PAYMENTS MODERNIZATION

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An eye on the horizon: Powering a digital economy

Part 2:
Powering a digital economy

In the previous chapter, we took a detailed look at the concept of payments modernization and how different countries will take different paths depending on a diverse range of needs, drivers and influences.

This chapter explores the drivers of modernization, including increasing overall efficiency of systems, risk reduction, and responding to demand for digitization of transactions. But whatever the driving force, the endpoint should be characteristically the same: increased financial inclusion, innovation and economic growth.

Setting the scene: The changing role of cash

One of the key drivers of payments modernization is a response to technological innovations and changing consumer demands.

We see this demand being played out in many markets with the use of cash declining relative to digital payment methods – a trend that has been accentuated in many countries as a result of the COVID-19 pandemic. Indeed, in Mastercard's 2021 New Payments Index, 71% of people globally said they expect to use less cash moving forward.

Accenture highlights that over the next decade, the payments industry expects a total of 2.7 trillion transactions, worth $48 trillion, to shift from cash to digital channels. And according to Boston Consulting Group, the switch to digital payments from cash can boost a country's annual GDP by as much as three percentage points.

Of course, cash remains hugely important for some members of society. The New Payments Index also found nearly eight in ten (77%) people say their preferred payment method changes based on the situation, and as such the same percentage say they're still likely to use cash in the next year. It's crucial that people's ability to access cash in a convenient way is preserved so those who need or choose to use cash, for example owing to lack of digital access or digital literacy, are able to.

While reducing the amount of physical cash circulating in society is one motivation for payments modernization – as it can bring greater transparency to payments systems and in some instances reduce some types of fraud – there are other drivers of payment system modernization.

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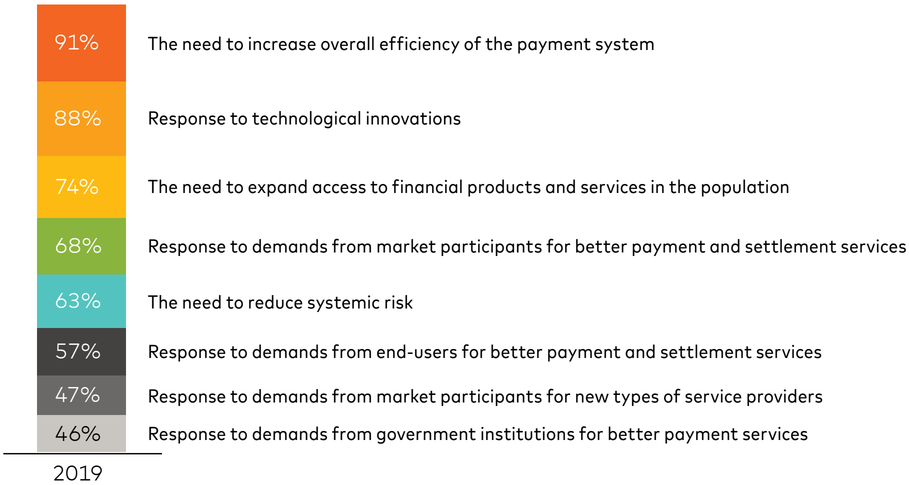
Understanding the broad range of drivers of payments modernization

The World Bank's Global Payment Systems Survey (GPSS) highlighted three standout triggers for payment system reform:

1. To increase overall efficiency of the payments system (91 percent of respondents);
2. A response to technological innovations (88 percent of respondents);
3. Expand access of financial products and services in the population (74 percent of respondents)

Factors triggering payment system reform



Source: World Bank GPSS 2020

Essentially, this comes down to costs, competition and financial inclusion. It's also worth noting that over two-thirds of central bank respondents cited their reforms as a response to demands from market participants for improved payment and settlement services.

We tend to consider payments modernization as being a top-down approach instigated by public bodies and central banks, but banks, non-bank providers and technical service providers regularly play a crucial role in pushing national payments reform.

In some cases banks are the primary driving force. And nor should we forget the bottom-up influences driving payments reform, such as increasing consumer expectations, which have only increased during the COVID-19 pandemic as the world moves online.

Modernization in practice

Sarie, Saudi Arabia's instant payments system developed through a collaboration between Saudi Payments, Mastercard and IBM, targets achieving 70 percent non-cash transactions by 2030, and yet recognizes the continued presence and important role of cash.

The introduction of Swish in Sweden, meanwhile, was primarily aimed at reducing the residual amount of cash used by consumers, according to a report by Riksbank. At the time of its launch in 2012, Sweden was already one of the world's most cashless and digital societies and remains so today. In fact, the reduction of cash has been so successful that the central bank has now begun to rethink and review policies around bank obligations to provide secure access to cash for those who still need it.

Looking at India, the vast efforts to digitize the country's payments industry over the last decade have had a massive transformative impact. The shift from cash to digital has become an economic enabler. To give just one example, a report from Oxford University's Internet Institute found India now accounts for a quarter of the growing global market for international freelancers. In these newly-digitized economies, payments modernization becomes a vital component to support market developments, ensuring workers are paid efficiently, on time, and can contribute to the economy.

18.6%

anticipated rise of CAGR between 2020 and 2025

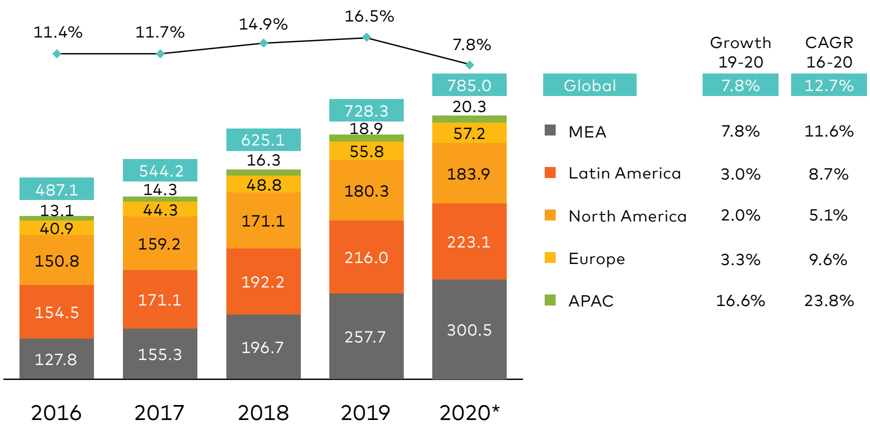
The growth opportunity

Documenting the process of payments modernization is one thing, but it's also worth putting it in the context of the progress being made in growing non-cash transactions over recent years.

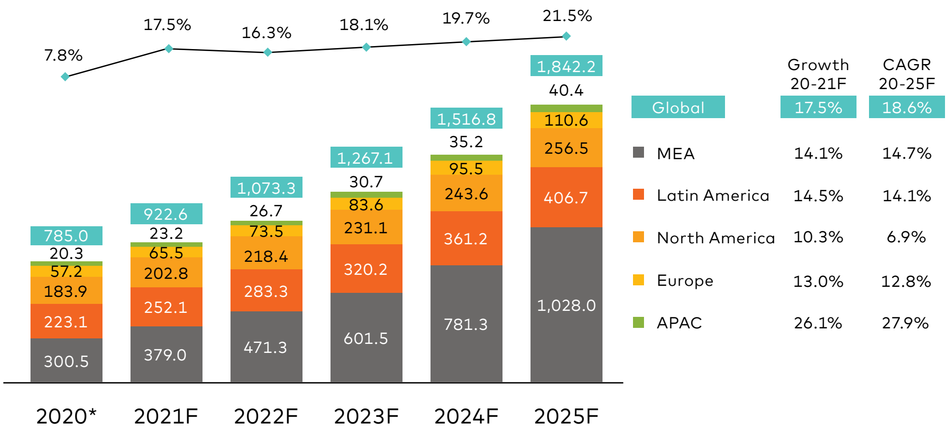
Not only does it highlight the success of many modernization efforts, but it also helps explain why others continue to invest in it. Being a second mover has its advantages – it allows you to navigate the terrain using learnings and practices of your peers.

Overall, the volume of global non-cash transactions grew by a compound annual growth rate (CAGR) of 12.7 percent between 2016 and 2020, highlighting a significant shift towards digital payments.

Worldwide non-cash transactions volume (billions) and YoY growth (%), 2016-2020



Worldwide non-cash transactions volume (billions) and YoY growth (%), 2020-2022



Source: *Capgemini's World Payments Report 2021*

"One of the great benefits of payments modernization is its ability to offer more accessible and convenient ways to pay."

While the double-digit volume growth dropped to 7.8 percent in 2020, due to COVID-19 lockdowns, stifled business activity and reduced spending, it's anticipated that the CAGR will rise to 18.6 percent between 2020 and 2025.

This expected growth rate will be driven by consumers and businesses demanding digital experiences similar to what they receive in adjacent industries, as well as the ongoing behaviour change driven by the pandemic.

One of the great benefits of payments modernization is its ability to grow the total volume of payments, targeting new use cases and supporting new digital experiences that offer more accessible and convenient ways to pay. There's a virtuous circle whereby payments modernization improves efficiency and access to payments, helping to grow an economy, which in turn supports more payments.

There's a huge opportunity to grow non-cash payments across the world. In India, for example, there's ambitious talk of reaching the target of 200 non-cash transactions per person annually. To put this in context, if all markets below 200 transactions per person annually were to reach this milestone, this would mean an additional 795 billion transactions globally.

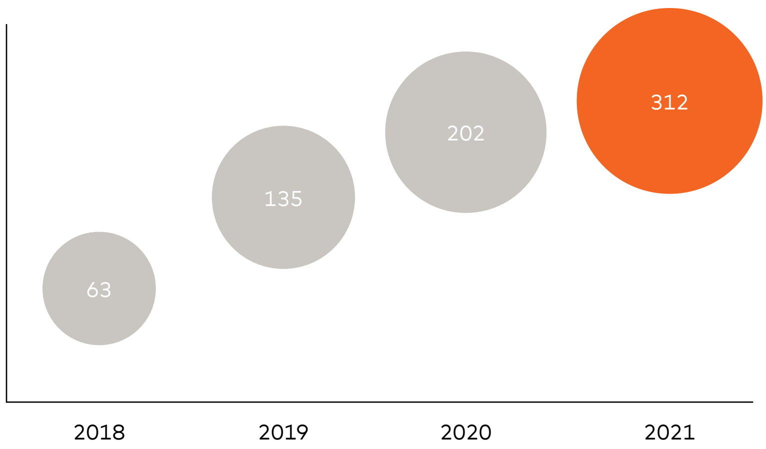
So just how realistic is such a goal? It will, of course, depend on a number of factors, but how we approach payments modernization can play a key role. Policy decisions, target use cases, overlay solutions and bank readiness can all play a big part. However, the Thai example shows this target can be achieved in a relatively short period of time.

"Learning from the experiences of your peers should play a vital role in helping you to develop your payments modernization plan."

Examples of best practice

In early 2017, with support from Mastercard, Thailand commercially launched its newly modernized real-time payments service, PromptPay. Five years later, PromptPay is one of the fastest growing real-time payment services globally, averaging 36.2 million daily transactions (a 79.4% year on year increase). The service has contributed to an overall four-fold increase in e-payments since 2018, according to Bank of Thailand data.

E-payment transactions per person: Year on Year



Source: Bank of Thailand

Several key decisions helped to lay the foundations for this remarkable growth story. Firstly, the Thai government decided to move certain government disbursement payments to the new system. This encouraged adoption from the outset as Thai citizens had a clear financial incentive to sign up and register their proxy information in order to prevent any delays in receiving key government payments.

This approach quickly created a critical mass of registered users. Banks were also mandated to support the service, which fuelled the growth of other use cases. Mobile P2P and P2M in-store merchant payments accelerated supported by a multi-proxy look-up service. Bill payments, request to pay functionality – supported through the MyPromptQR service – and business payments have also become established.

While there are several important lessons to take from the Thailand example, there's a more general point here worth emphasizing: learning from the experiences of your peers should play a vital role in helping you to develop your payments modernization plan.

Like Thailand, in India banks were mandated to join the real-time payments system but it has taken a more staggered approach to payments modernization. One challenge India has had to face compared to Thailand – and where it can demonstrate real success – is financial inclusion.

80%

af adults in India have access to a bank account (from 40% in 2010)

When India launched IMPS, its first real-time payments system, in 2010, just 40 percent of Indians had a bank account, according to figures from the World Bank. Today, well over 80 percent of adults in India have access to one. In 2016, Universal Payments Interface (UPI) launched and is now the largest scheme globally with 38.74 billion transactions recorded in 2021. The success of UPI is in part due to its accessibility, with its open banking-style implementation allowing people to pay from multiple bank accounts from a single app.

While current market trends suggest 200 transactions per capita will take a few more years to achieve, the Reserve Bank of India's move to allow private payments entities to set up, manage and operate retail payments systems — officially described as a New Umbrella Entity (NUE) — may accelerate things.

Elsewhere, other markets, including Peru, Indonesia, Pakistan and Vietnam, are progressing with their own payment system modernization plans.

But it's not just the world's developing markets that have significant growth opportunities. Major economies like Germany and Japan, for example, have non-cash transaction figures significantly below their peers. These markets have a long-standing affinity for cash, but the question is now whether they will also embrace the benefits of introducing new digital ways to pay to increase volumes and support new use cases.

For more chapters and further information visit
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