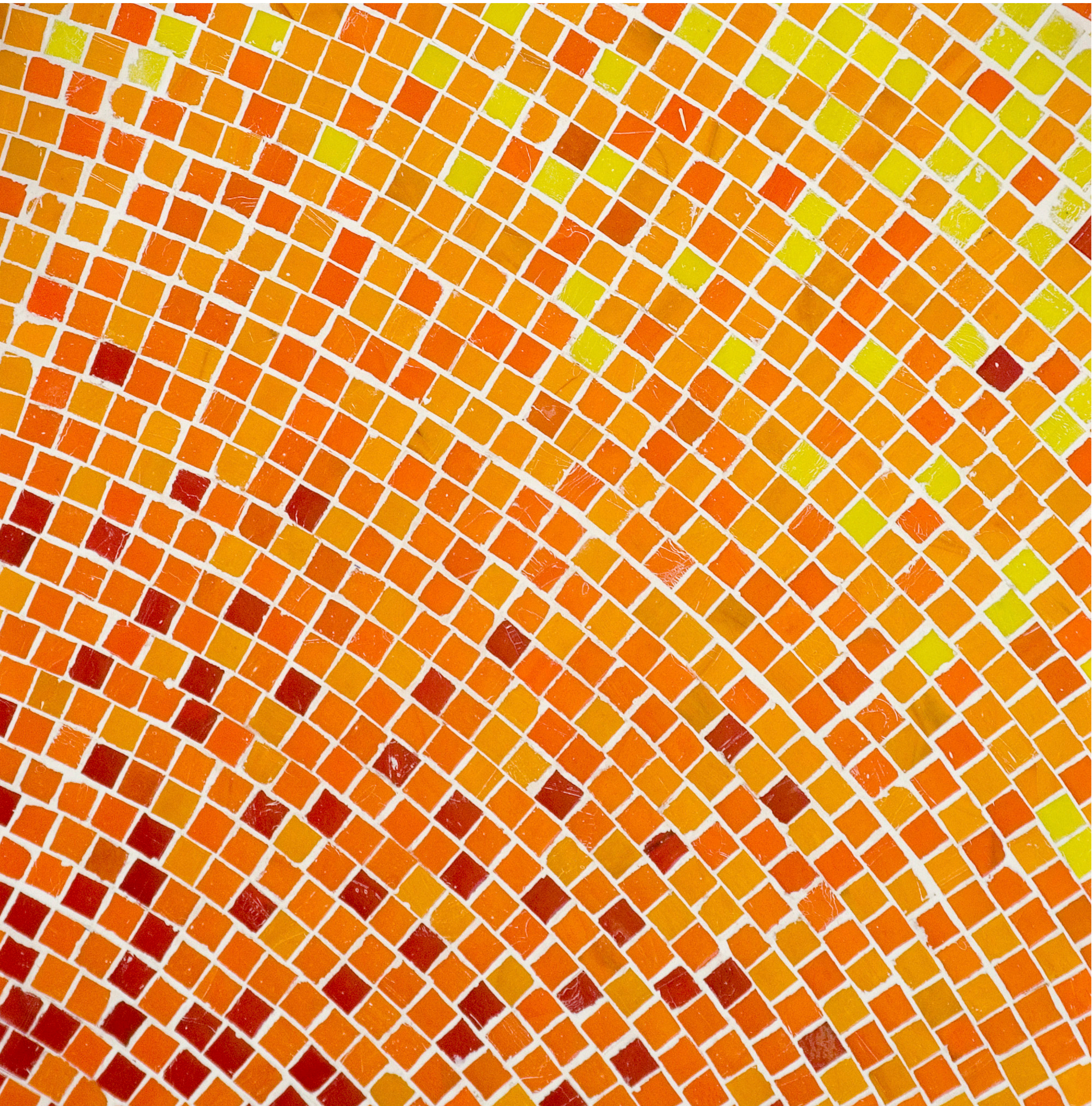
A First Data White Paper

E-Payments in Emerging Markets

By Amrish Rau
General Manager, First Data Merchant Solutions



Introduction

Emerging markets can be unpredictable, ever-changing and difficult to navigate, but they also present exciting opportunities for growth.[1] When it comes to electronic payments in these markets, what is driving change? What are the threats and questions to think about? And most importantly, how do banks, merchants, and service providers move forward with electronic payments to succeed in the future? This paper seeks to answer those questions.

This paper originally appeared in the Journal of Payments Strategy and Systems, Volume 7, Number 4. (http://www.henrystewartpublications.com/jpss)

Current Landscape

Non-Cash Payments Growing

Driven by both economic and behavioural changes, non-cash payments continue to grow quickly both globally and regionally. Underlying an ongoing global shift toward non-cash payments, First Data believes that the relative popularity and growth of different types of payments reflect the nuances of individual markets. Many economies in Asia Pacific still rely mostly on cash payments, with some countries moving away from cash faster than others. For instance, in Indonesia, 99.5 per cent of transactions are conducted using cash—and the number of cashless transactions is growing at an annual rate of 23 per cent.[2] Conversely, in Malaysia, 92.5 per cent of transactions are in cash, but electronic transactions are growing at a comparatively modest 9 per cent annually.[3]

Like other macro trends in the global economy, the most significant changes in payment behaviour are occurring in the developing world, driven by rapid urbanisation and a growing middle class. According to the World Payments Report, 40 per cent of the major card schemes' payment volumes now originate from emerging markets.[4] Asia Pacific remains the world's fastest growing non-cash transactions market, enjoying approximately 9.5 per cent compound annual growth—with *emerging* Asian markets collectively growing 20 per cent annually.[5] China recently recorded a 32.7 per cent annual increase in the number of non-cash transactions.[6] Vietnam's payment card market has become one of the most rapidly growing markets, increasing at an annual rate of 37 per cent between 2008 and 2012.[7] And according to Euromonitor, India's debit cards are growing at 13 per cent annually, with credit cards growing at 7 per cent.[8]

With the continued maturation of online purchase tools and consumer confidence, emerging Asian markets are driving the ongoing global acceleration of eCommerce spending.

Electronic Commerce Accelerating

Electronic commerce (eCommerce) is a vast and rapidly growing market, globally. Driven by the proliferation of smartphones and tablets, internet/mobile access, and electronic payments, global B2C eCommerce grew 21 per cent in 2012, topping $1 trillion for the first time.[9] Growth in Asia Pacific is even more impressive, with the region predicted to enjoy 30 per cent eCommerce growth in 2013—surpassing North America as the world's largest market for eCommerce sales.[10] First Data Universal Commerce research undertaken earlier this year shows that emerging economies in Asia—especially China—have enthusiastically embraced eCommerce. The research also revealed that Chinese merchants (46 per cent of those surveyed) are indeed ahead of their counterparts in the United States (23 per cent) in terms of offering eCommerce capabilities.[11]

With the continued maturation of online purchase tools and consumer confidence, emerging Asian markets are driving the ongoing global acceleration of eCommerce spending. For example, the volume of electronic commerce in Vietnam is projected to reach US$1.3B by 2015, nearly doubling from US$700 million in 2012.[12]

In addition, the Indian eCommerce market is expected to grow by 35 per cent in 2013 (after growing 40 per cent in 2012), and the Chinese eCommerce market is expected to increase by 65 per cent in 2013 over 2012.[13] Without question, the growth potential in these markets is incredible.

Half the Planet is Unbanked

As hard as it is to imagine, 50 per cent of adults worldwide are considered "unbanked"—meaning they do not have a formal banking relationship.[14] The World Bank states that 59 per cent of adults in developing economies are unbanked, while 67 per cent of adults in South Asia are unbanked (versus 45 per cent in East Asia).[15] According to the Reserve Bank of India, 74,000 villages there with populations over 2,000 were unbanked as of 2010.[16]

Macro Drivers for Electronic Payments

As discussed, the use of electronic payments—including debit, credit, prepaid, Automated Clearing House (ACH) and person-to-person (P2P)—is growing exponentially around the world. Whether consumer-to-business (C2B) or consumer-to-government (C2G), consumer adoption of non-cash instruments for the entire spectrum of purchases and disbursements is clearly taking off. Young adults in most markets are already very comfortable making cashless purchases, and demographic trends will continue to drive further adoption moving forward. Along with changing demographics, the following three drivers will be instrumental in accelerating the growth of electronic payments in emerging markets.

1. The Growth of the Middle Class

As history has shown, as a middle class emerges, increased purchasing power follows—creating the need for a more advanced payments infrastructure. Continued economic growth across the developing world, even during the global recession, has resulted in the emergence of an enormous new group of middle class consumers that has access to electronic payment options—and has quickly become accustomed to using them in a variety of ways.

As a result, traditional brick and mortar stores will experience growth in credit and debit card usage at the point of sale. Debit card usage at the POS is currently extremely low relative to total debit card spend (3.5 per cent, in India, for example[17]), but this will change as merchants in developing markets seek to better meet the expectations of the emerging middle class.

Debit cards are projected to grow more quickly than credit cards, particularly in markets where credit risk is high. In India, issuers shifted focus to lower-risk debit cards, reducing the banks' risk of bad debt while providing a better method for consumers to control their spending.

Technology and the internet are the biggest opportunities for the traditional acquiring model in Asia Pacific and other fast-growing economies. As income increases, online spending will continue to rise accordingly. The most innovative eCommerce companies will succeed by meeting changing consumer needs with the widest possible range of payment options.

With governments trying to drive e-payments through consumer spending, the middle class is more willing to spend electronically, which in turn drives more transactions at both retail locations and on the internet.

Many rural areas still do not have banking systems, while those that do are slowly moving from a cash-based society to electronic payments

Accordingly, mass transit programs present another opportunity for capitalising on middle class growth, especially as governments invest in transportation infrastructure (including innovative ticketing and payments solutions).

2. Financial Inclusion and Rural Economic Mobility

On the other side of the coin, the less financially well-off are being brought into the equation to help balance the distribution of wealth in developing countries. Financial inclusion is a prerequisite to sustained economic progress and electronic payments growth in the Asia Pacific region and other emerging markets. Many rural areas still do not have banking systems, while those that do are slowly moving from a cash-based society to electronic payments.

In highly underbanked countries, governments are making a tremendous push to encourage citizens to bank. In countries like the Philippines and Indonesia which have thousands of islands, opening branches and deploying the required physical infrastructure is challenging at best—which is why establishing electronic banking services in emerging markets is becoming a high priority.

When economies grow it is extremely important for the average man and woman to have access to credit. Making small scale credit available to citizens turns out to be a big deal. Small scale credit can be as low as 100 U.S. dollars, enough to start a small business. However, if the delivery model costs five dollars, then this is not feasible. Market entrants that can provide credit with a delivery mechanism costing less than 50 cents will be successful. E-payments can help accomplish this.

Unbanked and rural markets are huge unserved populations looking for a solution—and lower income does not mean that electronic payments are out of reach. In fact, over the years many successful initiatives targeting lower-income segments have been established, such as micro payments and micro finance. One example is the M-Pesa mobile money transfer and payment service launched by Vodafone India and ICICI Bank.

Governments are increasingly taking some initiative in facilitating the adoption of electronic payments—for example, in distributing government annuity payments. In some scenarios, a bank account is not even necessary to receive benefits. The government in India has introduced prepaid health cards for citizens below the poverty line and migrant workers so that they may efficiently receive medical care. This is one of the largest mass health insurance programs in the world, and it is entirely cashless. Furthermore, the Reserve Bank of India has mandated that banks provide basic savings accounts without minimum balances to support financial inclusion.

Consumers who are accustomed to living in cash-only societies are increasingly finding that they have access to the electronic payments system. This is an important development, since access to cash is elusive in remote areas of Asia where there sometimes exist few, if any, banks. Unlike the developed world where banks are prevalent and ATMs are on every corner, many parts of the emerging world are completely unbanked. Assisted by new technologies and government support, in many countries business correspondence networks are popping up, whereby a simple point-of-sale (POS) terminal in a store can fulfil basic payment needs. For example, in Brazil, a consumer can walk into a 'mom-and-pop' store and conduct all his or her electronic payment transactions.

3. Global Mobility and Remittances

As more and more people travel across the globe for work, the need to send money back home increases. This is evident in many countries across Asia where foreign workers are confronted with the challenge of remitting funds back to their families in a cost-effective manner. The same applies to transient workers within their home country, such as the 260 million migrant workers in China.

The world has already witnessed a move from paper money orders to wire transfers—and now it is moving to mobile-based payments. M-Pesa in Kenya is an outstanding success story for mobile payments in a developing market. GCASH in the Philippines is also being used to enable simple and fast person-to-person remittances in that country.

Next Steps

Having looked at the landscape and its drivers, it's clear that the future is bright and that opportunities abound. However, emerging markets can also be complicated and unpredictable. Now what?

Issues and Challenges

Regulators

Regulators have been playing an active role, realising that increasing electronic payments can accelerate the economic growth of a country. At the same time, they must also implement measures to manage security and fraud on these new networks. Consequently, positions taken by regulators sometimes lean more towards security than convenience. For an emerging market to thrive, it needs regulators that can balance growth with security.

Since electronic payments are mature in other countries, regulators know what challenges to look for, such as data theft or credit risk. Different countries with different regulators have their own unique set of challenges, which is why regulators need to plan requirements carefully in collaboration with commercial and financial sectors.

Unfortunately, sometimes international companies are limited by local regulations to serving as technology and infrastructure providers only (in an effort to protect local companies). This can actually slow the progress of e-payments implementation if not managed carefully.

Unique Infrastructure Requisite

If a certain market requires an infrastructure investment, how will it get paid off in a low-margin business, where each transaction may be only 50 cents? High volume is typically the answer in emerging markets. Therefore, low ticket values must be offset by high transaction velocity.

Looking again at Indonesia or the Philippines, where the populations are large and spread across many islands—how do the right people and networks get put in place? Potential market entrants, governments and other stakeholders must work together, and coordinate their investment efforts and objectives to overcome these challenges inherent to many emerging markets.

Financial Business Model

Finally, designing a viable overall business model in emerging markets can be the most difficult of all. With respect to new types of payments—for which there is often no precedent—it can be unclear where the eventual profits will come from.

In emerging markets, the population is generally large and the average transaction size small. This is the opposite of mature markets, which have completely different dynamics. For example, the typical business model in Singapore is based on large ticket sizes—but emerging markets currently skew towards small ticket sizes and low volumes, with the promise of reaching high volumes eventually.

The Road Ahead

What does the future hold? There is strong growth in e-payments, and regulatory support exists for them—but the market is complex. New entrants and investors are lured to these markets by their vast potential, but they need to think through some very important points. The following framework is recommended to help determine the right approach.

Financial inclusion – think "size of profit" not "size of margin"

Think about absolute returns: how much can the investment generate? If a market entrant focuses on metrics such as gross margin, its business case may never pass muster. However, by looking at the longer-term big picture, it may see that financial inclusion initiatives can pay off.

Most likely, a new market entrant will not reap profitable returns in two years' time, based on probable volumes and ticket sizes. It needs to invest over a longer term: five years and beyond.

Timing to market is key

Some products enter the market before their time and fail (think: Apple Newton). Organisations need to consider whether their idea or product is ready for the market. But they shouldn't over analyse this—sometimes they just have to seize the moment. There are countless stories of companies investing in India ten years ago to tap into a 900 million- person mobile market. First Data has observed 20-25 failed ventures there that started too early. When starting up, how ventures implement their strategies is critical. It may actually be advisable to be slightly late to the market, in some cases.

New entrants and investors are lured to these markets by their vast potential, but they need to think through some very important points.

Invest big or partner – trusted brands matter

Many companies are entering the e-payments market, so new entrants are advised to partner with the top brands. Choosing the right trusted partners can help companies get into the market, enabling them to learn the ropes. It is very difficult to test the waters solo; it is much better to sit alongside a smart partner.

Leverage expertise of existing players

Existing players in the market have a wealth of expertise to leverage. Most importantly, research what they have failed at, and learn from those experiences.

Given the reach it has in the Indian e-commerce market, smaller players with innovative technologies are looking to partner with First Data to achieve greater distribution there, which helps bring new products to customers—making the partnerships beneficial for everyone.

New technologies, but existing form factors

Consider how new technologies may be implemented in existing forms that already have widespread acceptance (e.g., cards, mobile phones). This could ease the transition into new technologies.

Innovations in e-payments, such as biometrics and Near Field Communications (NFC), have surfaced in recent years; these are exciting and commercially viable technologies, but in emerging markets these new form factors have not penetrated yet. Therefore, for the next five years, the form factor will still be the card. Maybe it will evolve to mobile, but probably not within five years. Despite the desire to "leapfrog," there is still much innovation to be done with the card form factor. Even PayPal is getting into the cards space, going 'back to the future.'

Manage regulatory complexity

Be proactive, and don't hide from regulators—understand their issues and work though them. In some cases, regulators will help organisations make decisions—for instance, if a regulation exists that prohibits something that is being considered. But most of the time, new ventures will need to be vigilant in approaching new markets—as they evolve, so do their regulations, especially in today's changing payments landscape.

The outlook

Unquestionably, banks, merchants, and service providers entering emerging markets face many challenges and uncertainties—but with carefully planned strategies and well-chosen partners, the likelihood of success increases considerably.

About the author

B. Amrish Rau is general manager for First Data Merchant Solutions, First Data's merchant acquiring business. In this role he is responsible for developing and delivering innovative payment solutions for retail merchants. Rau is also vice president and general manager for First Data in India. In this role, he is responsible for the company's growing presence in India, overseeing a team that supports more than 50 per cent of the credit card base using its award-winning Vision*PLUS*® solution.

Sources

[1] The exact definition varies, but for the purpose of this paper 'emerging markets' are defined as countries with low to middle per capita income that are experiencing rapid industrialisation and economic growth. Examples include China, India, Indonesia, South Africa and Brazil.

[2] McKinsey and Company. "McKinsey Global Payments Map." September 2012.

[3] Ibid.

[4] CapGemini, RBS, EFMA. "World Payments Report 2012." 2012.

[5] Ibid.

[6] Ibid.

[7] Timetric. "Emerging Opportunities in Vietnam's Cards and Payments Industry." February 2013.

[8] Euromonitor. "Passport: Financial Cards and Payments in India." March 2012

[9] eMarketer. "Ecommerce Sales Topped $1 Trillion for First Time in 2012." 5 February 2013.

[10] Ibid.

[11] First Data. "Global Merchant Universal Commerce Tracker" June 2013.

[12] Vietnam E-Commerce and Information Technology Agency. Press release. 26 May 2013.

[13] eMarketer. "B2C Ecommerce Climbs Worldwide, as Emerging Markets Drive Sales Higher." 27 June 2013.

[14] Asli Demirguc-Kunt and Leora Klapper. "Measuring Financial Inclusion." The World Bank. April 2012.

[15] Ibid.

[16] Duvvuri Subbarao. "Touching Hearts and Spreading Smiles." Reserve Bank of India. 10 August 2012.

[17] Lafferty. "World Cards Intelligence: India." 2012.

6626 1113