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Banking & Payments

Report Code: GDPE2274ICR

June, 2022

Payment Revenue Models in 2021 and Beyond

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Executive Summary

As the world continues its uneven recovery from the global pandemic, the changes to countries, economies, businesses, and individuals that arose from the first lockdowns in 2020 continue to reveal themselves today. The way people pay has seen major, if not unforeseen, transformation. The pandemic has accelerated the move away from cash towards digital payment solutions. This shift challenges traditional payment revenue models in a number of ways, including through convenient alternatives to card payments via digital wallets, payment network innovations, and simple, transparent substitutes for credit cards via buy now pay later (BNPL) apps. These new solutions have the potential to allow merchants and customers to cut out a key part of the traditional payment loop, bypassing interchange fees, system fees, and service charges – with major consequences for revenues. At the same time, global political changes and legal action continue to test established processes, making the 2021 payment revenue landscape a changing and challenging one for financial services companies to navigate.

Key findings

- Following a decade of strong growth, estimates place current global payment revenues at around $2tn. This is expected to drop as a result of the pandemic. But as the world starts to recover, the payment landscape reshapes itself, and consumer confidence returns, revenues will resume strong growth in the short term.
- Two key revenue streams – interchange fees and merchant service charges (MSCs), both specific to card-based transactions – account for around half of payment revenue. Together they will see growth of 25% between 2020 and 2023, when their value will reach $1.2tn.
- Credit card balances have contracted in several major countries, reducing interest income and resulting in some major issuers cutting credit limits.
- BNPL represents a major challenge to traditional credit cards, offering easy, flexible, and low-cost alternatives for spreading the cost of purchases.
- While payment cards remain the dominant payment mechanism in Europe and North America, the proportion of global transactions accounted for by mobile wallets has increased rapidly. This trend will continue out to 2023, driven by especially strong usage in Asia Pacific and growing adoption in the developed world.

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Market Overview

Between 2010 and 2020, global payment revenues saw consistent growth, doubling to $2tn over the decade (Source: McKinsey). Despite numerous interventions to cap interchange fees, the shift to electronic payments worldwide has enabled revenues to keep growing. The pandemic was anticipated to dent this growth, with McKinsey revising its pre-pandemic estimate for 2020 from $2.12tn to $1.74tn (a contraction of 7% year on year) in October 2020, but longer-term growth prospects are strong as consumers move away from paper-based payments en masse.

Our analysis shows that a combination of interchange fees and MSCs from card payments accounted for around $1tn in 2021. This figure is set to rise to $1.2tn in 2023. In 2021, credit transfers are estimated to account for 80% of global payment value but just 5% of volume. Mobile wallets account for the largest share of volume, followed by cash and payment cards: together these mechanisms make up 92% of volume but 8% of value.

Table 1: **Revenue potential is highest for mobile wallets, but disintermediation is a risk for the sector**

Payment method	Cheques	Cash	Cards	Mobile wallets
Global share of payment volumes in 2021 (estimate)	<1%	32%	23%	37%
Revenue potential for financial services	Mixed: Traditional route has high processing and handling costs, but scanning costs are far lower.	Low: Processing costs are lower than for payment cards, but operating (handling and maintenance) costs are higher.	High: Mix of interchange fees and MSCs, customer charges, and interest earned.	Mixed: If the wallet is part of the traditional payment system the income potential is high. This differs for disintermediated products (discussed below).
Customer experience	Historically slow to clear, but access to scanning tech means funds can be transferred instantly. However, cheques are increasingly seen as archaic.	Vital for customers in regions with poor infrastructure. Elsewhere still convenient, but seen as a contact risk during the pandemic.	Established and convenient, with purchase protection and value-added benefits. Contactless tech furthers ease of use.	Convenient, with growing appeal for purchases at the point of sale (POS) and online.
Change in global payment volumes, 2020 to 2023	-14%	-5%	22%	49%

Note: Direct debits and credit transfers are not shown. Together they account for 7% of payments by volume in 2021, and are covered in detail below.

Source: GlobalData's *Payment Instrument Analytics* © GlobalData

Competition

Just as competition between traditional payments and emerging digital solutions continues to intensify, so does competition within the digital space.

an established payment method, PayPal enhanced its proposition with the acquisition of Honey for $4bn in 2020 – one of the latest in a long line of synergistic acquisitions PayPal has made (including Xoom, iZettle, and Venmo, among many others) in the past few years. Boasting around 17 million monthly active users as per TechCrunch, the Honey digital platform is best known for its browser extension that automatically identifies savings consumers can make at the POS. The app also allows consumers to add items from multiple retailers into their basket and pay for them all at once – a feature which at the time of writing seems unique within the industry.

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This combination of rewards and innovative shopping technology means PayPal is an increasingly competitive threat to payment companies around the world. It already has a formidable online presence with a top three share of online payment methods in many major countries. Our 2020 Financial Services Consumer Survey shows it is the most popular payment mechanism in Italy; the second most popular payment mechanism in the US, Spain, and Germany; and the third most popular in Mexico, the UK, Australia, and many key European countries.

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Central Banks are considering digital currency

There is another potential disruptor to traditional revenue schemes. Digital currency – currency that is created and stored digitally – has been the focus of headlines for the past decade. When the concept emerged towards the end of the 2000s it was treated with skepticism by some commentators. Since then, digital currency – typified by (but not limited to) the Bitcoin cryptocurrency – has surged and waned in value and popularity, with headlines responding accordingly. Examples range from the indifferent ("Skeptics say digital currency has no real value" [CNBC, 2017]) to the neutral ("Bitcoin: too good to miss or a bubble ready to burst?" [FT, 2021]) to the effusive ("Cryptocurrency stocks skyrocket as Bitcoin tests new highs" [Business Insider, 2021]).

Until recently, the prevailing sentiment among the financial services industry (outside of speculative investments) has been uncertainty. But this is now changing. In 2021 the Bank of England announced it has mobilized a taskforce to explore the development of a CBDC to "exist alongside" traditional currency and its uses. The US Federal Reserve is following a similar path, with economists from Goldman Sachs suggesting the Fed is balancing the appetite for introducing a digital currency with caution that it does not undermine existing financial systems. One step ahead, the People's Bank of China is moving to introduce its own digital currency (currently planned for full launch in 2022) after extensive testing in the city of Shenzhen throughout 2020. This move gives the Chinese government greater control over localized currency and lessens the influence of both the historically dominant US dollar and locally flourishing cryptocurrencies. In May 2021, China announced restrictions to cryptocurrency trading that seem designed to drive use of its own digital yuan (source: Wall Street Journal). It has also used the digital yuan's launch as part of its strategy to curtail the dominance of local mobile wallet giants Ant Financial and Tencent, moving to potentially cut them out of the digital yuan system in April 2021.

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Impact of Social, Economic and Political Changes

Payment revenue is dictated by the payment mechanisms being used. The long-established mix of cash, card, and cheque was already showing signs of disruption from new technology. The pandemic has hastened these trends, encouraging the adoption of payment methods that reduce physical contact and indelibly reshaping the payments landscape around the world.

The use of cash was actively discouraged during the pandemic as it potentially enhanced the risk of viral transmission. Although not legally banned, many retailers that remained open either encouraged the use of plastic cards and contactless methods of payment or refused to accept cash. As a result, global cash transaction volume at the POS dropped 10% between 2019 and 2020 (source: Worldpay).

Conversely, the pandemic accelerated the growth of the fintech sector. Fintech companies – from challenger banks to ecommerce providers to BNPL lenders – had all been growing strongly in the last decade, but during the pandemic valuations for many of the most prominent unicorns shot up tremendously. 2020 and 2021 have already seen some huge fintech initial public offerings (IPOs), most notably BNPL firm Affirm's in January 2021, which raised $1.2bn. More companies are expected to top this number in the next year or so – Chinese firm Ant Financial made headlines in 2021 with what was expected to be a record-breaking IPO that has yet to materialize at the time of writing, while Swedish BNPL lender Klarna is also reportedly planning a huge IPO in 2021.

The changes go beyond POS payments. With lockdowns preventing bricks-and-mortar shopping for all but essential purchases, non-essential retailers adopted digital platforms to enable them to keep trading. Meanwhile, essential retailers promoted in-store contactless payments to reduce the risk of the virus as well as promoting their online channels. For example, in North America online grocery sales saw triple digit year-on-year growth at the onset of the pandemic in March 2020 (source: Research and Markets). In addition, two thirds of consumers reported shopping in-store less (source: Gartner).

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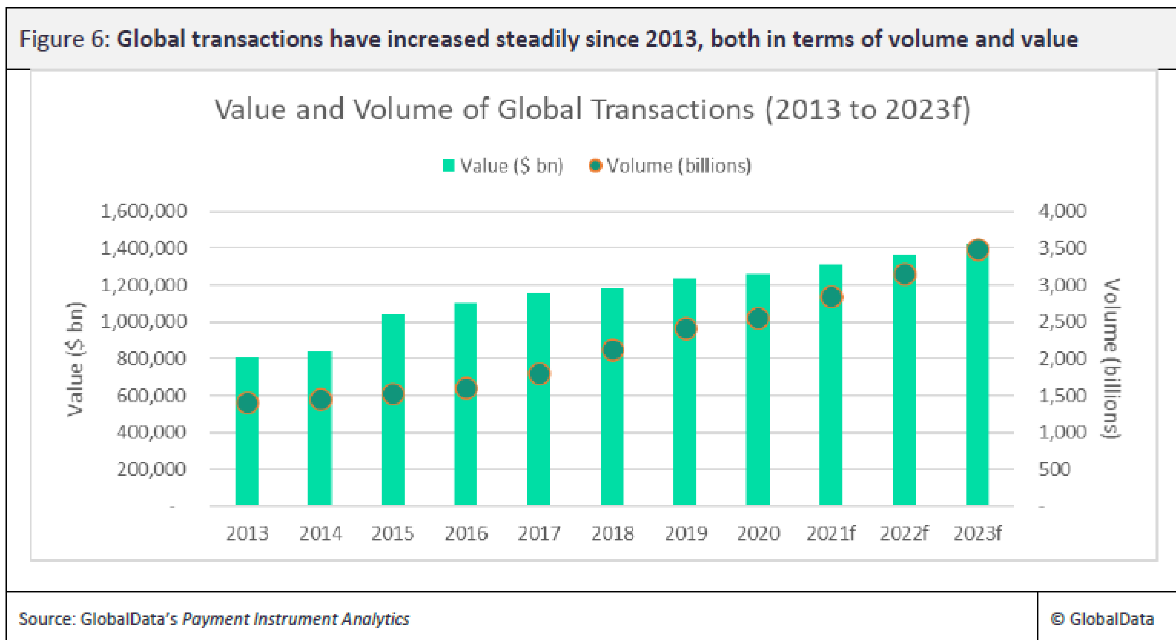
The Changing Payments Landscape

Our research and analysis indicates that the changes in usage and preference for different types of payment tool brought on by the pandemic are simply accelerations of existing trends, which vary by region – often quite significantly.

Our analysis is based on annual payment volumes and values for all commercial and consumer transactions. Our data shows payment volumes at 3,493 billion in 2023f, having more than doubled over the preceding 10 years, while value will stand at $1,426tn – growth of 146% over the same period. At a global level, looking at commercial and consumer payments by volume we see clear evidence of the trends outlined above. Cash accounted for three quarters of payments by volume in 2013 but is expected to drop to a quarter in 2023f, replaced by mobile wallets as the dominant payment mechanism. Payment cards and direct debits will remain relatively steady between 2020 and 2023f, while cheques – already dwindling in usage in 2013 – will have all but disappeared by 2023f.

Figure 6: **Global transactions have increased steadily since 2013, both in terms of volume and value**



Source: GlobalData's *Payment Instrument Analytics*

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Share of value tells quite a different story. Here credit transfers dominate, accounting for a consistent 80% of all payments by value due to their dominance in high-value payments and especially in B2B payments. Direct debits and cheques compete for a modest second, while the mechanisms most likely to be used at the POS and for smaller, regular transactions together account for under 10%.

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Interchange and Merchant Service Charges

Analysis of select countries shows that the US has the highest interchange rate for credit cards. Other regional leaders include Argentina, Singapore, and Russia. Some of the lowest rates can be found in Europe, with most countries at 0.30%. However, China has the lowest rate at 0.07%. Generally speaking, in markets with dominant domestic payment schemes (like China with UnionPay's near-monopoly), interchange will be lower than in locations where the international schemes dominate (much of the rest of the world).

Reasons for interchange being set at its current rate vary by country. In Latin America, for example, a higher risk of fraud is linked to interchange rates being at a higher level (source: Emerging Payments Association).

Elsewhere, the high rate in Singapore is linked to a ruling by the country's Competition Commission several years ago. Asked by Visa to determine whether its interchange fee was in violation of local competition law, the commission ruled it was not anti-competitive and did not need to change. As a result, levels have remained high – at greater cost to merchants, but with a positive impact on payment revenue (source: TODAYonline). This is almost the exact opposite of the situation in Europe, where rates have been challenged almost constantly over the past two decades, resulting in legal action against Mastercard and Visa as well as rate suppression across the region by EU regulators.

In North America, the higher rates are more directly linked to loyalty and rewards. A boom in credit cards in Canada over the past decade was driven in part by the generous rewards used to boost acquisition. Higher interchange rates helped fund these schemes (source: Payments Canada). As a corollary to this point, when interchange fees are capped, generally issuers react by reducing the value of loyalty schemes and/or imposing account fees to compensate.

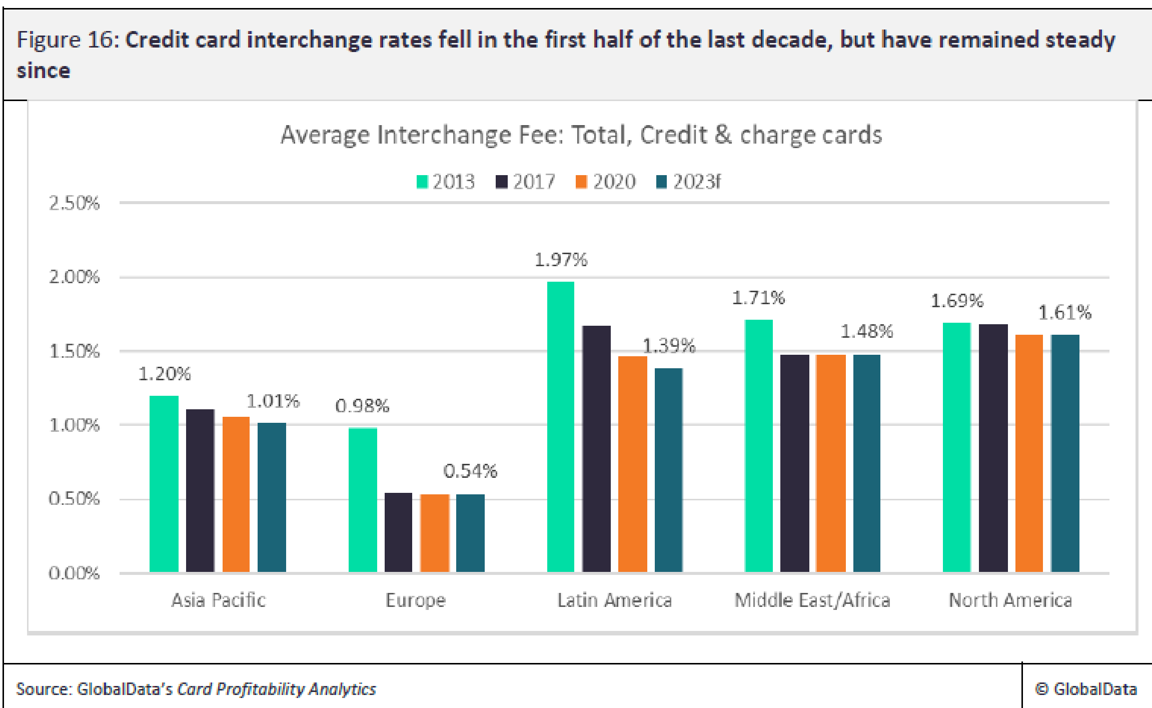

Figure 16: **Credit card interchange rates fell in the first half of the last decade, but have remained steady since**

Source: GlobalData's *Card Profitability Analytics* © GlobalData

Credit Card Profitability Challenges

Assuming interest rates remain largely unchanged over the next few years, country-level changes in behavior will have different degrees of impact on credit card companies' interest income. The US and the UK – both countries with traditionally high credit card usage – will see higher-than-average declines in rollover rate levels over the next few years, posing a significant risk to income. Countries where credit card use is less pronounced with lower rollover rates will see less of a decline, meaning interest income can be expected to be steady. Indonesia and the Netherlands are both forecast to see increases in already high rollover rates over the same period.

Threat of BNPL

The competitive threat from substitutions is another consideration for credit card providers. BNPL options at the POS are not a new concept, having been a mainstay of retail finance for several decades. But in recent years the financing of such deals has broadened beyond traditional banks and lending houses, with a number of new challengers emerging

Founded in Sweden in 2005, Klarna is a provider with a particularly strong presence globally with 90 million active customers and 250 merchants across 17 countries (source: Klarna). The app comes into play at the POS, where customer can choose from several payment options. These include: spreading the purchase cost over three months with no interest charged; paying for goods only when they are received; and a low-cost finance option across up to 36 months, which is interest-free if the full repayment is made in under six months (with a competitive interest rate on longer terms).

There are many other brands operating in this space. Notable examples include PayPal (PayPal Credit, Pay in 3, Pay in 4), Affirm (three interest-free payments, with longer periods available at low interest rates), and Afterpay (interest-free over six weeks). They all tend to advertise simplicity and transparency, stating that their services have no hidden costs or charges to surprise the customer. However, regulators in the UK have expressed concerns that consumers could become over-reliant on BNPL (which often includes small print relating to debt collection agencies if payments cannot be made) – echoing the rapid growth in payday loans that boomed in the country after the 2008 credit crisis .

Nonetheless, Klarna saw just under 1 million downloads in the UK in the first half of 2020, which is more than the total amount of downloads for the four next biggest BNPL apps combined. In the UK, BNPL has been used by over three in 10 people, which includes an increase in use during the pandemic and 8.6 million planning to use BNPL in the future. The payment method is especially popular with the millennial cohort (source Finder.co.uk). This group is less likely to have credit cards and is already more likely to be familiar with new payment options, so the concept is an ideal fit.

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