
  - **Level of development**
  - **Structural architecture**
- **Adaptability**
- **Competition vs. collaboration**
- **Culture for innovation**

# ***Developing a business case for step change innovation is problematic - even more so today***

---

- Profit margins on payment transactions have been decreasing
  - Increasing competition in the marketplace
  - User belief that cost of payments should be constantly reducing
- Investment in payments has to compete with other investment opportunities, which tend to provide better returns
- Current appetite in FI's for investment is very low
- Step change innovations bring more risk
  - Tend to be larger investments
  - Estimating the adoption curve embodies more “guess work”
  - Longer pay back period, due to low adoption in early years (consumer payment habits take time to “break”)
  - May be eclipsed by new technology before reaching critical mass

# ***Hence focus is on innovation providing continuous incremental improvement***

---

- **Consumers more easily understand, accept and adopt innovations that require little change in behaviour**
  
- **Investment in incremental improvement is lower, and can more easily be unwound**
  - **Easier to test market**
  - **Easier to build business case with more certainty**
  - **Leverages existing systems**
  
- **Can be substantiated on the adoption by smaller market segments/niches**



# ***Australian study findings (1)***

---

- **There are differing views on the level of innovation the Australian market**
- **Drivers of innovation are not as strong in Australia as in some other markets**
  - **in part because existing systems are ubiquitous and effective, and the population is highly banked**
- **The business case is key to innovation, and is impacted negatively in Australia by a number of factors**
- **Collaboration (resulting in “co-opetition”) is seen as a key component of systemic innovation in payments. Systemic innovation is important, but:**
  - **Competitive differentiation, cost savings and customer value can be generated through multiple incremental changes**
  - **The business case is harder to establish than for incremental change**

## ***Australian study findings (2)***

---

- **The competitive environment in Australia is more aligned to incremental change and price competition**
  
- **A number of preconditions were suggested to increase the opportunity for systemic innovation in Australia. These include:**
  - **A consistent regulatory framework**
  - **Government investment in basic payments infrastructure**
  - **Financial incentives/certainty**
  - **The completion of major core banking system upgrades**

## ***The Australian discussion paper was not asked to make conclusions, but . . .***

---

- **It is hard to argue that Australia does not have a modern retail payments system by international standards**
  - **The Australian consumer appears well served and has lots of choice**
- **It is true that Australia does not have a number of innovations found overseas**
  - **But many of these involved government funding/intervention**
- **The industry has invested substantially in continuous incremental innovation**
  - **Lower risk, easier business case and more accepted by consumers**
- **Step change innovation is infrequent in all markets**

***“You need vision and faith, not a business case; and a belief that it is the right thing to do”*** Peter Lewis, Oyster Development Manager