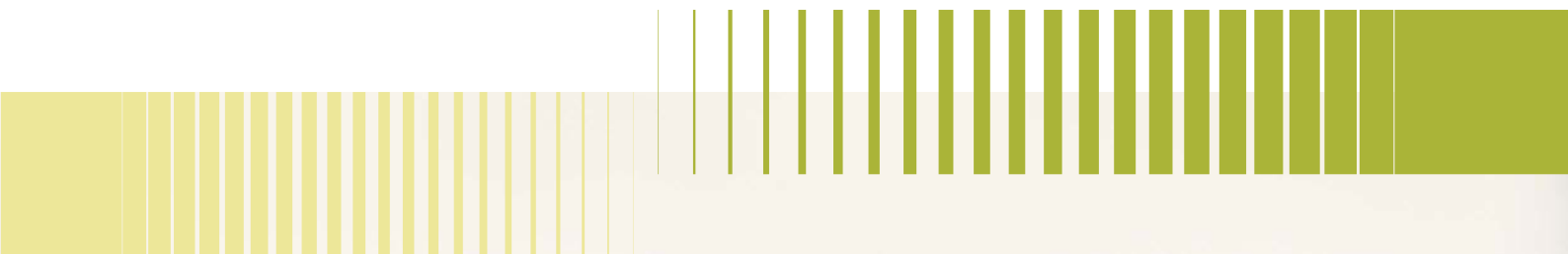


GLOBAL PAYMENTS 2021

All In for Growth

October 2021

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Leading in the New Reality

Digital Transformation |



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Overview

Payments snapped back from the rigors of the pandemic faster than most observers would have expected. Analysts use the term *elastic* to describe a market participant's success in absorbing change. But the payments industry wasn't just elastic—it was a slingshot. The nimbleness with which it adapted to the crisis enabled economies the world over to rebound faster as well.

As purchasing habits shifted almost overnight from offline to online and from cash to noncash, payments players responded in kind, accelerating e-commerce enablement, expanding fulfillment options, and streamlining point-of-sale and online checkout. They helped people who were dealing with financial uncertainty by providing debt relief, flexible installment purchases, supplier financing, and cash-flow management.

Although many industry experts, including BCG, expected payments growth to slow significantly as a result of the crisis, revenues declined only marginally from 2019 to 2020. We now anticipate that the total revenue pool could nearly double to \$2.9 trillion by 2030, up from about \$1.5 trillion today.

But growth has a price. The industry's success is attracting new players and leading to faster innovation. Over the next several years, we're likely to see continued platformization as payments acceptance and services become embedded in more digital ecosystems and as software solutions become more specialized. Regulators, governments, and central banks are engaging more actively, too. Many are developing new payments frameworks and holding players to higher standards in a number of areas. As a result of these changes, most industry participants will have to adapt their strategies, operating models, and routes to market—in some cases, retooling down to the core.

These are among the findings of BCG's 19th annual analysis of payments businesses worldwide. Our coverage opens with a comprehensive market outlook, examining global trends and regional performance. Then we examine the likely implications of these trends for the industry's major participants—focusing on challenges they're likely to face over the next five years and on actions they can take to secure long-term growth.

The pandemic revealed the payments industry's ability to respond to change. Now is the time to build on this capability. The race for advantage starts now.

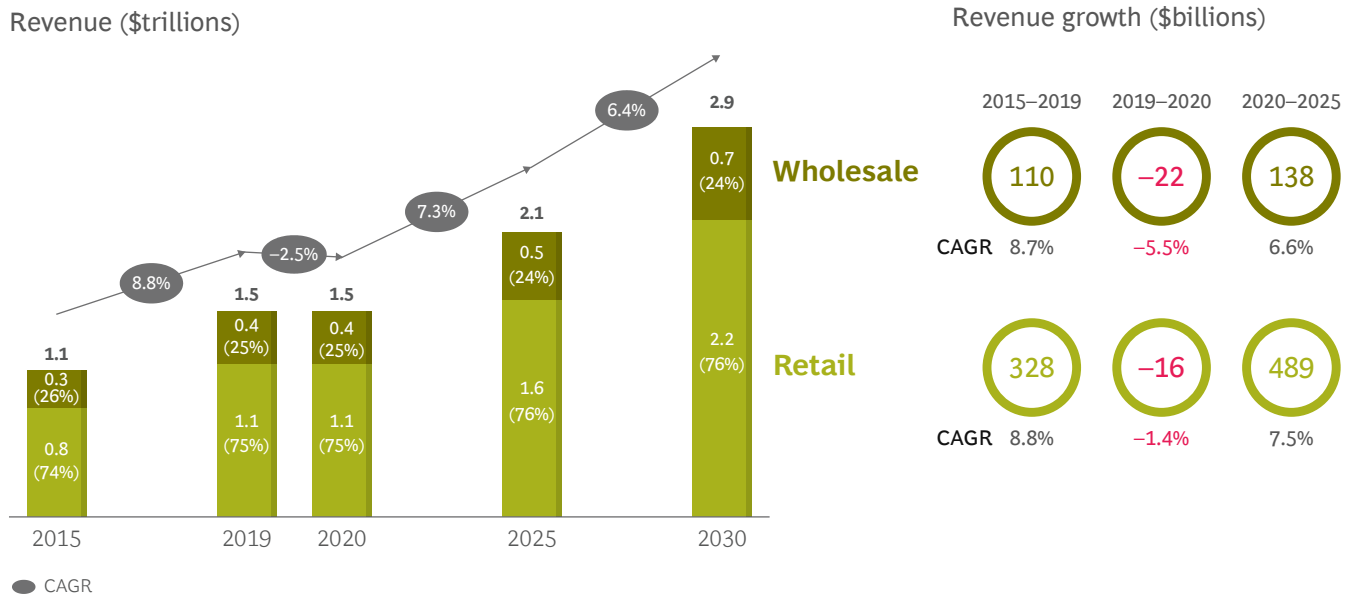


Market Outlook

One year ago, as the pandemic threw communities and the wider global economy into turmoil, BCG's payments modeling suggested that revenue growth could drop by nearly half—from a compound annual growth rate (CAGR) of 9% from 2015 to 2019 to just over 4% going forward. But even though transaction volumes globally dipped in the early months of the crisis, a combination of government stimulus and the rapid recovery of major markets such as the US and China prevented a major decline from occurring. Overall, payments revenues globally declined only marginally in percentage terms from 2019 to 2020 and stayed at roughly \$1.5 trillion year on year. (See Exhibit 1.)

The pandemic also accelerated two important drivers of global payments activity: cash-to-noncash conversion and e-commerce adoption. BCG's five-year outlook suggests that global payments revenues will expand by a healthy 7.3% from 2020 to 2025. Growth will continue at nearly the same pace for the remainder of the decade, and we expect the total revenue pool to reach \$2.9 trillion by 2030.

Exhibit 1 - Global Payments Revenue Is Expected to Grow to About \$2.9 Trillion by 2030



Source: BCG Global Payments Model 2021.

Five Global Trends

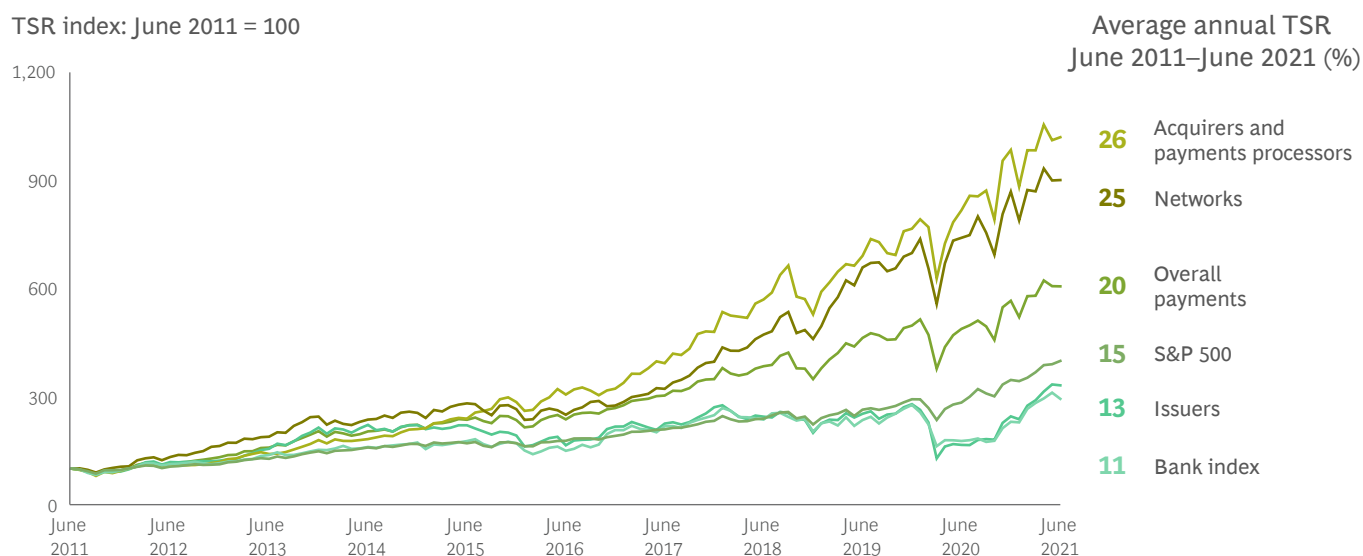
As the payments industry attracts new players, greater innovation, and increased scrutiny, here's what industry participants should anticipate over the next several years.

Deeper Payments Integration. Digitization has enabled companies to embed payments systems in an increasing number of platforms, workflows, and customer-facing offerings—from large marketplaces to business supply chains and enterprise processes. Integrated software vendors (ISVs), bigtech players, fintechs, and other ecosystem participants are likely to weave transactions-related capabilities into more offerings. This will increase the competitive stakes, but it will also create new partnership and revenue opportunities. Today just 30% of SMBs in the US use integrated software platforms. But that figure will rise substantially, we expect, and more financial services products will become part of platform ecosystems. The rise of platforms will allow payments players to create two-sided offerings, delivering value to customers and merchants and generating robust revenues and data assets in return. (The Square-Afterpay and PayPal-Honey deals are examples.)

Increased use of high-quality application programming interfaces (APIs) and standardized data models will give payments services providers new routes to market through third parties and create a channel for complementary value-added services (VAS). For these reasons, the ability to participate in ecosystem-driven transaction flows and software offerings that target specific industry verticals will be a significant differentiator that could determine the winners and losers in payments over the next decade.

More Active Bank Engagement. Banks increasingly view merchant acquiring and other payments activities as a strategic source of reliable revenues and rich streams of customer data. They have also seen the attractive returns that pure-play payments businesses have reaped over the past decade and are eager to benefit from the same investor enthusiasm. (See Exhibit 2.) As a result, more banks are engaging or reengaging in the payments space; pressure-testing different product, segment, and infrastructure strategies; and looking for alliances that combine distribution power with superior technology and capabilities. That activity is likely to accelerate over the next several years.

Exhibit 2 - Acquirers, Payments Processors, and Networks Have Outperformed the S&P 500 in TSR Since 2011



Sources: S&P Capital IQ; BCG ValueScience Center; BCG analysis.

Note: Total shareholder return (TSR), share prices, and market capitalization are as of June 2021.

Faster Pace of Digital Currency Activity. Mainstream interest in digital currencies grew significantly during 2020, as crypto asset trading became more prevalent on consumer financial apps and Bitcoin's valuation reached historic highs. Stablecoins, whose value is tied to a national fiat currency, also attracted speculative interest: both Tether and Binance achieved record valuations. The frenzy of activity has prompted financial bodies to speed the launch of central bank digital currencies (CBDCs). The Bahamas introduced the world's first CBDC in 2020, and we expect a number of other CBDCs to enter the market within the next 12 months. One reason is enlightened self-interest. Central banks are concerned that the rise of private digital currencies and stablecoins such as Facebook's Diem and JP Morgan's JPM Coin could threaten their ability to implement effective monetary policy interventions. Another reason is practicality. With a CBDC, payers can offer legal tender in a digital format and send it instantly. A third reason is the potential for greater financial inclusion. Parties can use a simple smartphone app to exchange digital currencies. Despite the energy around CBDCs and digital currencies more broadly, their use in day-to-day retail and wholesale transactions remains at an early phase, with a host of regulatory, security, and privacy issues yet to be resolved before adoption goes mainstream.

Regulatory Emphasis on Open Banking and Payment Infrastructure. Financial services regulators globally are keen to promote economic growth by removing encrusted structures that favor established players and make it harder for innovative offerings to come to market. As a result, we expect open banking to remain a top agenda item for payments regulators in many major markets. In Europe, open banking rules such as the Payments Services Directive 2 (PSD 2) have taken effect, but the European Banking Association hopes to promote greater use case development by conducting an API audit of banks in the region. In Latin America, Brazil's central bank has introduced one of the world's most comprehensive frameworks and set aggressive implementation targets, with banks expected to complete most of the new data aggregation requirements by the end of 2021. And in Asia-Pacific, China's recent introduction of data privacy laws aimed at protecting consumers' data brings its data privacy regulations closer to international standards, which should help both domestic and international companies run data-sharing relationships more smoothly. Although the US has lagged other regions from a regulatory perspective, financial authorities have recently begun developing regulatory frameworks for open banking, and private entities such as Plaid and Finticity have developed platforms that enable open-banking connectivity.

Payments infrastructure is another focal point. Market concentration and data sovereignty are growing concerns. Governments, regulators, and market participants in more than 50 countries have introduced instant payments rails to offset the dominance of international players and to incentivize the emergence of domestic alternatives. Banks and payments players are also likely to adopt the ISO 20022 messaging standard. Although not mandatory from a regulatory perspective, adoption will allow them to participate in international payments systems and benefit from enriched data.

More Industry Consolidation and M&A. Deal making slowed during the first few months of the pandemic, but activity picked up in 2021, and we expect that momentum to continue. Across the diverse payments industry, leaders are using their strong position in one part of the value chain to acquire toeholds in others, as evidenced by the PayPal-Honey and Square-Afterpay acquisitions. The buy now, pay later (BNPL) category could become a focal point for consolidation activity over the next few years, as payments players seek greater scale and improved risk modeling capabilities to accommodate growth in consumer finance products.

Although payments companies in every region should prepare for a spike in M&A, those in Latin America and Asia-Pacific could see some of the most intense deal-making. In Malaysia alone, the number of digital wallet providers is likely to shrink from roughly 40 to just a handful of players over the next few years.

Regional Outlook

We expect the payments industry in all regions to see growth over the next five years, albeit at very different speeds. (See Exhibit 3.)

EUROPE

Payments revenue in Europe is expected to rise at a CAGR of 5.3% from 2020 to 2025, driven by increased adoption of cashless transactions and online shopping. Eastern Europe will continue to lead the area's growth, with a CAGR of 8.3% expected through 2025. Western Europe and the Nordics will see revenues rise by 3.9% and 5.2%, respectively—impressive rates of growth, given the larger scale of these markets.

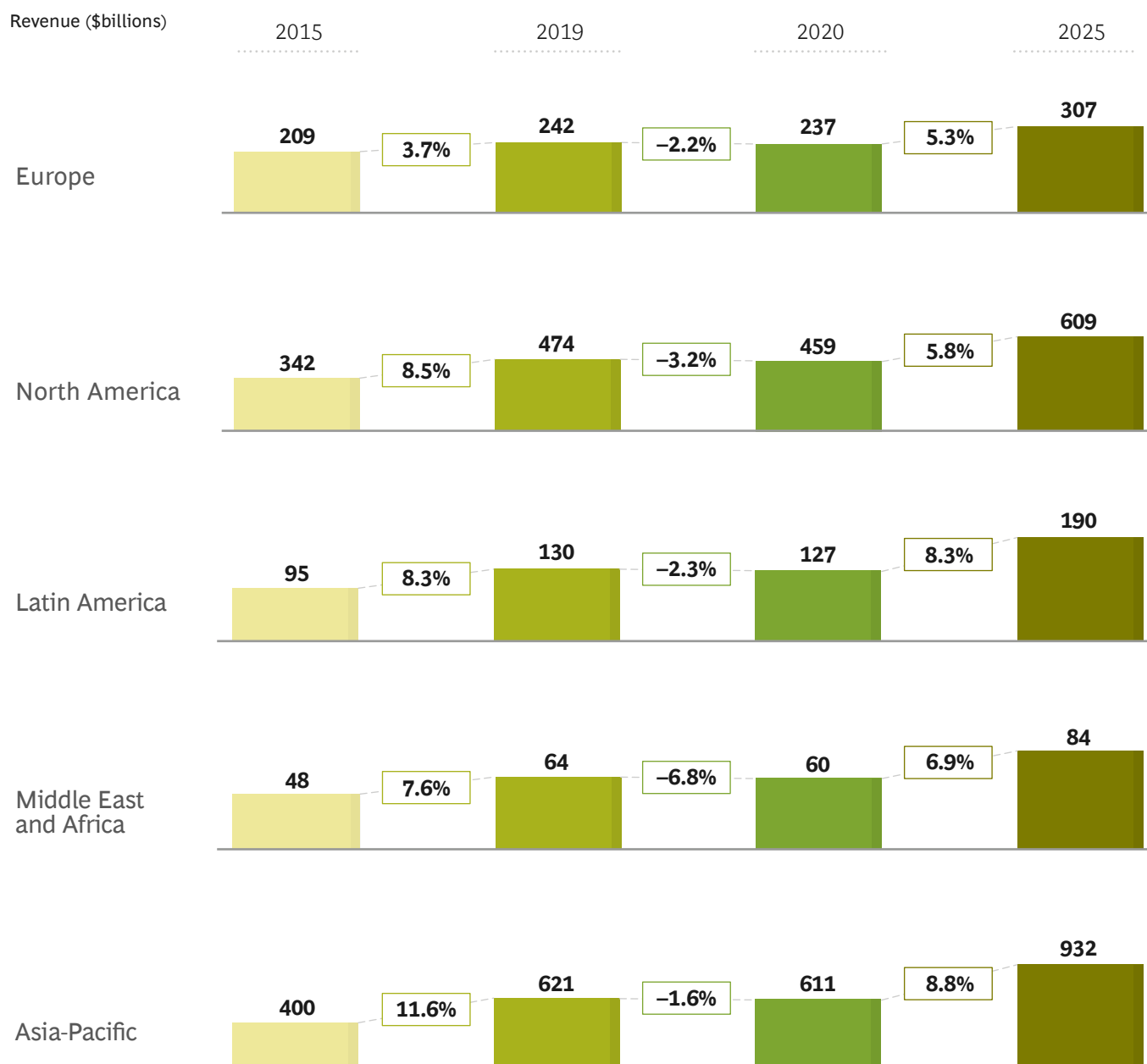
Owing to the mix of payments methods and schemes within the region, enabling pan-European reach continues to be a major focus for competitors and the industry at large. Some businesses have used M&A to address this challenge. Worldline (with its acquisition of Ingenico) and Nexi (with its acquisition of Nets and Sia) now operate across Europe, giving them a strong leadership position. Industry collaboration is another approach. To regain control from international players such as Visa, American Express, MasterCard, and Alipay, a number of industry partners have been working together to harmonize the European payments infrastructure. One example is the European Payments Initiative, which seeks to develop an independent, unified European payments scheme that supports multiple types of digital payments. So far, 31 banks and financial institutions have joined the initiative.

Looking ahead, payments companies in the region can expect competition to intensify significantly. Fueled by steady investment, fintechs such as Klarna, ZipCo, Checkout.com, and Adyen are expanding their footprint across Europe. Banks are making their presence known, too. Deutsche Bank recently reentered merchant payments through a joint venture with Fiserv. Santander has snapped up assets from Wirecard and is building a global payments business called PagoNxt. BNL in Italy and Handelsbanken in Sweden entered into a merchant-acquiring partnership with Worldline. And many other European banks are considering joining forces with payments specialists to augment their own product and service offerings. We may also see heightened competitive activity from traditional and emerging players such as Plaid and Tink in the account-to-account space as open-banking use cases mature and real-time payments (RTP) infrastructure becomes more available.

NORTH AMERICA

Our forecast in 2020 suggested that lingering economic effects of the pandemic would keep payments revenue growth in the 2% range over the next several years. But markets recovered exceptionally quickly. We now estimate that payments revenues in the region will grow at a CAGR of 5.8% from 2020 to 2025.

Exhibit 3 - Payments Revenue Could Grow by More Than 5% Across Regions



Source: BCG Global Payments Model 2021.

The onset of the pandemic had three immediate impacts on North America. The first and most obvious was to propel the shift away from cash. In the US, for instance, non-cash payments methods accounted for approximately 80% of all transactions in 2021, up from about 70% in 2019. Second, enabled by government stimulus and a moratorium on many loans, consumers paid off credit balances at rates not seen in the previous 20 years. Third, more merchants embraced software-embedded payments methods to enable e-commerce, curbside pickup, and other omnichannel and contactless exchanges. Software platforms such as Toast and Shopify enjoyed record growth during the first waves of the pandemic in 2020.

We believe that the move away from cash will remain a prevailing trend and that digital payments will become the default method for a growing number of consumers in the years ahead. Credit card balances are likely to start growing again as economies regain momentum and as government stimulus wears off. Industry participants are already ramping up for what they hope will be a more active spending environment. Credit card mail offers during the first quarter of 2021 were at their highest levels since March 2020, and many issuers have eased credit limits imposed during the pandemic to boost consumer interest and purchasing activity.

Omnichannel commerce is likely to remain a fixture in most verticals, with “buy online, pick up in store” a must-have feature for merchants. Across the region, software providers will continue to integrate payments and banking services in their offerings, and we expect embedded finance—particularly lending—to become mainstream.

LATIN AMERICA

Payments revenues in Latin America are on track to grow by 8.3% annually over the next five years. In part, this trajectory reflects steady improvements in the region’s RTP infrastructure. Brazil, in particular, has seen RTP use soar since it introduced PIX in November 2020. This system, developed by Brazil’s central bank, is now the country’s dominant transfer model for person-to-person payments—a position it claimed within the first six months following its launch. RTP systems are also available in Argentina, Colombia, and Mexico, and will soon appear in Chile. However, interoperability challenges between private rail systems, along with a lack of forceful regulatory mandates, have slowed RTP adoption in these countries.

Strong adoption of digital wallets is driving payments revenue growth in the region and spurring fierce competitive activity. Regional champions such as Mercado Pago and Rappi continue to expand aggressively, but well-resourced fintechs—including Ualá (Argentina), DLocal (Uruguay), and Clip (Mexico)—have begun to attack. Banks and payments incumbents are investing significantly, too, and many have launched digital propositions of their own. The Chilean bank Banco de Crédito e Inversiones (Bci) turned MACH into the country’s leading peer-to-peer wallet. Retailers and telcos are partnering with many banks and payments specialists to gain access to the digital payments market.

ASIA-PACIFIC

From 2015 to 2019, payments revenues in Asia-Pacific grew at an average annual rate of 11.6%, far higher than the global average. From 2020 to 2025, the region is likely to continue to outpace other regions in revenue growth, though at a less dizzying CAGR of 8.8%.

As was true globally, lockdowns and a desire to minimize the risk of contagion prompted more individuals in Asia-Pacific to move to contactless payments over the past year. In China, mobile wallet transactions grew from \$7 trillion in 2016 to \$37 trillion in 2020, a CAGR of 50%.

Inspired by AliPay’s success in China, more payments businesses have set their sights on becoming platform players. Initial public offerings are on the agenda for the most ambitious companies, which include Ant Group, Gojek, Grab, PayTM, and the Tencent-backed Yeahka. Many competitors consider having a digital bank to be a crucial anchor in their payments ecosystem as well. Grab-Singtel, Ant Group, and SEA Group (owner of the e-commerce platform, Shopee) acquired digital banking licenses during the past year to operate in their respective markets.

Over the next few years, competition is likely to intensify. In the first quarter of 2021, fintechs received more than \$2 billion in funding, a 35% year-on-year increase. Southeast Asia has attracted most of this funding (44% of the region’s total as of the first quarter of 2021), with Grab in Singapore and Mynt in the Philippines the top recipients. Global competitors are entering the region, too. For example, in June 2020, American Express received a clearing license to operate in China. In November 2020, Facebook’s WhatsApp Pay began offering payments services in India. And in January 2021, PayPal acquired a 70% stake in GoPay, becoming the first foreign firm in China to have majority ownership.

**The payments sector has
outperformed the banking sector
in total shareholder returns by
about 2x from 2011 to 2021**

MIDDLE EAST AND AFRICA

We believe that the Middle East and Africa could see revenue growth rise at a CAGR of 6.9% from 2020 to 2025, making it one of the world's strongest frontiers for payments. This is a huge region, however, with very different market characteristics from one subregion to another.

The payments landscape in the Middle East features mobile penetration of close to 100%, thanks to a young, international, digital-native population. Many governments are strong proponents of digital payments, which they see as an enabler for digitization and economic development more broadly. For instance, Saudi Arabia has set a goal of moving 70% or more of all transactions to cashless payments by 2030. Collectively, these efforts are likely to accelerate the move away from cash and toward digital alternatives. Merchant adoption is growing across the Middle East, as more commercial enterprises accept digital payments methods such as Apple Pay, Google Pay, and Samsung Pay than did just a few years ago.

Competition is on the rise as well. More banks are investing in instant payments, APIs, and microservices. We're also seeing the emergence of neobanks, BNPL, and alternative lending players such as Tabby in the UAE and Tamara in Saudi Arabia.

In Northern Africa, the dynamics of payments growth mirror those of the Middle East in terms of established infrastructure, strong local governance, and central bank support. For example, the central bank of Egypt has made financial inclusion a key component of its current five-year plan.

The banking infrastructure in sub-Saharan Africa is less developed. With the right strategies in place, however, [mobile payments players in Africa should see strong growth](#). In Kenya, Ghana, Uganda, and Côte d'Ivoire, for example, mobile wallets and money have largely displaced cash and opened access to financial services products. South Africa, of course, is a mature market with regard to payments infrastructure. Most major banks there have enabled digital wallets such as Apple Pay, and the country's retail real-time payments system is expected to launch in 2022.

We believe that Africa as a whole is poised to see significant payments growth. Like China and India before it, Africa's explosive digital payments evolution will be driven by local dynamics that include strong consumer interest in using mobile money and low card and banking penetration. Fintech ecosystems are expanding rapidly, too, with payments players capturing as much as two-thirds of the region's fintech funding in 2019. Even though cash transactions still account for an estimated 95% of all transactions in Nigeria, the country is emerging as a regional innovation hub where fintechs that focus on infrastructure building are capturing the attention of global players keen to capitalize on that growth. In October 2020, Stripe announced the acquisition of Lagos-based fintech Paystack, which already processes over 50% of online transactions in Nigeria and counts more than 60,000 merchants in Nigeria, Ghana, and South Africa as customers. The opportunity to increase adoption of digital payments across the continent could allow Africa to leapfrog more mature markets, where cards remain the primary instrument.

But banks and networks across the continent are not standing idle. To fend off competition from mobile network operators and fintechs, banks are modernizing their payments technology and leveraging their geographical footprint to introduce innovative payments services. Standard Bank, for example, launched the Unayo digital platform to enable consumers and small merchants to perform day-to-day transactions in several countries within its footprint. Meanwhile, MasterCard acquired a 25% stake in the mobile money subsidiary of Airtel Africa to support its payments ambitions in the region.



Merchant Payments Players Are Fighting Disintermediation

Merchant acquiring is one of the fastest-growing businesses in payments. From 2015 to 2019, revenues in this area increased at an average rate of 11.8% globally, driven by e-commerce adoption, new payments methods, and value-added services (VAS) such as risk and fraud management and merchant and consumer finance. Although growth tapered to just 2.2% from 2019 to 2020, the outlook for the next five years is for revenues to resume their former trajectory, with a CAGR of 11.3% expected through 2025. Capturing that growth, however, will require new and established players to work differently than they did before.

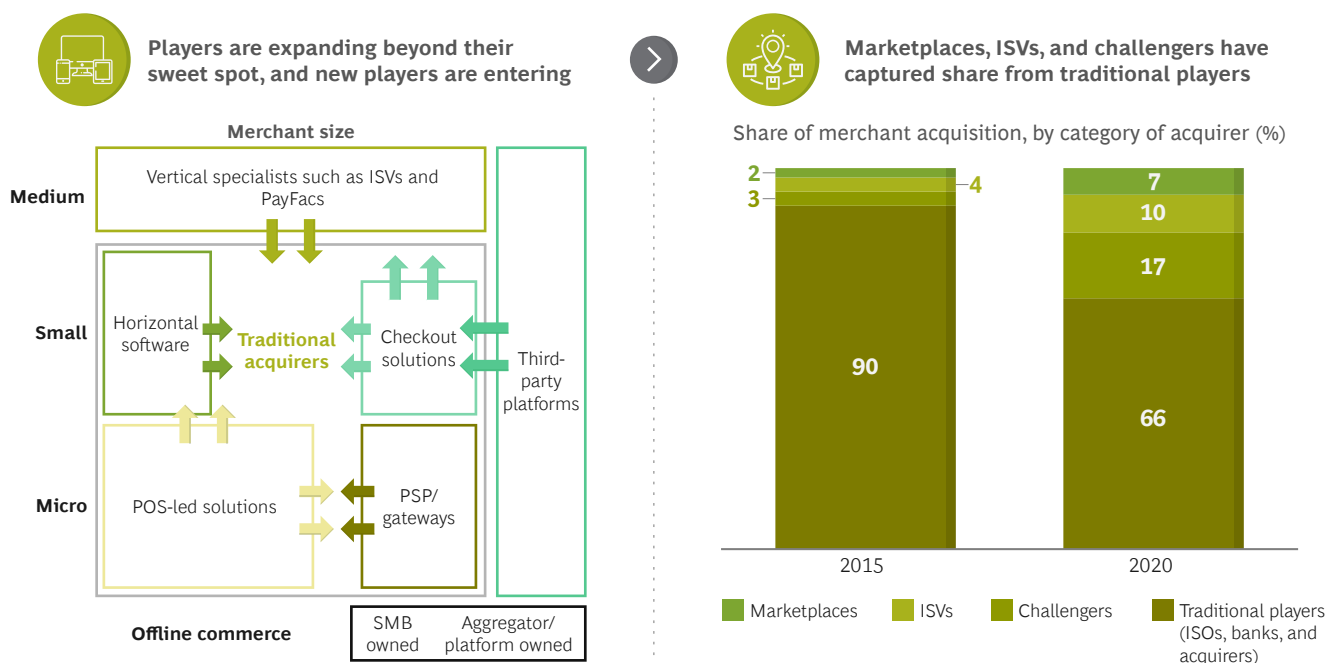
Three Challenges to Address

Just a few years ago, payments offered plenty of opportunity for all comers. However, the market has become increasingly disaggregated. The COVID-19 pandemic is one force behind this development, hurting acquirers that are exposed to sectors hit hard by the crisis, such as entertainment, travel, and tourism. But business model and market characteristics are additional factors, driving valuations sharply higher for companies with certain segment, product, and operational strengths. Three elements are particularly important:

- Profitability varies widely across segments.** The SMB and online segments have generally had the strongest payments revenue growth and margin potential, but some verticals saw their growth clipped during the early stages of the pandemic as aggregators and delivery services such as Doordash and PostMates ate into transaction volumes. In contrast, large corporate customers—which typically produce less attractive margins—have continued to deliver high transaction volumes that provide payments players with a steady stream of revenues and enable them to amortize their fixed costs. These segment dynamics may require payments players to adjust their customer portfolio composition to strike an optimal balance between growth and margin performance. Rebalancing is not simple, however, as the SMB and large corporate segments have very different go-to-market characteristics.

- A fast-expanding heterogeneous market adds complexity and pressure.** The desire to enter high-growth sectors and claim first-mover advantage has fueled massive business development across the value chain. (See Exhibit 4.) That value chain consists of three broad markets: incumbents and payments services providers that historically have served large, offline merchants; global, digital-native players that predominantly serve online businesses; and local integrators and SMB specialists that offer specialized payments services. Entities that have secured a strong position in one market are using their financial and customer momentum to jump into new categories where they hope to build critical mass and create platform dominance. Because this activity is occurring throughout the value chain, slower movers have to spend more to defend their turf, and they face an increasing risk of lockout when attempting to enter new markets.

Exhibit 4 - The SMB Acquiring Landscape Is Evolving Rapidly



Source: BCG analysis.

Note: Because of rounding, not all bar chart percentages add up to 100%. ISO = independent sales organization; ISV = integrated software vendor; PayFac = payments facilitator; POS = point of sale; PSP = payments service provider; SMB = small or medium-size business.

- **E-commerce growth is accelerating disintermediation.** Boosted by pandemic-related shifts in buying patterns, e-commerce adoption will likely grow by double digits over the next several years—much faster than physical point-of-sale transactions will. Online marketplaces are also becoming more popular for both buyers and sellers. Shopify and other software platforms that support the configuration of online shops and websites make this form of e-commerce engagement simpler and more cost-effective for merchants, especially small and medium-size ones that may lack the resources to staff digital development in-house. As the sharing economy expands beyond car services and lodging, ISVs and online marketplaces will embed payments capabilities—such as onboarding for small, local merchants; checkout for consumers; and recurring or subscription-based payments—into their platforms, commoditizing the core transaction product. To remain competitive, established payments players will need to offer specialized VAS and rethink their direct-to-customer distribution models.

A Time to Refocus and Retool

The ongoing rapid changes within the payments landscape will require organizations to adjust their strategy, operating model, and go-to-market approach. We have identified three areas where companies should focus their attention.

Reboot strategy to identify defendable pockets of growth. Acquirers and processors need to evaluate opportunities through multiple lenses. First they must determine which segments, verticals, and geographies hold the most promise for their particular combination of strengths. Second, they must identify the capabilities and investment required to win. For example, to succeed in the high-growth e-commerce segment, acquirers will need to accommodate everything from the initial gateway and acceptance of relevant local payment methods to VAS and data analytics. They will also need to enable rapid digital merchant onboarding and seamless integration into online platforms. Anticipating downstream risks and competitor moves is important to help management articulate differentiators that will allow the business to defend its advantage. But all of these efforts call for significant upfront planning.

Banks contemplating a reentry into the merchant acquiring arena could have a compelling advantage over non-bank competitors, since they can offer merchant customers both payments acceptance and such banking services as current accounts, foreign exchange hedging, and lending products. That breadth enlarges the customer value proposition, but banks must still undertake the same calculus as monoline acquirers and figure out how best to differentiate their offerings. Institutions considering this move must also decide whether to bring acceptance and acquiring fully in-house, which can be a challenge for businesses that are starting from scratch, or outsource noncore activities such as processing, which could result in less control. Each approach has different investment requirements, too.

Upgrade the operating model. Four core capabilities are essential to winning in the merchant acquiring space. The first is establishing an agile product innovation engine, given the strategic importance of technology. Leaders must have multiple bets in play so they can adjust quickly to market movements. And rather than leaving maintenance of that portfolio to chance, acquirers must create a formal product innovation discipline with a senior executive sponsor and support from cross-functional teams. Executive ownership is essential to ensure alignment from the business, remove organizational blockers, and procure needed resources.

To encourage bold thinking, acquirers may wish to keep the product innovation function separate from the core business. Independence can free innovation teams to test multiple concepts—including ones that could cannibalize the core business. We have seen instances where, after creating a robust product innovation muscle, acquirers have been quicker to validate new value propositions and move into attractive segments.

The second core capability is professionalizing risk management and compliance. The spike in credit and fraud risks (notably in segments where the spread between purchase and service delivery is wide), the Wirecard accounting scandal, and the need to implement anti-money-laundering and sanctions provisions have increased institutional concern over [risk management in merchant acquiring](#), especially for nonbank acquirers that have not been subject to bank-style regulations in the past. To professionalize risk management and compliance, acquirers need to consider merchant credit-risk factors and related scoring, develop a toolset to codify and streamline mitigation interventions, establish risk governance and risk steering mechanisms, and define specific merchant-onboarding guidelines. (See Exhibit 5.)

Fintechs today account for roughly 5% of banking revenue in the US and as much as 20% in payments-related fields

Exhibit 5 - Five Core Elements to Professionalize Risk and Compliance

Core element	Description	Priority		
		Crisis response	M&A/postmerger integration	Growth agenda
Risk fact base	Quantify merchant credit risk, and determine risk-bearing capacity	High	High	High
Risk mitigation and portfolio restructuring toolset	Develop levers to reduce exposure from unexpected loss, and define requirements for merchants	High	High	Medium
Risk governance setup	Ensure involvement of relevant decision-making bodies, focusing on onboarding and monitoring processes	High	High	High
Risk steering cockpit	Leverage internal and external sources to enable concise risk reporting, and report on interactions with merchants	High	High	High
Onboarding playbook	Establish requirements for new merchants, set contract terms, and prepare quick guides for sales team	Low	High	High

Source: BCG analysis.

Third, acquirers must upgrade their digital sales capabilities. Outbound marketing and early direct sales used to be the primary method of customer acquisition in B2B; but in the digital era, data-driven lead generation and sales activity have become more important than they used to be. To win new business, acquirers need to attract merchants over all digital channels—the web, mobile, and chat. Leaders will improve their inbound marketing capabilities, optimizing digital search and their own websites to make it easier and more rewarding for merchants to find product information. They'll also master automatically collecting merchant contact information, tracking merchant interests online, qualifying leads in near real time, and quickly routing the most promising leads to sales teams for a seamless buying journey. Enabling swift, efficient digital onboarding and robust customer service after the sale are other must-dos to retain customers and upsell with VAS.

Fourth, acquirers must retool their approach to M&A. In the past, the primary driver of large deals was the need to gain scale and geographic reach. Now, however, acquirers also use partnerships to aid market and product expansion, so they need to evaluate a broader set of potential targets—an undertaking that requires detailed analytics across a range of market niches. In addition, they must adjust their screening mechanisms. With valuations at record highs, investors want to see evidence that acquirers can deliver revenue performance that justifies those multiples. Long-term synergies are no longer enough. Acquirers will have to prepare a clear business case for any planned partnership and engage in more frequent stakeholder communications. In support of that effort, they should create a comprehensive integration plan that articulates the overall M&A narrative, guides investor communications, and establishes the day-to-day operating rhythm for different deal stages. We recommend setting up a dedicated integration office, laying out the decision-making chain of command, and creating concrete milestones such as day-30 plans, day-60 plans, and day-90 plans. In parallel, acquirers should also create a postmerger integration strategy that lays the groundwork for the future governance and operating model, factors in the distinctive cultural characteristics of the acquired organization, and identifies change-management practices to help align and embed successful ways of working.

Adapt go-to-market approaches. Acquirers have an opportunity to forge new and deeper customer relationships by doubling down on two strategic channels. The first of these is to become the go-to data and analytics partner for merchants—something that merchants have told us they very much desire.

Analytics, A/B testing, and customer journey optimization are key needs that fall into an acquirer's wheelhouse. For example, acquirers can use their data and analytics resources to help merchants screen for fraud more effectively. Merchants can then use those insights to focus their interventions on a few bad apples, rather than encumbering everyone else's purchasing experience by imposing authorization checks on the entire customer base.

Likewise, A/B testing can help merchants determine which payments options customers prefer and how to best present these methods on the checkout page. Doing so can help declutter websites that may currently list seven or eight payments methods. In addition, acquirers can help merchants create a seamless omnichannel experience by advising them on the best ways to integrate payments into the customer journey, such as through curbside pick up and other fulfillment methods. Acting as a trusted advisor in these ways can help merchants improve their conversion rates and allow acquirers to build strong relationships and greater customer lifetime value.

The second play is to define a channel strategy for the SMB segment. Acquirers have the chance to ride the growth wave in this space, but they must decide whether it makes sense for them to disrupt their business model by selling through an ISV, online marketplace, webshop provider, or other partner—or to go to market directly. Aligning with a partner could allow the acquirer to sell complementary VAS through the vendor's platform, increasing reach and revenues. But in that scenario, acquirers must enable easy integration, develop a robust API portfolio, and foster a strong developer community. Alternatively, going direct would give the acquirer more control and the potential for greater margins—but that path might require high levels of sustained investment.

In addition to thinking through their ISV play, acquirers should revisit their go-to-market approach for captive channels. For example, banks may want to pivot from a branch-based distribution model to a digital one, to lower costs and improve scale. Creating a quick, simple onboarding experience for SMBs is critical to success. Banks and nonbanks should also look for multipliers such as hotel, restaurant, and hospitality industry associations that can improve lead generation and lower acquisition costs in markets that have a large number of diverse participants. Finally, players should manage their value propositions in these channels strategically, by offering such things as smarter product bundles tailored to industry-specific needs and by applying risk-based pricing.



Issuers and Networks Have to Chart a New Course

Issuers and networks are among the brightest spots in the payments landscape. Over the past five years, their revenues pools have grown at a CAGR of 9.4% and 11.2%, respectively. A few large players dominate both markets, with networks enjoying the highest margins among any payments subsector. Although issuers are subject to cyclicalities, they benefit more than most during an economic upswing, generating a return on their assets of 2.5% to 3.0%, compared to roughly 1% for the banking sector as a whole in the US.

From 2020 to 2025, we expect issuing revenues to grow by 7.6% and networks by 11.4%. In order to capture that growth potential, however, issuers and networks must address several near-term challenges.

Navigating Immediate Headwinds

The recessionary environment provoked by the pandemic interrupted a decade-long bull market. Issuers felt the pinch at once, and year-on-year revenue growth fell to -4.8%. Credit spending declined, too, as consumers reined in debt-related purchasing. And the interest-free forbearance programs that many issuers offered constrained their margins further. Now those companies must spend additional sums on new card programs and loyalty incentives to win consumers back. Networks are less exposed to cyclical volatility, and their revenue growth stayed flat year on year. But they are enduring a different sort of volatility, as technological innovation shakes up the playing field. To protect their bottom-line health, both issuers and networks must find a way to address three main risks.

Growth of Noncard Payments Options. Alternative rails and payments schemes are emerging in more countries. Many have heavy muscle behind them, with governments, central banks, or powerful industry consortia leading development in most cases. Examples include Brazil's PIX, India's United Payments Interface (UPI), and the EU's European Payments Initiative (EPI). The growing popularity of BNPL poses another threat, since it allows customers to bypass cards and networks. (See the sidebar, "BNPL Has More Than Proved Its Concept.") As these alternative offerings and routes to market become more popular, revenue flows to issuers and networks could suffer.

Costly Tender Share Gain. The issuer landscape is diverse. Revolving credit is common in the US and the UK, while charge cards are more customary in many European markets. Despite these distinctions, many issuers are engaged in a race to the bottom in terms of net interchange, with the high cost of wooing customers back to revolving credit cards causing many to take a loss-leading position. In the US, for example, it's not uncommon for new customer offers to include cash-back payments of 1.5% to 2.0%, an introductory 0% APR on balance transfers, and no annual fee. Although these strategies are good for customer acquisition, they also eat into fee revenues and raise the risk of cross-product cannibalization and back-book challenges.

A Rising Innovation Bar. Because next-generation card processors have modular offerings and an API-first approach, they can integrate their services into platforms and marketplaces relatively easily. This gives them a significant speed-to-market advantage. For example, many can launch cobrand programs and other offerings in a quarter of the time incumbent players need. Drawn to these advantages, ISVs and fintechs are partnering with many such processors on commercial card opportunities. In light of these shifts, issuers and networks must adapt their overall value proposition and adopt a use-case approach to market instead of relying on the loyalty-driven cobrand approach they have traditionally employed.

How Issuers Can Return to Growth

Several actions can help issuers address their core profitability challenges and open new revenue opportunities.

Streamline the portfolio, and double-down on winning propositions. Issuers need to drill deep into their portfolio fundamentals by conducting in-depth market, competitor, and investment analyses. The goal should be to narrow the strategic scope to a core set of areas where issuers have the market permission, capabilities, and resources to gain a leadership position over the next two to three years. For instance, banks that have a strong competitive standing (with an offering that spans merchant services, SMB banking, and retail banking products) should consider developing their own BNPL offerings in order to participate in this high-growth space. Successful participation, however, will hinge on building a compelling digital customer experience and real-time approval processes that can be integrated with online and physical point-of-sale technologies as well as with debit and credit cards. Issuers with a less advantageous starting position may prefer to partner with existing BNPL fintechs instead.

Making these portfolio determinations requires rigorous modeling. Teams need to understand not only which product categories are most promising, but also which version of a product to back. Variables may include such things as how many installments to offer in a BNPL option and what the optimal terms and conditions are. After identifying these winning propositions, issuers need to back them aggressively and take other, lower-growth programs off the table.

Reimagine the data strategy. To participate in high-growth markets, most issuers will have to revamp their approaches to data acquisition and management—pulling information from a wider variety of areas and analyzing it more deeply. Expanding data collection to nontraditional sources such as bank account and installment plan activity could help issuers offer loans to more customers, including those who lack formal credit histories. More robust data analysis can also assist with targeting. Issuers can work with their cobrand partners to test and model campaigns in order to identify the optimal stage in the customer decision journey for making an offer and the right channel and format in which to make it. Determining which data sets most accurately predict different uses takes testing and exploration. When underwriting in new segments, for example, issuers can use rejection inferencing to inform risk scoring. This method extrapolates risk indicators from customer credit applications that were denied. Any change in data strategy must extend across the entire customer life cycle, taking into account such downstream impacts as credit line management, pricing, fraud, and collections. Overseeing all of these data-related shifts requires considerable leadership attention and substantial change management capabilities.



BNPL Has More Than Proved Its Concept

Buy now, pay later (BNPL) creates a classic two-sided network that delivers strong benefits to both consumers and merchants. For consumers, the upside includes easy checkout, generous and often interest-free installment terms, and convenient payments. Online retail stores also win. For a transaction fee ranging from 1% to 6% (depending on local market and competitive factors), they gain increased traffic, larger shopping baskets, higher conversion rates, and repeat customers.

With many of the world's best-known brands and retailers embracing it, **BNPL is likely to see strong growth** over the next several years. Investors have already signaled their rosy view of the sector, valuing Klarna and Afterpay at \$46 billion and \$29 billion, respectively. And both PayPal and Apple Pay have recently added BNPL options to their feature set, which will further accelerate growth, given their large customer base. The rise of BNPL poses a challenge to traditional point-of-sale consumer finance offerings and

credit card issuers. Although incumbents such as American Express have introduced versions of BNPL that are tied to their credit cards, they aren't monetizing this payments method with merchants in the same ways. For example, becoming an affiliate marketing channel for merchants, as Capital One has done with Wikibuy, could enable incumbents to deliver added value. Issuers must also determine whether they want to include BNPL as a feature on all of their cards, including debit cards, to counter Apple Pay and to slow down growth at the pure-play BNPL companies.

Still, it's not all smooth sailing for BNPL pure-play companies. As is often the case with fast-growing technology plays, achieving sustainable profitability will depend on developing new capabilities. Competition is intensifying, and the industry's relentless growth is attracting regulatory attention. The path forward presents financial industry players with risks as well as opportunities.

Enhance customer experience and loyalty. Issuers need to take a hard look at their loyalty propositions and ensure that they deliver distinct customer value. Most will need to expand these programs to offer greater differentiation. For example, “earn and burn” choices that include novel experiences such as sports offerings or celebrity chef dinners may feel more exciting to customers than simple discounts and credits. Gamification initiatives, in which customers can acquire and trade badges for digital currencies or other sources of value are another way to energize audiences and increase loyalty. Executing these propositions will require new partnerships and a mechanism to monitor and enforce fulfillment agreements.

Dispute resolution is another area where banks can improve the customer experience. Our data shows that disputes increase churn by a factor of two to three, regardless of the outcome. Enhancing customer communications, providing complete and easy-to-read transaction details in mobile apps, and automating some reconciliation processes can improve retention.

Issuers also need to enable a consistent and rewarding experience across channels to simplify the customer experience. Integrating customer data across interfaces can permit users to move from mobile to web to phone and pick up where they left off each time, sparing them the hassle of reentering or repeating information.

Move to persona-based approaches in collections.

Traditional collections and recovery practices tend to lump customers into generic risk bands, addressing them with equally generic communications. Using a persona-based approach can be more effective. This method uses a holistic set of demographic and behavioral characteristics—such as lifestyle patterns and channel preferences—to sort customers into clusters, allowing issuers to send tailored messages in the appropriate format and medium. To develop personas, issuers must map different customer needs and expectations across the collections journey. For example, a middle-income millennial and a low-income baby boomer might react very differently to the pre-delinquency process. Issuers then need to determine the optimal interventions for these customer bands on the basis of likely questions, concerns, and aspirations. We recommend starting with a few baseline personas, refining them over time as data and learning accrue. The resulting insights can shape messaging and outreach. Ongoing testing and feedback must be part of the implementation plan. We have seen cases in which similar persona-based models have increased open, click, and pay rates for collection and customer-retention activities by up to 30%.

How Networks Can Sustain Their Market Leadership

Although the pandemic affected networks less adversely than it did issuers, networks’ ability to drive future growth depends on two broad capabilities.

Capture the white spaces. Networks need to know which card and noncard flows to go after and how aggressively to pursue them. Within B2B payments, for example, networks already have solutions to enable domestic and cross-border money movement between buyers and suppliers. But these services tap only a fraction of the potential value in the B2B space. To grow their revenue pool sustainably, networks must determine whether their offering should be supplier led, buyer led, or focused on a particular sector. By looking at the dynamics of different verticals and how flows move between participants in those supply chains, networks can isolate the most lucrative opportunities and articulate a viable path to market.

In the BNPL space, networks can partner with or advise issuers that are incapable of bringing their own offering to market. BNPL-issuer collaborations can be especially strategic in markets where card and e-commerce penetration is high, allowing networks to defend their turf. For this play to be viable, networks must revisit their pricing model and create a clear value proposition for merchants, particularly in affiliate marketing. Operationally, they must also develop APIs to enable issuer connectivity.

Work through complexity. Most networks now manage multiple large-scale global businesses. Foraying into new spaces beyond their core will significantly increase operating complexity, in terms of market execution, regulatory compliance, and risk management. Ensuring enterprise-wide data management and privacy protections will be especially important as will creating a centralized function to oversee data taxonomies, data-sharing rules, risk management, and other compliance tasks.

In addition, networks must have the capacity to manage channel conflict between partners. Scaling sales motions and clarifying global, regional, and local partnership arrangements require significant expertise and planning. Getting a jump on all of this activity now can help networks sustain their market momentum and expand more rapidly.



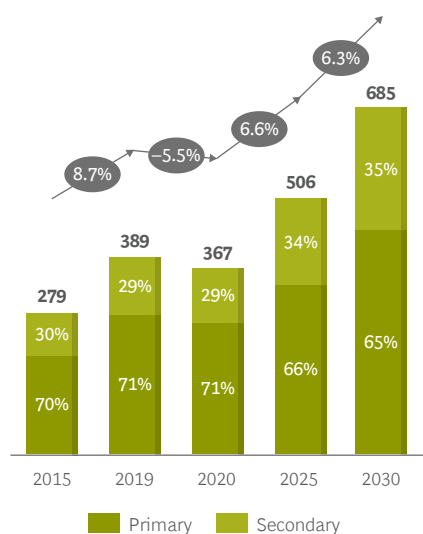
Wholesale Transaction Banks Must Go Digital

Wholesale payments revenues declined by roughly 5.5% from 2019 to 2020. Ongoing low interest rates and pandemic effects such as a falloff in business spending and a temporary breakdown in international supply chains shaved \$22 billion from the revenue pool, reducing the total to \$367 billion. (See Exhibit 6.) These setbacks are likely to be temporary. Our modeling suggests that growth will recover briskly and remain at approximately 6.6% through 2025. Primary, transaction-related revenues are likely to drive much of this growth, especially in Latin America and Asia-Pacific, propelled by vigorous business expansion and the ongoing digitization of paper-based transactions.

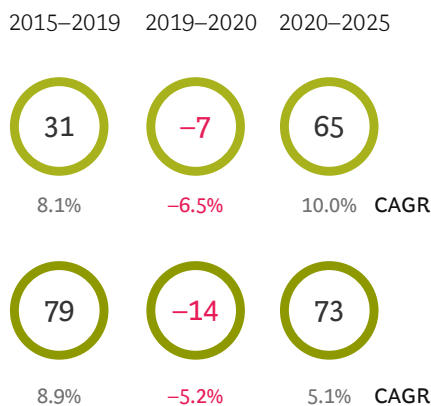
Ecosystems will account for a rising share of all payments activity in the years ahead. To avail themselves of future growth, wholesale banks must make platforms part of their strategy and determine where and how best to engage. Lending platforms, foreign exchange platforms, and working capital finance platforms are all likely to have wide B2B appeal.

Exhibit 6 - The Growth Outlook in Wholesale Transaction Banking Is Bright, Particularly for Platform Plays

Revenue (\$billions)



Revenue growth (\$billions)



Example: SME banking

Ecosystem opportunities for wholesale transaction banking



Source: BCG Global Payments Model 2021.

Note: Primary revenues relate to transaction-based revenues. Secondary revenues relate to fee and interest revenues associated with checking accounts and credit cards.

Three Forces Reshaping Transaction Banking

The payments business is vital to the success of wholesale banks, not only as a source of revenue and low-cost funding via deposits, but also as a strategic gateway for cross-selling other services such as cash management and pooling, foreign exchange hedging, and working capital and trade finance lending. But achieving success in wholesale payments has become significantly more challenging over the past several years, for three reasons.

Competition is intensifying. Attracted to wholesale banking's significant potential, determined incumbents and nontraditional players are investing heavily in the space. Among them are card schemes such as Visa, MasterCard, and American Express. Visa, for example, plans to expand B2B Connect, its cross-border payments solution, to more than 100 countries. MasterCard hopes use its acquisition of Nets' account-to-account business as a springboard to build multirail payments solutions. And American Express is using its acquisition of Kabbage to add digital SMB

lending capabilities. Meanwhile, specialized fintechs are making inroads into the wholesale banking market and courting audiences with innovative treasury management, cross-border, and working capital offerings. These businesses have attracted more than \$12 billion in equity funding during the past five years. Leading enterprise resource planning (ERP) and accounting software providers aim to improve and standardize the bank-corporate interface with high-quality APIs. Many are also evaluating how to best integrate payments and financial services functionality into their software-as-a-service (SaaS) offerings to corporate customers. Heavyweight incumbents are ratcheting up their ambitions as well. For instance, Goldman Sachs has begun offering traditional transaction banking products such as cash management and treasury services on a cloud-based digital platform. And HSBC is piloting an innovative cross-border payments proposition with its Global Wallet product. These competitor moves make it harder for traditional players to differentiate themselves through their core product offering alone.

Corporate customers expect more. Chief financial officers and corporate treasurers are looking for more than just a reliable transactions processor for domestic and cross-border payments. They want modern banking and payments services with streamlined account opening and know-your-customer processes, easy corporate-to-bank connectivity through APIs or bank portals, and account aggregation and cash pooling. Data transparency, reconciliation, and analytics are other must-haves. But most solutions that wholesale banks offer aren't set up to provide these insights or to allow seamless data integration into corporate ERP, accounting, procurement, and treasury management systems. Nor are banks making the most of the data they have. With a more clearly defined data strategy, they could offer VAS such as predictive payments scheduling and risk management analytics. Strong customer support is another essential: treasurers want to track payments end to end and are looking for a reliable source to address technical problems and payments investigations.

Digital platforms and ecosystems are becoming ubiquitous. Digital B2B and B2B2C platforms are becoming a mainstay for companies across industries. They include accounts payable and receivable platforms maintained by SaaS providers; procurement platforms connecting buyers and suppliers such as those offered by SAP Ariba, Coupa, and Tradecraft; and industry-specific platforms such as Booking.com and Toast. Digital marketplaces such as those hosted by Alibaba or Amazon Business are in the mix as well.

Right now, none of these ecosystem orchestrators are banks. But many orchestrators have their eyes set on gaining these capabilities. Most will seek to do so by collaborating with financial institutions rather than attempting to acquire a banking license independently. For instance, Coupa's bank partnerships allowed it to launch Coupa Pay, which provides customers with a full suite of payments and financing opportunities. As more ERPs, procurement specialists, and software vendors embed payments in their ecosystems, banks that fail to articulate an effective route to market in this evolving space—either by partnering with leading B2B ecosystems or by acting as an orchestrator—risk being shut out.

How Wholesale Transaction Banks Can Meet This Moment

Banks cannot afford to cede the advantage in the payments space. But to stay competitive, they must significantly change the way they do business. On the basis of our client work, we believe that the following four actions can help wholesale banks drive profitable growth in the postcrisis period and beyond.

Redefine the core offering. The first move that banks should make is to address their pricing—a practice that tends to be inconsistent and heavily reliant on the judgment of relationship managers rather than on data-driven pricing arrangements. To address this, we recommend that banks rethink their fee structure. A starting point is to analyze and test different pricing models to see whether a transaction-based approach, a service-based approach, or a subscription-based approach would deliver the most customer and business value. They should then use data analytics to establish the appropriate price point for different services and standardize this pricing across their portfolio. Next, banks need to determine which sources of future growth to back.

In the future, amid growing commodification and ongoing low interest rates, the current account and domestic and cross-border payments anchor products that served to sustain wholesale banks in past years are unlikely to generate sufficient profit. The top-performing transaction banking institutions over the next decade will continue to expand their capabilities into adjacent products. These include liquidity planning, cash pooling, risk management (foreign exchange risk, interest rate risk, and commodity risks), and digital procurement cards. CFOs and treasurers also seek working capital finance solutions—such as merchant cash advance, invoice discounting, and supply chain finance—to offset temporary liquidity shortfalls.

As payments increasingly become embedded in industry-specific business processes, banks should prioritize vertical plays, identifying sectors where they can provide specialized capabilities (either on a standalone basis or by partnering with a SaaS provider). Banks should give strategic consideration to white space opportunities in emerging industries such as the still-nascent payments infrastructure for electric vehicle charging stations, since these new areas could deliver first-mover advantage to early participants.

In addition, banks should develop a suite of offerings tailored to the needs of SMBs, which often lack the staffing and expertise to manage payments, insurance, payroll, accounting, and tax demands as efficiently as they'd like. Banks that fill this void with processes that automatically analyze transaction data, track cash flow, schedule payments, monitor working capital, and assess liquidity needs can create a large and scalable source of revenue growth.

Finally, banks must refresh their go-to-market strategy. In the case of SMBs, for instance, a hybrid model that combines a strong digital channel with the existing branch network can give banks the cost efficiencies they need to turn this segment into a valuable, long-term relationship base. Forming strategic partnerships with ecosystem orchestrators and SaaS providers will also be important. Opportunities are wide ranging. For example, Goldman Sachs teamed up with Amazon to offer merchants on its marketplace a credit line of up to \$1 million. And Standard Chartered partnered with TradeLens, a logistic blockchain shipping platform, to authenticate global shipments in real time.

Modernize the payments infrastructure. Transaction banking is a technology-intensive business that can consume 30% to 40% of an institution's annual change-the-bank IT budget. Regulatory requirements and new technical standards are key drivers of this IT intensity. For instance, banks globally must adopt the new ISO 20022 messaging standard by 2025. Financial institutions operating in Europe must also comply with consolidation of TARGET2 and TARGET2-Securities, building the European Central Bank's future real-time gross settlement and securities settlement platforms. In addition, many banks in the region will feel competitive pressure to enable the Single Euro Payments Area's Request to Pay scheme, a messaging functionality that can initiate an instant credit transfer for payments.

Implementing these requirements cost-effectively will require close collaboration between the bank's payments business and its IT function. Teams must be clearly aligned on which capabilities to prioritize in the modernization effort. And they must possess enterprise-grade project management skills to oversee the change effort.

Transaction banks that have the necessary resources will want to invest in a modern payments infrastructure to maintain high-quality products and services. Building that capability will be essential to success in a platform economy, given the rapid growth of B2B ecosystems. It could also allow banks to offer payments-as-a-service (PaaS) to competitors that lack the budget or capabilities to upgrade their own infrastructures. Small banks and regional banks will have to make a strategic choice regarding their transaction banking proposition. Players that lack the expertise or financial resources to update their payments infrastructure should explore alternative routes such as the use of payments utilities, outsourcing arrangements, or PaaS offerings. For example, two regional European banks—UniCredit and Commerzbank—have fairly recently decided to outsource their payments operations to Worldline.

Become a data-driven organization. Today, most banks use payments and transaction data primarily to optimize internal processes such as transaction monitoring, credit decisions, cross-selling, and churn prevention. But with the competitive bar rising, banks need to use data more strategically throughout the value chain. Leaders will develop capabilities that allow them to combine payments and transaction data with internal and external sources of data (for example, balance sheet or P&L information, and industry benchmarks), including detailed customer analytics, to improve their predictive accuracy and incisiveness. A more holistic data aggregation can help banks model the ebbs and flows in a customer's incoming and outgoing payments, identify the pros and cons of different hedging strategies, and provide value-added insights such as optimization of business spending or working capital. To successfully monetize data, banks must keep abreast of privacy and regulatory boundaries and be upfront with customers about what data is being used and why.

Digitize core products and develop an API portfolio. To participate in the digital platform boom, wholesale transaction banks will have to redesign payments products in a modular, digital-native way, factoring in how customers approach different stages of the payments journey. Doing so can help them optimize onboarding, credit applications, and other steps for digital channels. In addition, banks should develop APIs that can simplify bank-to-customer connectivity and enable plug-and-play access to attractive payments features and capabilities. Examples include APIs that allow corporate treasurers to execute rail-agnostic payments, automate reconciliation, and forecast liquidity. They should configure APIs to integrate easily into corporate ERP and third-party applications and to link banking capabilities to core commercial processes. The portfolio should also include platform APIs that third parties can embed in their ecosystems to enable corporate customers to execute payments, manage liquidity, and address foreign exchange risks.



Fintechs Are at an Inflection Point

There's no disputing that fintechs have become a major disruptive force over the past 20 years. More than 20,000 of these sophisticated digital players have launched since 2000, backed by over \$300 billion in cumulative equity funding from angel investors, venture capital and private equity funds, and strategic investors.

Payments-related businesses have driven much of this growth, accounting for nearly a quarter of total fintech funding over the past five years. (See Exhibit 7.) Two decades ago, early players such as PayPal focused on the retail segment. Today, leaders span the value chain, covering B2C to SMBs from front office to back. For example, PayPal has extended its reach well beyond the core payments transaction to offer banking, investing, commerce enablement, and data and identity services. It has become a payments giant with a market capitalization of more than \$300 billion.

Exhibit 7 - Payments Businesses Represented Nearly a Quarter of All Fintechs Launched and Funded from 2015 to 2020

Payments represented approximately 1/4 of fintech activity in 2015–2020...



22%

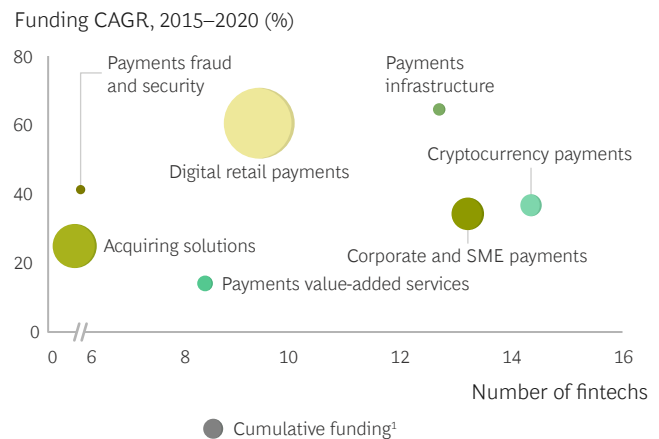
Share of total fintechs launched during 2015–2020



24%

Share of total fintech funding during 2015–2020

...with digital retail payments and acquiring solutions receiving the largest share



Source: BCG FinTech Control Tower database.

¹Reference circle size = \$5 billion.

Collectively, fintechs account for roughly 5% of all banking revenue in the US and as much as 20% in payments-related fields. They also represent many of the financial services industry's most notable unicorns—businesses whose valuations exceed \$1 billion. In fact, unicorns such as Square, Stripe, and Ant Financial (with its Alipay offering) are valued well above \$100 billion.

With that growth, however, have come some growing pains.

As Fintechs Mature, Challenges Grow

After years of strong funding, payments fintechs may be reaching an inflection point. Sky-high asset values are one sign that change is in the offing. Some businesses have seen their valuations soar in recent years. But strong investor enthusiasm carries a price, forcing fintechs to move quickly to identify new avenues of incremental growth and profitability. Although total equity investment levels continue to rise year over year, backers are funneling a higher percentage of their dollars into a smaller number of entities. As a result, deals attracting more than \$100 million in funding accounted for more than 70% of all fintech investments in the first quarter of 2021.

The evolving environment raises questions. Some founders and investors wish to use the capital markets to attract new funding for growth by going public or finding new partners. But knowing the right timing, formulating the appropriate IPO or M&A strategy, and extracting maximum value from investor negotiations require significant attention and financial and accounting expertise, which leaders may lack.

Successful fintechs also need to figure out the smartest and most efficient ways to grow. Businesses that rode to success on the basis of one set of offerings must decide whether to go deeper into those areas or broaden into new segments, markets, use cases, or revenue pools. They also need to revisit their route to market. As more payments fintechs inch their way into banking-related services and as more banks move into payments, key partners may become key competitors.

Organizational models are in flux, too. Some fintechs have reached the awkward teenager stage of development. No longer startups, they don't yet have the organizational model or enterprise-grade capabilities to manage their run rate and grow efficiently. Because of their size and stature, fintechs are also attracting greater regulatory attention. To withstand that increased scrutiny, they must establish a robust compliance and risk management function. Their people organization is going through immense change as well. The tasks of recruiting hundreds of new hires per year and of expanding into new markets and products have strained many companies and diluted their core startup culture.

It's Time to Prepare for the Next Stage of Growth

Our estimates suggest that by the end of the decade, fintechs and other nonbanking competitors such as bigtechs, merchants, and specialized software companies could capture 25% of all banking revenues. However, fintechs—especially those beginning the transition from early growth to mature growth—must take several actions to make good on this opportunity.

Refine the business model to sustain growth. Payments fintechs can't wait until they reach the top of their initial growth curve to determine which initiatives will unleash the next wave of opportunity. They need to start identifying those business model extensions now. Choosing whether to go deep by focusing on the core business or to go broad by expanding into new products, customer groups, or geographies requires detailed strategic analysis. While some payments fintechs aim to disrupt incumbents, others have built thriving businesses by serving them. For example, Marqeta began by offering issuing-as-a-service solutions to e-commerce marketplaces, but then it widened its customer base to include banks such as Marcus and J.P. Morgan. In weighing their choices, fintechs should consider the total addressable market and run scenarios that test the potential for growth and examine likely changes within the competitive environment. For instance, if a business has been growing at 10% in a core market that is rapidly converging around three or four main players, can it reasonably expect to continue to grow at 10% or higher, or does it need to recalibrate? Which products or markets can give it the runway it needs? What level of investment will be necessary to lead in that space? And how much time will the business need to get the initiative off the ground, test it, and bring it to scale?

After identifying several opportunities, fintechs must look at sequencing. Balancing growth, profitability, and strategic direction, they have to determine which initiatives to act on immediately, which to monitor, and which to table until the business can develop the needed capacity and capabilities.

They must also be clear-eyed about their partnership approach. Many fintechs were born as disruptors. But as the payments ecosystem becomes more interconnected, fintechs need to look downstream and consider where to place their bets. Which businesses should they partner with, which ones should they compete with, and what is the optimal structure for the collaborations they do forge? If they fail to think through these considerations at the outset, fintechs can unwittingly paint themselves into a corner, as potentially desirable partner organizations join forces with others.

Transition the operating model. As fintechs evolve from startups to mature businesses, the engine powering their core products and services must grow as well. In the go-go early days of a company's development, for example, what matters most is growing the base. But in later years, the keys to success are to grow the base efficiently, reduce customer acquisition costs, penetrate existing accounts more deeply, and protect against churn. Organizational structures need to evolve to accommodate larger teams.

It's relatively easy to share knowledge and test ideas when companies have a few dozen employees. But these tasks become exponentially more complicated when headcount expands to hundreds or thousands across geographies. To maximize their teams' productivity, maturing fintechs need to revise and standardize their business processes, data management, and ways of working.

Governance approaches must evolve as well. Fintechs will need to professionalize their risk management and compliance function and ensure that they have the requisite data, systems, and expertise to protect the growing business, particularly as it expands into other legal jurisdictions. Performance management needs to evolve similarly. Fintechs can use their advanced digital capabilities to fashion reporting dashboards and automated feedback loops that help teams from the frontline to the senior leadership ranks track key metrics, troubleshoot early, and continually refine and improve their processes.

Grow talent while safeguarding culture. Fintechs have what may seem to be an enviable problem. Their rapid growth and reputation for generating exciting innovations has made them a talent magnet in some markets. But trying to gauge what, when, where, and how rapidly to add new positions can be overwhelming. When a business is small, recruiting and onboarding can occur over a cup of coffee. But as the business scales, finding, placing, and onboarding talent can take weeks or months. Particularly as they explore new avenues of growth, fintechs need to think two steps ahead and anticipate the types of capabilities they'll need so that those skill sets will be available without delaying strategic initiatives. Fintechs that are still in the early hyper-growth stage of development may want to establish a recruiting pipeline in strategic locales, either directly or through partnerships with universities or high-tech incubators, to gain needed language or local-market capabilities. Structured training and standardized onboarding and performance management processes become more important as a business grows. These fundamentals get new hires grounded quickly and enable more consistent and productive work practices across geographies. Because many of these capabilities may extend outside a founder's own experience set, investing in senior human resources support and formalizing the HR function can be extremely valuable.

Professionalizing staffing is a critical objective, but preserving the organization's culture while doing so is even more critical. Addressing this requires action on several fronts. The first is through visible and active leadership. Values and a sense of enduring purpose that may have been implicit in small teams need to be communicated explicitly as the organization grows. Founders and their teams can play a meaningful role in consistently communicating what the business stands for.

The second action involves establishing empowered teams. Many digital natives are well versed in agile ways of working. Their next task is to deploy that method of teaming at scale—breaking large projects into smaller ones; prioritizing tech initiatives based on IT capacity; staffing diverse, cross-functional teams; and ensuring ongoing progress reporting within and across groups. Establishing project-based teams can help prevent a silo-based mentality from creeping in as the organization grows. Because such teams may form and collapse as projects begin and end, the individuals assigned to them can continuously learn from and engage with others. This type of structure allows colleagues to share ideas and values organically, helping to cement the company's culture in ways that feel authentic and lived even as the company grows.

Incumbent Players Will Also Need to Make Changes

Banks, established payments service providers, and credit card schemes will need to navigate the complex fintech ecosystem to articulate their own path to growth, defend their territories, and identify fruitful collaborations. Most will need to industrialize their partnership strategy to conduct due diligence with appropriate depth and regularity. To succeed, they must dedicate resources to evaluating fintechs' business, technology, and operating models, including their strategic fit with the incumbents' core business. Banks and other established players must also determine what type of partnership arrangement makes the most sense for particular circumstances—for example, when it would be better to engage in a revenue-sharing agreement than in a joint venture. In addition, incumbents need to anticipate which technological capabilities will be critical to success. For instance, they may need to accelerate moving certain applications to the cloud, making key data available through APIs, and advancing data security.

Incumbents should also consider building new ventures in house when they command a distinct advantage. Bci in Chile applied its subject-matter expertise and infrastructure resources to turn MACH into the leading peer-to-peer wallet in the country. Lippo Group, a conglomerate based in Southeast Asia, built the fintech unicorn OVO by leveraging its retail footprint and banking infrastructure. Despite not being digital-first, these businesses ideated, developed, and scaled leading fintech businesses entirely in house.



Conclusion

Act Now to Capture Long-Term Advantage

To avail themselves of the massive growth potential in payments, entities must consider their place in the market today and decide what spaces they want to win in the next five years. Multiple forces are at play, and the payments ecosystem is more dynamic than ever. Organizations that act decisively in plotting their strategic path, detailing the specific capabilities and investments they need, and committing to bold action will earn long-term strategic advantage. The growth potential is there. This is the time to seize it.

For Further Reading

Boston Consulting Group has published other reports and articles that may be of interest to senior financial executives. Recent examples include those listed here.

[Winning the Digital Banking Battle in Asia-Pacific](#)

An article by Boston Consulting Group, August 2021

[Six Steps to a Sustainability Transformation](#)

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