Innovation begins at home

John Chaplin

Auspaynet Summit, December 2019
Key questions about domestic payments organisations

- Do they have the potential to innovate?
- Who cares and why?
- What determines their success or failure?
Where is most innovation happening?

<table>
<thead>
<tr>
<th>Region</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>ASIA</td>
<td>64%</td>
</tr>
<tr>
<td>EUROPE</td>
<td>14%</td>
</tr>
<tr>
<td>AFRICA</td>
<td>12%</td>
</tr>
<tr>
<td>NORTH AMERICA</td>
<td>8%</td>
</tr>
<tr>
<td>LATIN AMERICA</td>
<td>2%</td>
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</tbody>
</table>

Global Jury view on the top region for innovation.
Before the goldrush there was less competition

International schemes
Major focus on international transactions

Shared mag stripe technology
Mutual business model
Overlapping ownership
Acceptance of each other’s role

Domestic schemes
Exclusively focussed on domestic transactions
Demutualisation changed everything

**International schemes**
- For profit listed companies
- Targeting domestic transactions
- Major investments in innovation

**Domestic schemes**
- Remained as mutuals
- Stayed close to market needs and regulators
- Low cost utility model
How have domestic payments companies responded?

Rest in Peace

Ireland

Netherlands

UK
How have domestic payments companies responded?

Birth announcements

Brazil

Turkey

India
Domestic payments companies must play the innovation game
Domestic payments companies must play the innovation game

Have they got the tool kit?

Business model

Board support

Investment funds

Human resource
Business model and board support

Following the same route as international players.

SCHEME & SWITCH OWNERSHIP

- 16% Private investors or listed company
- 84% Bank owned
Business model and board support

PRESSES FROM BOARD/OWNERS FOR INNOVATION

Jury score
- High: 16%
- Medium: 84%

And/or pushing management to innovate
Investment and staffing

**INNOVATION STAFFING LEVELS**

<table>
<thead>
<tr>
<th>Percentage</th>
<th>None</th>
<th>1 to 3</th>
<th>More than 3</th>
<th>None - part of everyone's responsibility</th>
</tr>
</thead>
<tbody>
<tr>
<td>% of Orgs.</td>
<td>10%</td>
<td>30%</td>
<td>60%</td>
<td>10%</td>
</tr>
</tbody>
</table>

**PUT YOUR MONEY WHERE YOUR MOUTH IS**

**HOW INNOVATION IS FUNDED**

<table>
<thead>
<tr>
<th>Funding Source</th>
<th>% of Orgs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Innovation budget funded from ongoing organisation</td>
<td>70%</td>
</tr>
<tr>
<td>Specific initiatives approved and funded by members</td>
<td>50%</td>
</tr>
<tr>
<td>No significant budget - rely on external partnerships</td>
<td>10%</td>
</tr>
</tbody>
</table>
Who cares if domestic payments organisations succeed?

Payment service providers

Retailers

Government/regulators

MAIN BENEFITS OF DOMESTIC SCHEMES

- Market Specific Service: 33%
- Lower Overall Cost: 33%
- Local Decision Making: 22%
- Other: 12%
How can costs of domestic & international providers be compared?

With great difficulty

Significant rebates for some players

Highly complex tariffs

Different usage cases

Combination of service fees & transfer payments
How can costs of domestic & international providers be compared?

For similar domestic transactions
Issuer and acquirer combined
Net of all incentives & rebates
Excludes interchange as a transfer payment
How can costs of domestic & international providers be compared?

Conclusions – scheme fees

Domestic providers have a significant cost advantage at total industry level

Position for individual players can differ from total industry

No inference that costs and value are tightly connected

For similar domestic transactions
Issuer and acquirer combined
Net of all incentives & rebates
Excludes interchange as a transfer payment
How can costs of domestic & international providers be compared?

Retailer perspective

.....is different from payment service providers’ viewpoint

But scheme fees are rising and now exceed interchange in some markets

The source of most competition authorities’ concerns because interbank transfer payments are imposed on retailers

Lower interchange offered by most domestic schemes is attractive to merchants but harmful to issuer economics
What do regulators want?

AND A LEVEL PLAYING FIELD?
Different country policy makers have different objectives

Morocco
Single non-bank owned infrastructure for cards & mobile payment

South Africa
Maintenance of in-country switching capabilities

India
National self-sufficiency in payments

Turkey
Reduce international influence on domestic economics

Russia
Freedom from US influence

Canada
Low cost debit card payments
What do regulators get?

Using domestic players as enabler for policy:
- More supportive: 47%
- No change: 50%
- Less supportive: 3%

Unchecked competition can be counter to policy objectives:
- M-PESA dominance of mobile payments in Kenya
- UK debit card market dominance by Visa
- Upwards pressure on USA card interchange
- Migration of South African switching to international systems
Where are domestic payments companies looking for gold
Where payments innovation can go wrong

“We didn’t do anything wrong, but somehow, we lost.”

Why FinTechs Fail

- Not a major improvement over existing solutions
- Overestimate market size
- Competition from other new players
- Incumbents fight back
- Regulation
Where payments innovation can go wrong

“We didn’t do anything wrong, but somehow, we lost.”

WHY SCHEMES AND SWITCHES FAIL

<table>
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<th>% of schemes</th>
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<tbody>
<tr>
<td>70%</td>
</tr>
<tr>
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<td>40%</td>
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<td>20%</td>
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<tr>
<td>10%</td>
</tr>
<tr>
<td>0%</td>
</tr>
</tbody>
</table>

- Banks do not use the new service
- Decision making process too slow
- Don't have the required mindset & skills
- Unrealistic board expectations
- Run out of money
Domestic payments gold finders?

**Norway**
Combination of multiple services (card scheme, mobile payments, identity)

**Brazil**
ELO maximizes profit and influence for banks

**India**
UPI for account to account, identity with Aadhar, and Rupay with transport strategies
Nuggets to take away

- Domestic players need to act commercially & must innovate
- Regulators play a critical role in maintaining a competitive market – payments & competition regulation should align
- Some domestic organisations are innovating very successfully
- The best market outcomes are achieved by a mix of strong domestic players and international schemes
Reports: www.innovationjury.com

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