PAYMENTS INDUSTRY INTELLIGENCE

Payments
CARDS & MOBILE

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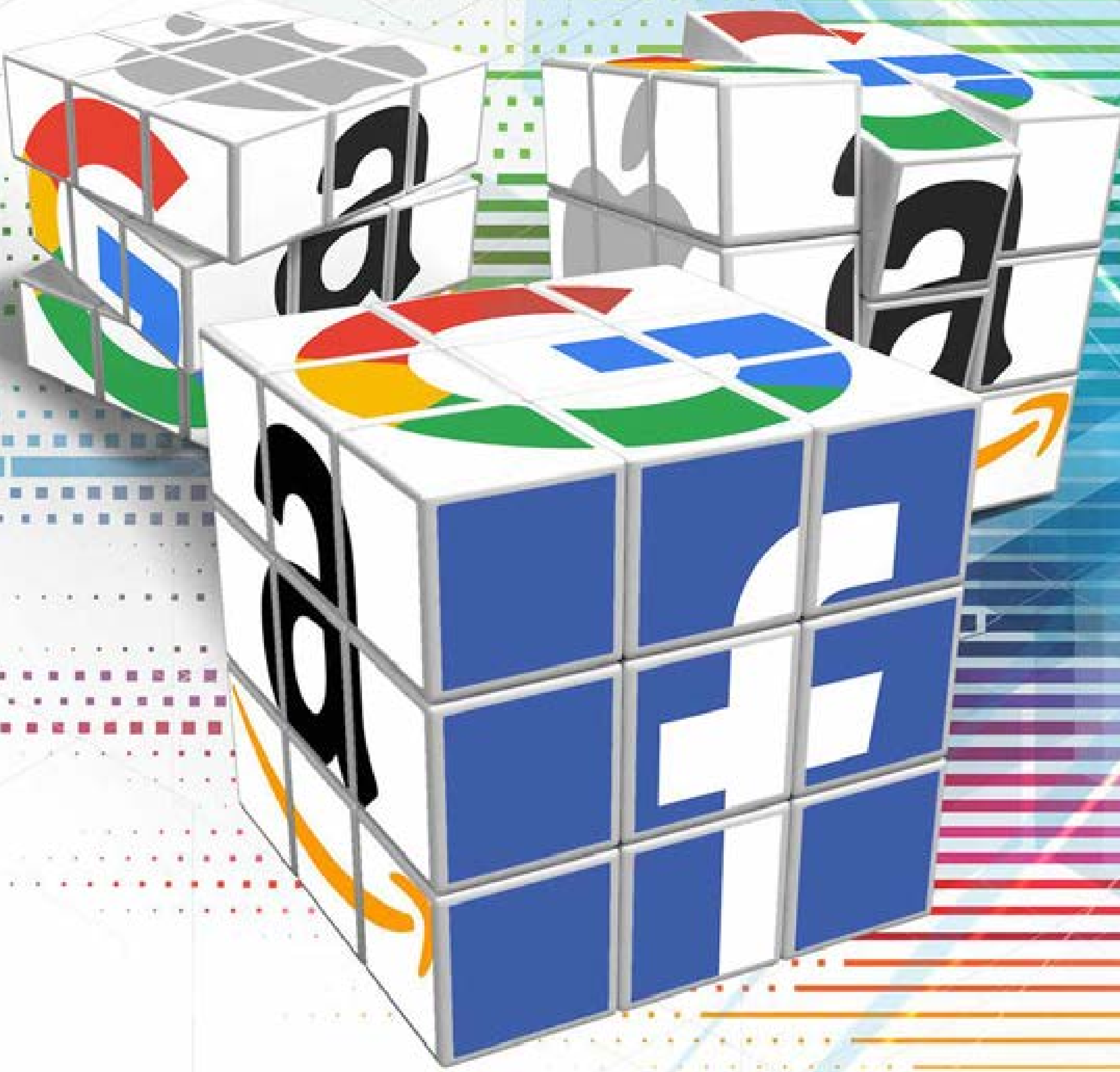
25 YEARS



COVER FEATURE

BIG TECH AND PAYMENTS

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by James Wood, PCM Editor

A late 2017 McKinsey study warned payments firms should be more worried about "Big Tech" than fintechs as a threat to their businesses. Since then, Facebook, Apple, Google and Amazon ("FAGA") have made further inroads into global payments. PCM Editor James Wood looks at recent developments, and asks whether Big Tech's relentless advance may be halted by regulatory concerns and consumer reluctance.

The attractions of payments for a new entrant are clear: rapid revenue growth over the next ten years, initiatives like Open Banking enhancing competition by favouring new entrants, and stability: people will always need to pay for things. Against these attractions, there's rising regulation (including five major pieces of US legislation since 2015); firmly established global brands with deep pockets and, worst of all, consumer inertia. When it comes to payments, people trust what they know.

Ideally, any new entrant would have enough cash and the marketing clout to take on existing giants such as Visa and Mastercard. They would also be fluent in emerging payment technologies like mobile and digital, and conversant with data privacy and consumer protection issues.

Enter Big Tech. By end 2018, the world's five largest brands were tech companies: Amazon, Apple, Google, Samsung and Facebook. They have the consumer recognition and financial muscle to make this kind of move work. Bloomberg Markets recently weighed in alongside McKinsey, describing the advent of big tech as a "nightmare scenario for US finance, should one of these companies succeed in replicating WeChat's success in the West."

Facing the Future

Although Samsung, IBM and Intel have all made moves into payments, with Samsung's mobile wallet targeting the company's device users, there's little doubt that the four tech giants known as "FAGA" are most aggressively targeting the entire payments spectrum, from virtual currencies to credit cards, intermediation services and P2P.

Facebook CEO Mark Zuckerberg made headlines last month with a new strategy including a specific intent to move into payments. This announcement comes as no surprise to those following the company: as of 31 December 2018, payments revenues at Facebook rose 42 percent year-on-year. Four months ago, the company announced the launch of "Facecoin", a so-called "stablecoin" – or crypto-currency linked to the US dollar. Facecoin allows users to transfer value person-to-person and make purchases across all of the company's plaforms.

Having previously purchased social media platforms WhatsApp and Instagram, Facebook intends to create a single platform for social messaging, imaging and payments across all of its platforms. Collectively, these platforms have more than 1.5 billion users around the world.

As a first step to realising these ambitions, the company has been trialling payments over WhatsApp in India since January 2018. Intended as a rival to PayTM, Facebook's Indian social media payments service has more than 1 million users. Whatever the platform, the huge advantage Facebook and other tech companies have in launching digital payments is the capacity to identify parties to any transaction through their own verification technologies, as well as behavioural data that acts like a virtual biometric, confirming the consumer is present and acting normally. As the physical and virtual worlds continue to merge, maintaining consumer identity on-line will be a massive benefit.

Apple Takes a Bite

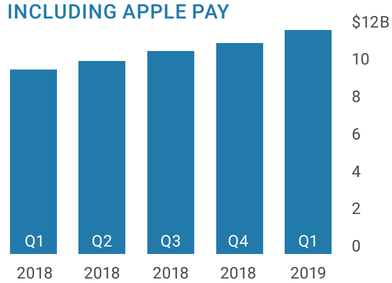
Facebook's competitors have not stood by watching. Though many have carped that Apple Pay is less successful than other wallets, one of Big Tech's distinguishing features is the capacity to lead a sustained, multi-year push into sectors ripe for disintermediation. In January 2019, Apple Pay announced all US Taco Bell locations and Target stores, some 11,000 locations, would accept its digital wallet – and also declared that Apple Pay now reaches 60 percent of US retail locations.

Since then, Apple has proceeded to notch further acceptance deals in France, Australia and Ireland that bolster its network. As Jennifer Bailey, Vice-President of Internet Services at Apple Pay, put it to *Time* magazine late last year: "Our aim is to replace the physical wallet altogether. Payments are something people do every day … this is all about making people love their iPhones."

Bailey's statement masks a more frank strategic intent – the need to make money for investors. Whether measured by growth rate or profit margin, Apple Pay is a growth machine, with revenue and profitability growth, if not raw dollar numbers, now outstripping Apple's hardware and software (see Figure 1). As Apple Pay continues its rise, the iPhone is faltering, with sales down 15 percent in Q4 2018. It's clear that Apple has watched the rise of digital P2P payment systems like AliPay and WeChat with interest.

As with Facebook, Apple believes it can deploy huge amounts of data from other customer interactions into the stringent identity required by payments. The meteoric rise of digital payments in China has only been made possible by that country's compulsory online ID system. In using data harvested from its devices to confirm the identity of parties to a transaction, Big Tech believes it can steal a march on banks and card networks still struggling with the issue of online security.

FIG 1 - APPLE SERVICES GROWTH - INCLUDING APPLE PAY



Source: Compay filings

Amazon: Before the Flood

If Big Tech is all about capturing customer data and translating this into the opportunity to pay securely, then the world's largest online marketplace should be best placed to lead the charge. Amazon's move into financial services is not limited to payments: in recent years, the company has launched a small-business lending platform offering loans of up to $750,000, with more than $3 billion in loans to 205,000 small businesses. A suite of personal insurance products – Amazon Protect – is now available, and the firm has begun establishing a physical presence to match its virtual dominance. Following its well-flagged purchase of WholeFoods, which integrated grocery payments with customer loyalty offers, the company set up 25,000 "Amazon Cash" kiosks in 7/11 and CVS stores across the US. Amazon Cash helps the underbanked to shop on-line by topping up their virtual amazon accounts using cash.

Amazon's financial services offering goes on – branded US credit cards with Citibank; debit cards in Mexico; government payments and charity subscriptions across France, Spain and Italy. If this sounds like the company has no clear strategy, think again: these products have two clear objectives. They deepen the customer's relationship with Amazon, and allow the firm to harvest as much information as possible about spending habits, building up strong customer identity. Amazon is so keen on customer information that they've enabled AmazonPay, their digital wallet solution, as a third-party proxy for other merchant websites: as the 1990's advertising slogan had it, for everything else – there's AmazonPay.

Eyes Agoogle

As this template of data redeployment emerges, the question of when consumers may revolt against being treated like cabbages on a data farm rears from the mist. Such revolts are not unfamiliar: Ireland's competition commission announced a preliminary study into Facebook and Google for monopolistic practices in late 2018, and 2020 US Presidential Candidate Elizabeth Warren has just called for FAGA to be broken up into smaller companies. If cynics believe this can't happen, they should consider the break-up of Standard Oil in 1911, which gave birth to Esso and Texaco. Standard Oil simply got too big for anyone's comfort.

In the payments world, Visa and Mastercard are no strangers to such accusations, with allegations of alleged anti-competitive practices echoing around the globe over the last twenty years. However, these allegations are yet to dampen Big Tech's enthusiasm for payments, least of all at Google.

Although the search giant may appear a blushing debutante next to more brash public statements by its peers, Google's comparatively low profile may speak to a more considered approach. Despite lagging behind Samsung and Apple in the US digital wallet market, with only 11 percent market share, GooglePay has now enabled P2P payments and debit payments for GooglePay, making it a comprehensive digital solution from physical wallet payments via tap to online debit. GooglePay is now more likely to be used for debit transactions than either Venmo or Zelle in the US, demonstrating customer enthusiasm for this model.

In January 2019, Google announced that it would be trialling non-tap contactless payments via Google HandsFree; at the same time, the company said it would offer tokenised card payments via GooglePay. These developments clearly aim to pick up market share in the digital and physical worlds, both from traditional card payments and P2P providers such PayPal and Square (See Figure 2).

Google has reserved its most ambitious moves for India, where it launched Google Tez (now rebranded GooglePay) in early 2017. Sitting on top of India's Unified Payments Interface, Google Tez immediately gained acceptance across India at all UPI locations. It offers instantaneous settlement of transactions at point of sale by transmitting a QR code over the air to acceptance terminals, doing away with the need for contactless software in the merchant terminal. One month after launch, the technology had been downloaded 8.5 million times and used for 30 million transactions.

India's Where It's At

India is proving to be a testbed for Big Tech's ambitions in global payments (See Figure 3). As the world's second-largest single market after China, India has great potential for new entrants to payments. So much so that a 2019 Credit Suisse study predicts the Indian payments market will quickly surpass the $1 trillion threshold. While dwarfed by China's $5 trillion market value, Credit Suisse note that local players dominate in China, making this a less attractive market. This may be why seven out of Amazon's eight private equity investments in payments went to India last year, with total value of $138 million – Big Tech sees India as a market where they can prove solutions for introduction elsewhere at a later date.

Customer Says No?

For all this enthusiasm and activity on the part of Big Tech, there are still many hurdles for tech firms to overcome as they seek to take on traditional payments players. As Mark Flamme, Managing Director at management consultants AlixPartners puts it, "Compliance and regulatory awareness remain weak spots for Big Tech firms. There are payments-specific risks they may have less experience of, such as KYC and credit risk – it's unlikely many senior staff at Facebook or Google have experienced the downside of a credit cycle."

Putting regulatory concerns to one side, perhaps the biggest challenge Big Tech faces is consumer reluctance. A fact little spoken of in Silicon Valley is that Facebook usage declined by more than 5 percent across all demographics in the US last year (See Figure 4) as consumers became aware of how the company was using their data.

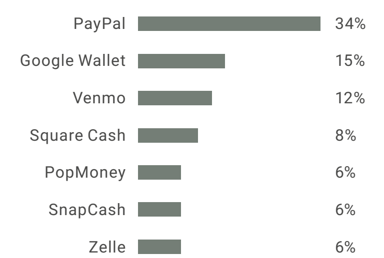
It's also likely that players with locally-dominant positions, such as Russia's YANDEX search engine or the online marketplace Alibaba in China, are going to move into adjacent markets with linguistic and cultural connections. And alternate players like Firefox and DuckDuckGo in search are gaining traction as the campaign against Google's dominance continues.

Meanwhile, politicians across the developed world are ramping up the campaign against Big Tech, with German lawmakers limiting Facebook's capacity to gather data in February 2019 and CNN and *The Guardian* in the UK both calling for all four companies to be dismantled. Google is now the subject of three separate monopolistic practice investigations in the EU, and *Forbes* magazine recently described Amazon as "ingenious" for managing to avoid similar accusations for so long.

Indeed, the departure of 11 senior managers from Facebook and analyst downgrades based on impending regulatory action have seen the company's shares drop by around three percent in recent trading on the NYSE. Wall Street brokerage analysts Needham have downgraded the stock from buy to hold, with analyst Laura Martin writing that Facebook's pivot towards addressing privacy concerns and encrypted messaging, alongside rising regulatory risk, will accelerate the management exodus in what she called a "Negative Network Effect." Although some commentators see clear revenue opportunities for Facebook and other big tech firms in the payments space, it's by no means a given that regulators will allow the tech giants to become any more powerful than they already are today.

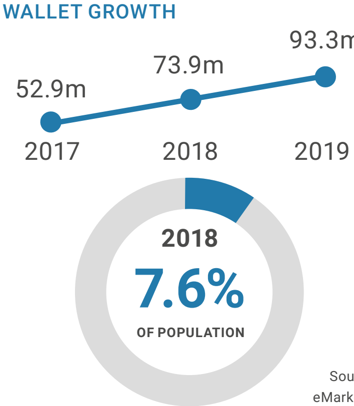
Business concerns aside, some consumers have organised a boycott of Facebook after it allowed the live streaming of a terrorist attack in New Zealand. Add growing cybersecurity concerns to these levels of consumer action, and it's hard to imagine consumers giving their payments information to companies who treat them like captives in cages, able to view their personal information from any angle and, in some markets, without their explicit consent. Yet Big Tech does offer a solution to a seemingly intractable problem – how to unlock the power of digital payments by easily and quickly confirming the identity of all parties in an online transaction. Solving this problem goes to the heart of one of the biggest issues of our time – the extent to which consumers are prepared to surrender their personal information in exchange for faster, better and cheaper services.

FIG 2 - IF P2P PROVIDERS OFFERED A GENERAL USE DEBIT CARD



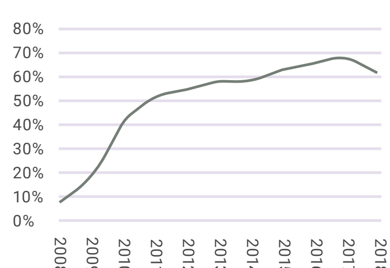
Source: Cardlytics

FIG 3 - INDIAN MOBILE WALLET GROWTH



Source: eMarketer

FIG 4 - US FACEBOOK USERS DECLINING



Source: Statista