strategy&

Future of payments in Australia

&

The future of transaction banking and payments in 2020

pwc

Contacts

Eduardo Arnoni
Partner
+61 477 014 774
+61 (3) 8603 0896
eduardo.arnoni
@pwc.com

Chuck Lyman
Partner
+61 400 279 358
+61 (3) 8603 1064
chuck.lyman@pwc.com

Robert Allen
Director
+61 (2) 8266 1636
robert.k.allen@pwc.com

Shirish Jain
Director
+61 499 883 342
+61 (2) 8266 4710
shirish.jain@pwc.com

Evan Hinchliffe
Senior Manager
+61 406 997 566
+61 (2) 8266 0567
evan.hinchliffe@pwc.com

Kunal Guha
Manager
+61 413 711 847
+61 (3) 8603 0409
kunal.guha@pwc.com

Table of Contents

1. Executive summary

Disruption across the payments industry is still in its early stages: what seem like small shifts now are set to result in a drastically changed landscape by 2020.

With payments and transaction banking services almost the defining feature of a financial institution, it is critical for these institutions to differentiate and selectively innovate to remain front-of-mind for their customers.

Here, we aim to answer the key question, 'What will be the future of transaction banking and payments in 2020 as a result of these disruptive forces?'

2. Payments today – a changing world

Payments (including transaction banking offerings) are at the centre of everyday banking. They generate around 25 per cent of all revenue in the Australian financial system and are one of the most critical attributes customers look at when choosing financial institutions. They provide stable earning through the business cycle and generate superior return on equity, essential as the market evolves towards stronger capital requirements.

However, the current payment system is outdated (slow to settle, hard to reconcile and cumbersome to send and receive) and the ecosystem is evolving rapidly. The world of payments will look very different in the next five years. We should expect changes not only in the way we conduct transactions, but also in the way we conduct commerce more broadly.

Five main forces will play the biggest role in shaping a new world of payments in Australia:

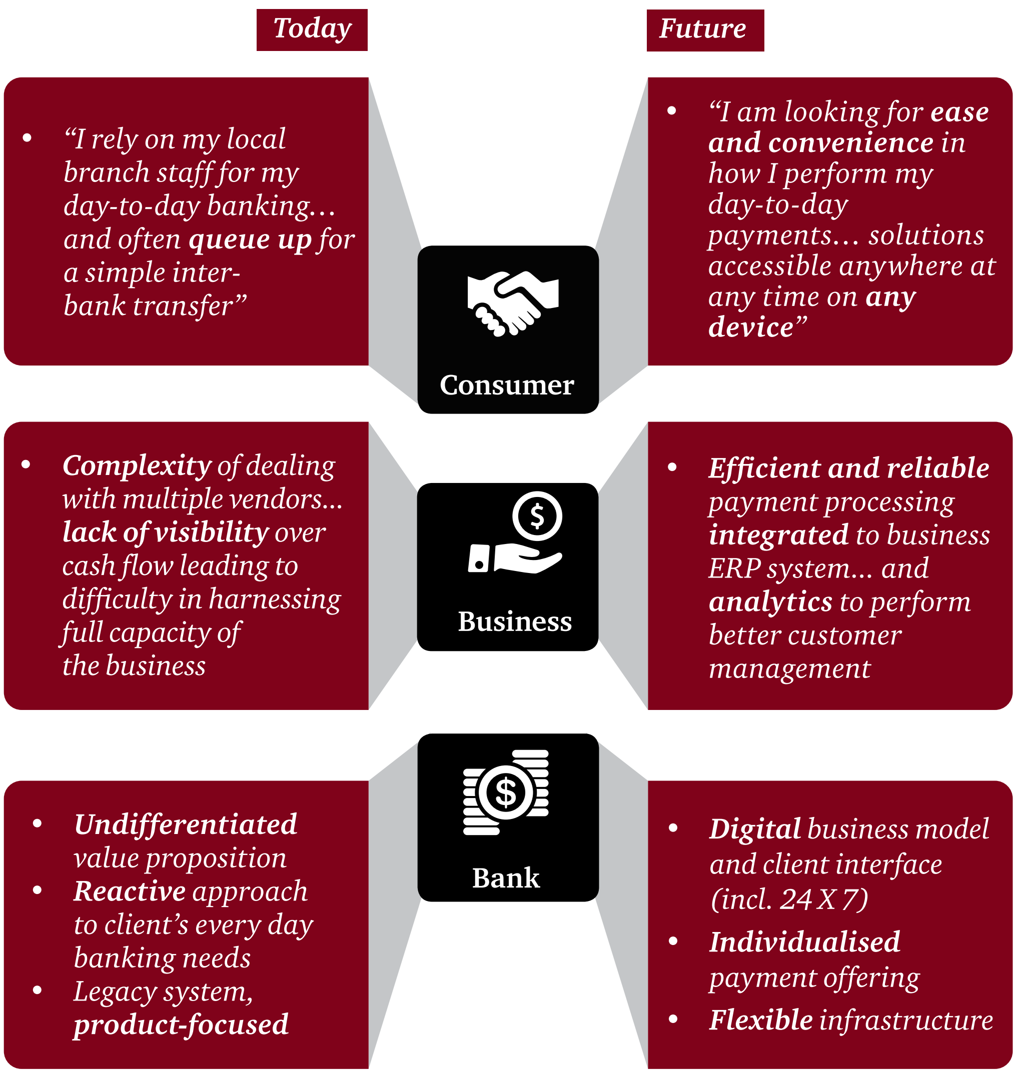
2.1. Customer demand for greater personalisation

The advent of digital, mobile and social media has integrated finance into the daily life of the individual in a way it never was before. The traditional payments customer persona is fast being replaced by one that expects a personalised experience from banks similar to that of other industry players, like Apple, Vend or Level Up.

Digital natives, oriented towards convenience and practical usability, will become the majority of clients in the near term. More and more, consumers will expect a differentiated experience from banks: convenient, always on, personal and proactive in understanding and anticipating their needs. For example, a bank could use data analytics that draws insights from a consumer's previous transactions to predict future needs and then send real-time offers to their banking app for a store they are walking past. However, reliability and security must not be compromised in the process. Privacy, data protection and digital identity are increasing concerns for both consumers concerns and regulators.

What will be the future of transaction banking and payments in 2020 as a result of disruption across the payments industry?

On the business side, clients increasingly expect the same speed, simplicity, and insights they get as consumers. Business will move towards integration and simplicity, seeking a ‘one-stop shop’ for business payment solutions and insight-driven, tailored services. For example, a bank could advise a cash management client to pay their overseas supplier in euros instead of dollars at the time the client pays an invoice, based on currency fluctuations and tracking the company’s seasonal trends. Changing expectations around payments and transaction banking from both consumers and business are illustrated below.

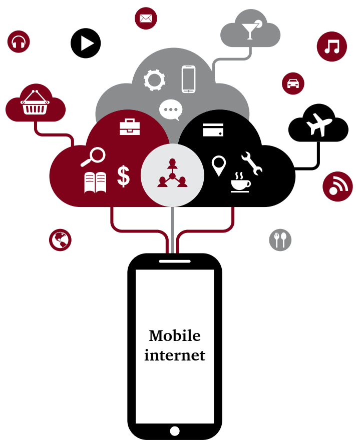


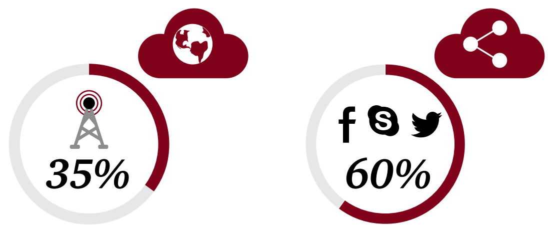
To meet these changing demands, the payments industry will need to keep a vision of the overarching customer experience at the heart of its business.

Payments generate nearly 25% of all revenue in the Australian financial system and are one of the most critical attributes customers look at when choosing financial institutions

2.2. *Technology advancements*

What was previously considered highly sophisticated, niche infrastructure is now a commodity.





Mobile internet is in the hands of more than ***35 per cent*** of the world's population, more than ***60 per cent*** of adults worldwide use social media, and authentication through retina scans and biometrics is already a reality.

These advancements are turning what used to be a discrete payment action – swiping a card – into a single step for everything from marketing at the front end to in-depth analytics at the back end. Between now and 2020, the shift to insight around digital commerce will keep accelerating, establishing a new paradigm where banks, card providers and retailers see more, know more, and exchange more data about customers (consumer and business) than ever before. Indeed 90 per cent of the world's data has been created in the last two years –using this data effectively is the next step forward.

2.3. *Globalisation of commerce*

Proliferation of trade and commerce across borders is creating new challenges for business, and in turn, opportunities for payment-chain participants to find innovative solutions. This is especially so in the Asia-Pacific region, which has experienced higher growth in trade flows than any member country's individual GDP. This is likely to continue in the near future, increasing supply chain complexity for companies operating across borders and creating demand for banks with new capabilities around seamless interfaces, the correspondent banking network, foreign exchange agreements and management of multiple countries' regulatory and compliance requirements, just to name a few.

90 per cent of the world's data has been created in the last two years –using this data effectively is the next step forward

Globalisation offers growth opportunities for Australian banking in emerging economies, particularly with increased trade flows with China. However, to capture these opportunities the banks will need to invest in developing the required capabilities. Not doing so risks conceding premium fees to the Payoneers, PayPals and Western Unions of the world.

2.4. Increasing regulatory requirements

The New Payments Platform (NPP), an industry-led, government-backed program to deliver real-time, data-rich payments is in development and has the potential to both create new business opportunities and disrupt some of the current offerings. By enabling faster payments, NPP will minimise the need for cheques and provide an alternative to some BPAY and Direct Entry transactions. In the long run, it could also become an alternative to credit card schemes transactions.

NPP can create new offerings in the transaction banking and payments space by leveraging the rich data transmitted along with the value transfer itself. For example, processes such as reconciliation could be simplified, and insights could be used to provide more targeted offerings. Some verticals, such as health, superannuation and others, could have customised offerings through the NPP infrastructure.

However, in order to capture the full value from NPP, industry players will have to make some significant investments and, not surprisingly, will need to adapt their operating models. 24/7 service expectations, better information management and revised fraud management procedures are new requirements for the industry.

In addition to NPP, banks must respond to new technology companies entering the fray, like Square, Ripple and Xero, while complying with the increasing regulatory requirements. These technology companies move quickly, often below the regulatory radar, to exploit what they see as a slow-moving, antiquated payments infrastructure.

The regulatory agenda is now at the top of business priorities with particular focus on customer data protection, technical payment standards, interchange pricing and money laundering.

Technology companies are moving quickly, often below the regulatory radar, to exploit what they see as a slow-moving, antiquated payments infrastructure

2.5. Disintermediation

As mentioned earlier, several non-traditional players are disrupting the market with payment solutions and platforms that address friction points and changing consumer behaviour. It’s now commonplace to make a payment through our smartphone, sometimes not even noticing we are paying as we leave the taxi or ask for a coffee.

In the future, we might use our social network to send payments the way we send messages. Businesses may see the software provider as their main financial relationship. Blockchain could become the new standard for cross-border payments and cryptocurrencies or ‘altcoins’ could be the solution to micropayments.

Participants in the payments value chain need to think about exchanging payments more quickly, yet just as securely as before – and using digital currencies that did not exist a few years ago. They will need to support a growing volume of cross-border transactions. And while they comply with different legal and regulatory demands, they must also strive to create business models that serve customers above all. It is perhaps an unprecedented balancing act – but one that payment-chain companies will not be able to avoid. Organisations in Australia have not been standing still, especially in the Fintech space. Over the last 18 months, the big four banks have all announced a venture fund or some form of incubation space, not to mention the independent, not-for-profit Fintech hub Stone and Chalk, launched in 2015.

Innovative and non-traditional competitors will be increasing their market share to up to 10% of revenues by 2020

3. Payments 2020

The forces shaping the future of payments in Australia will have effects on the revenue potential for the players in 2020. The future market is likely to see close to stable growth in revenues (i.e. less than 1 per cent per year) despite growing volumes, due to the transition from physical to electronic payments.

Pricing will be affected by the shift in mix and pressure from regulators and new entrants. The consumer segment is likely to feel a greater impact from pressures on price and the migration from credit to debit (which lowers revenue growth rates for banks) than the business segment.

Innovative and non-traditional competitors (e.g. large technology players, tech start-ups, telecommunications and retailers), although still emerging, will be increasing their market share to up to 10 per cent of revenues by 2020.

New developments in the market will enable payment-chain participants to access and compete for new revenue streams. For example, there is enormous potential to commercialise understanding of the entire digital commerce lifecycle, beyond just the payment event: how people research purchases, what they eventually buy, how they pay for it, how frequently they return items and how to enhance their experience. System-to-system integration will become a reality with ISO 20022 developments and payment-chain participants could benefit by providing value-added services to business customers.

Players not typically associated with payments will drive significant investment in new solutions that increase customers convenience – e.g. transportation companies looking at account-based solutions or government departments (Health, Human Services, etc.) investing in new business models and platforms.

Traditional financial services providers in Australia must embrace change to serve consumers and corporate customers or risk being pushed further from their customers' minds. With that aim, the Australian Payments Council launched the Australian Payments Plan in December 2015 – a roadmap for payments system improvements over the next ten years. The Plan articulates three core themes:

New developments in the market will enable payment-chain participants to access and compete for new revenue streams

- **Security and trust**: establish principles for digital identity and data management; lead the development of robust cybersecurity strategies and frameworks

- **Managing Australia's payment mix**: modernise payments to support more convenient payment choices; develop strategies for a 'less cash' society; offer collaborative solutions to payments development

- **Enabling the future**: promote an environment where innovation can flourish.

Below the industry level, we have identified seven key imperatives for financial institutions to capitalise on these changing trends and be positioned to capture growth:

1. **Streamlined operations**: rationalise traditional payment streams and deliver on NPP requirements, driving efficiency.

   Although innovation captures significant attention and investment within organisations, doing the basics right is still extremely important for most players. Simply improving client acquisition, on-boarding and servicing can boost efficiency and client stickiness, building up the resources needed for investments in new propositions.

   There are massive challenges to meet in fulfilling the requirements of the NPP on time and within budget. Expectations from customers will require changes to the operating model to create with a seamless and frictionless 24/7 experience, and to incorporate information management as a new capability.

   Furthermore, economic corridors will change and financial institutions will have different economics such as revenues and cost structure depending on the payment method from credit card to direct entry.

2. **Customer-centric business model**: putting customer needs first.

   Payment-chain participants will need to shift their perspective from the services they provide to the services customers need in order to provide true customer-centricity. If what banks offer is a commodity, then they will have to start thinking not just in terms of customers' interactions with the bank, but services that customers currently

While commerce is increasingly global, consumer payments will almost always be handled locally at the point-of-sale perform internally. This new perspective results in deeper insight into customers and how their businesses work. It's a way for payment-chain participants to deepen the customer relationship in ways that have never been done previously.

3. **Digital ecosystem leveraging improved data analytics:** use of analytics and mobile platforms to simplify and derive greater insights about payment transactions.

   Mobile payments, digital wallets, personal financial management, and smart POS are more and more common within the payments space. While these have individual benefits, they cannot achieve their full potential unless they operate in conjunction. When payment-chain participants manage to create an ecosystem encompassing these platforms and information, new opportunities will emerge.

   In retail, for example, new information will be captured beyond what was purchased and for how much; payment-chain participants will be able to see how consumers were enticed into a purchase and how loyal a customer they become. Even more interestingly, participants will have the ability to aggregate and quickly analyse information about customer purchases in a way that isn't possible today. For instance, retailers know what items consumers buy, but only what's been purchased in their stores. Card companies know how much consumers spend at each retailer, but not the individual items they buy. Technology companies have insights into other products consumers have already researched. Aggregating this information will be powerful.

   When payment-chain participants make better use of data, they will be able to personalise offers to specific customers at scale, and to correlate demographic behaviour to larger groups. They will see, for example, that one type of promotion works better with customers under 30 using smartphones, while others work better with customers over 50 using the web. They will be able to leverage geo-location technology to extend geographically customised offers to customers.

Payment-chain participants with the highest potential for success in this new world will be those who understand how to use data to gain deeper understanding of behaviour before and after the transaction

4. **Business payment solutions**: new solutions for businesses to drive in-depth customer relationship and revenue growth from services.

   Imagine a player that could provide businesses with a one-stop integrated solution catering to day-to-day operational, financial management, banking and payments needs, encompassing invoicing, billing, working capital management, auto-reconciliation, customer management and loyalty, accounting, tax reporting and inventory management. Businesses are already asking for these types of solutions to simplify business administration. Although requiring a larger investment in data analytics capabilities, new technology and information protocols can make such propositions viable.

   With the insights payment-chain participants can glean from more data, they must create more value-added services for retail and commercial customers, and for potentially new, non-customer consumers of data. These will relate to forecasting, trending and advisory services. They will have to go beyond basic cash management advice to deeper issues, such as when to accelerate payments based on currency valuations and other information.

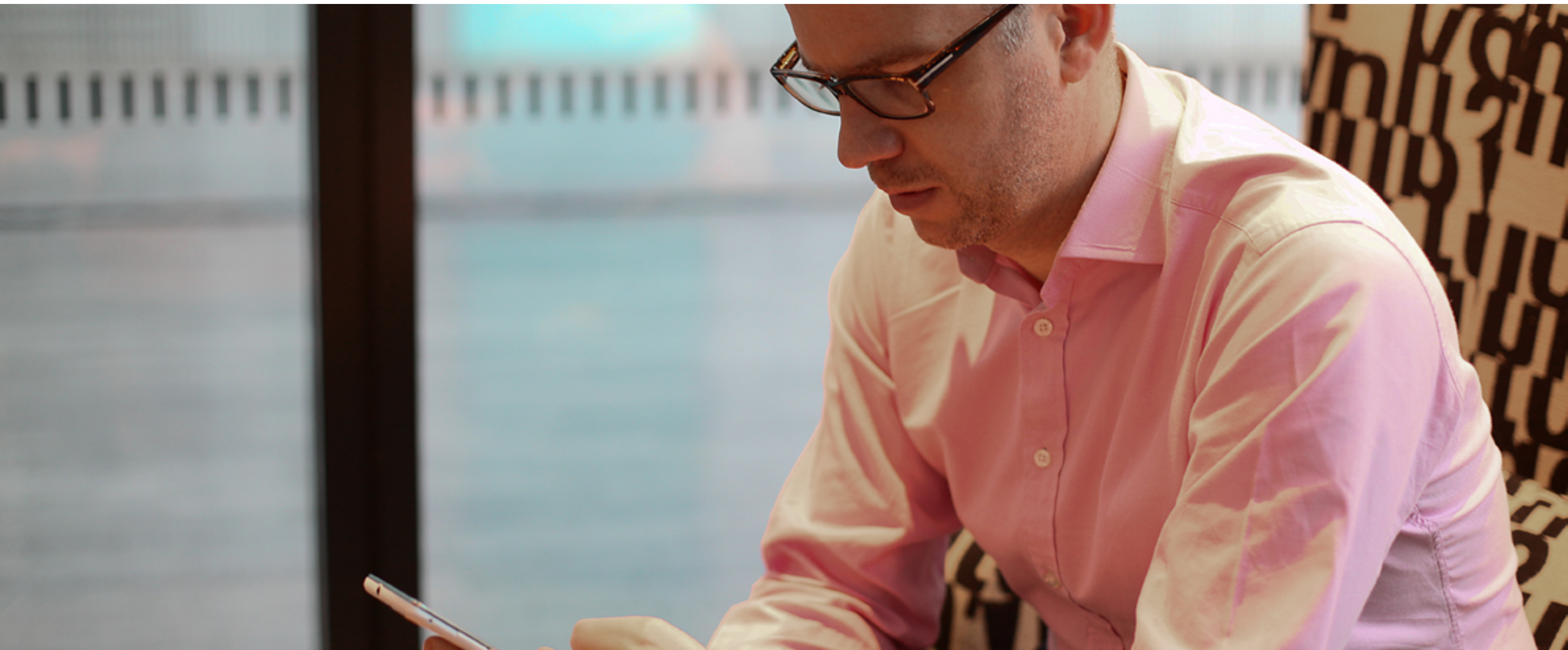
5. **Simplified cross-border payment system:** support for globalisation.

   The strong growth of international trade, particularly within the AsiaPacific region and between Australia and China is likely to continue for some time. How payment-chain participants should respond to the challenges is still unknown. The innovators (e.g. blockchain, digital currencies) will have to learn how to exist in the regulated world, and banks must learn to take advantage of innovators' advances to upgrade infrastructure and further develop capabilities linked to yuan-denominated trade. By working together on security issues, they will both be able to maintain customer confidence.

6. **Open innovation**: recognition that banks need partnerships for faster innovation and open up underlying platforms with APIs to allow plug-and-play data exchange.

   Banks will need to stop being averse to non-proprietary solutions and work closely with outside partners, especially technology partners who can bring speed and agility to the innovation process. Because more and more products are going to be joint ventures with outside companies, payment-chain participants will need to change their organisational dynamics; functions like risk and IT will need to be involved earlier, and have a greater say in the product development process. Product ideas will have to be vetted with a wider range of stakeholders, since third parties will introduce operational, reputational and financial risks. Privacy, data protection and digital identity frameworks and regulations will have to be enhanced to cope with a more complex and open environment.

7. **Underlying infrastructure**: like many developed markets around the world, Australia's payments systems – many of which were conceived and architected in the 1970s and 1980s – have been holding back innovation and the full realisation of the experience economy. New infrastructure and technology will create new opportunities for the banks. NPP and its overlay services will enable real-time, low-value payments between financial institutions. The potential of blockchain and distributed ledgers is still to be seen, but financial institutions can benefit from innovative solutions and a more efficient infrastructure. It is time for each bank to have robust discussions around which technologies will be part of their future architecture and how to capitalise on industry innovations.



4. Final notes

What will the world of payments look like in 2020? Even with unprecedented change, some facets of the payments industry are immutable. First, while commerce is increasingly global, consumer payments will almost always be handled locally at the point-of-sale. But payment-chain participants must consider the entire value chain, including where transactions and payments start and finish (and the increasing likelihood that this will be a mobile device).

Many players in this process have a lot to lose in the new world of payments. As processes become digitised and paper becomes less necessary, some services will become obsolete. With all the attention on the soft spots in the payment value chain, any system that can be disintermediated by innovation probably will be. The transition will be most difficult for those who cannot shift their thinking.

The payment chain will be so complex that no single entity will be able to control every element of it. That means partnerships will be crucial, especially for regional and national banks that will need to compete with global banks and address their own inexperience with innovation. Technology companies have the culture and the financial wherewithal to try new things and fail; banks do not. Only through partnerships will payment-chain participants be able to make the leap from incremental to breakthrough innovation.

Payment-chain participants with the highest potential for success in this new world will be those who understand how to use data to gain deeper understanding of behaviour before and after the transaction. Those who can gain this insight while remaining an invisible, or at least frictionless, part of the purchase will have an advantage. And they must understand how to use this data to personalise services for customers.

A new world awaits, and to thrive in this dynamic and challenging climate, banks will need to selectively innovate while defending their core.

Emerging markets – driving the payments transformation

Setting the pace

Over the next ten years (and beyond) we're set to see even faster changes in the payment landscape building on the accelerating growth in electronic payments and the advent of new and disruptive market players. Emerging markets will be at the forefront of this payments transformation.

The emerging markets are home to 85% of the global population. India and China's 2.5 billion people alone represent more than a third of the world's population, making even modest market developments in fast growing companies extremely significant. Customer expectations are driving a significant change in the payments industry in these countries. The young 'tech-savvy' populations of the emerging markets will lead the shift in payments expectations among retail and commercial consumers.

More than 50% of consumers in the age group 18-24 are likely to try new technology-enabled payment tools.

The dynamic nature of emerging markets and their ability to leapfrog developments in mature markets creates challenges that have never confronted the developed world but also opens up opportunities for innovation and to set the pace for markets worldwide. Payment platforms will evolve from being commoditised propositions to strategic solutions that complement and add value to people's lifestyles.

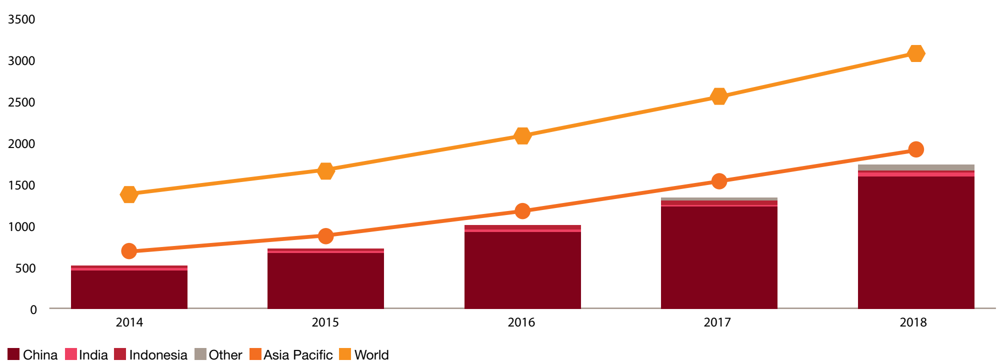
In comparison to Australia, here's a snapshot of what's happening in payments transformation across emerging markets

Customer adoption and a rise in e-commerce driving the pace of change

With the continued development of online purchase tools and increasing consumer acceptance and confidence, emerging markets are driving the ongoing global acceleration of e-commerce spending. One of the major drivers of this growth has been the proliferation of smartphones and tablets which is serving as a convenient, cash free and card-free financial transaction medium. What we're seeing is rapid development of new payment concepts and business structures based on mobile infrastructure initiated by online retailers and payment service providers.

Increased convergence and integration between e-commerce and mobile technology have radically changed the shape of the payments marketplace. Globally e-commerce is a vast and rapidly growing market (See Figure 1).

Figure 1: Retail e-commerce sales in Asia-Pacific countries 2014-2018E, $Bn



Source: eMarketer, 2015

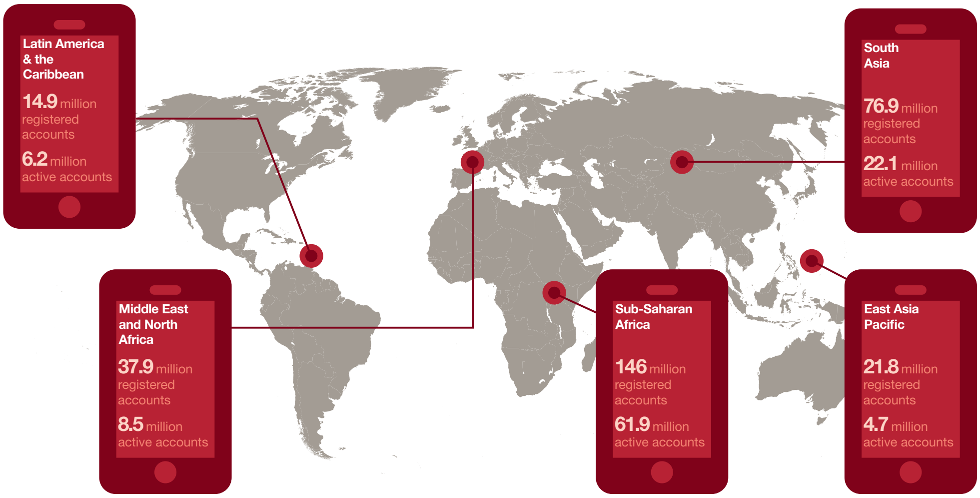
Rapidly growing mobile technology

Mobile financial technology providers are leveraging the familiarity of the mobile device across the emerging markets, coupled with the assurance of security and ease of use to provide impetus to the growing cashless economy supported by regulators.

Increasingly companies are creating smartphone apps that not only significantly reduce reliance on traditional payment processes but also provide a unique customer experience and increase engagement by smoothing traditional friction points.

In markets such as India, China and Nigeria, the growth of mobile penetration has had a massive impact on financial inclusion, with people moving from no previous banking history to being able to make payments via a mobile phone. Emerging markets will be at the forefront of innovation and the adoption of mobile technology for payments. The figure 2 below shows the number of mobile money accounts in emerging market across the world is a testament to this.

Figure 2: Number of mobile money accounts in emerging markets



Source: State of the Industry report on Mobile Financial, GSMA 2015

For more details and case studies of Emerging Markets driving the payments transformation, read the full report: www.pwc.com.au/fofs2020

Strategy& is a global team of practical strategists committed to helping you seize essential advantage.

We do that by working alongside you to solve your toughest problems and helping you capture your greatest opportunities.

These are complex and high-stakes undertakings—often game-changing transformations. We bring 100 years of strategy consulting experience and the unrivaled industry and functional capabilities of the PwC network to the task. Whether you're charting your corporate strategy, transforming a function or business unit, or building critical capabilities, we'll help you create the value you're looking for with speed, confidence, and impact.

We are part of the PwC network of firms in 157 countries with more than 208,000 people committed to delivering quality in assurance, tax, and advisory services. Tell us what matters to you and find out more by visiting us at strategyand.pwc.com.

www.strategyand.pwc.com

127041452