Global payments trends: Challenges amid rebounding revenues

Global payments revenue rebounded to $1.34 trillion in 2011, a steep increase from 2009's $1.1 trillion. According to McKinsey's Global Payments Map, global payments revenues will grow at a CAGR of 5 percent between 2011 and 2016, with emerging countries in Asia and Latin America contributing more than half of global payments revenue growth (Exhibit 1). The latest payments map reveals a number of trends in the global industry.

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Payments revenue will grow faster than overall banking revenues

In 2011, global payments revenues accounted for 33 percent of total banking revenues. This figure is impressive, but perhaps a bit misleading, since more than 60 percent of global payments revenue derives from interest revenue, including current account deposits (59 percent), overdraft lines (16 percent) and credit card revolving loans (22 percent). North America is the only region where the share of interest revenue is less than 50 percent.

Because interest revenues are dependent on interest rates, payments revenues are increasingly under pressure. Case in point: Between 2008 and 2011, banks suffered a sharp decline in payments revenues as a result of the collapse of interest rates. Changes in interest rates continue to be unpredictable. Continuing troubles in the interbank lending market and new financial regulatory measures (e.g., Basel III and the Vickers rule) are also pressuring revenues. As a result, banks will have to become less dependent on interest revenue. This will lead to increasing competition to capture customer deposits (which will put downward pressure on net interest margins).

These trends mean that payments revenue will only increase in importance for banks. In fact, we expect that payments' share of banking revenues will increase to 37 percent by 2016.

As interest rates face continued volatility, growth in revenue is expected to be driven by fee – rather than interest – income. In Asia, for example, we expect that more than

75 percent of the increase in payments revenue will be in fee revenue. Not all regions will grow at the same rate, of course. Emerging regions of Asia and Latin America, for instance, are expected to grow at nearly double the rate of Europe and North America. The sources of growth will also differ. North America and Latin America will benefit from the continued growth of retail credit cards, with cards likely accounting for 30 percent and 46 percent of growth respectively. Asia and Europe, on the other hand, will benefit from the rise in corporate transaction fees – about 34 percent and 39 percent respectively.

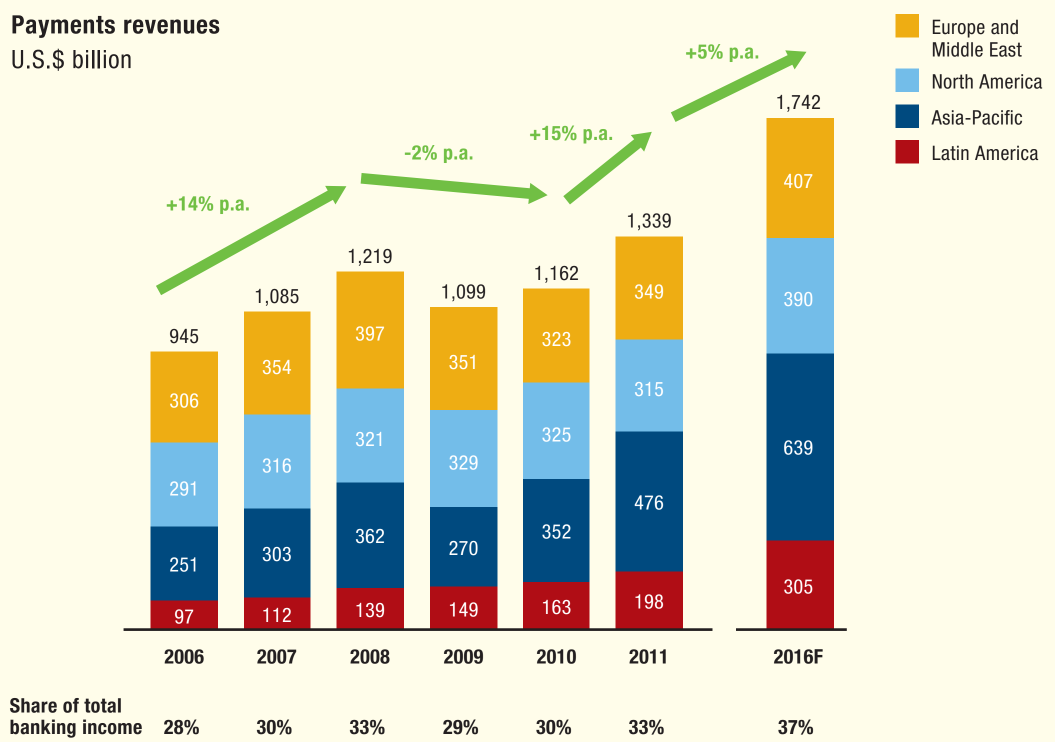
Mobile revenues still a question mark

Banks and non-banks throughout the world have invested heavily in mobile payments products and solutions, but it is not yet certain that mobile payments actually increase overall payments industry revenues, or whether they reallocate revenues across new channels and instruments. The answer really depends on geography.

In emerging countries, mobile payments frequently provide formal banking and financial services to previously unbanked populations, thus creating additional revenue. Mobile payments in developed countries have not changed the landscape to this extent. Here, mobile is merely more convenient than online channels, or, as in the case of QR codes, an alternative to traditional cards. This shifts revenues, but doesn't generate new revenues. The pie can be increased, but mostly by boosting revenue

Exhibit 1

Global payments revenue is expected to grow at 5% over the next 5 years



Source: McKinsey Global Payments Map

from marketing and advertising, loyalty programs and analytics.

Credit versus debit

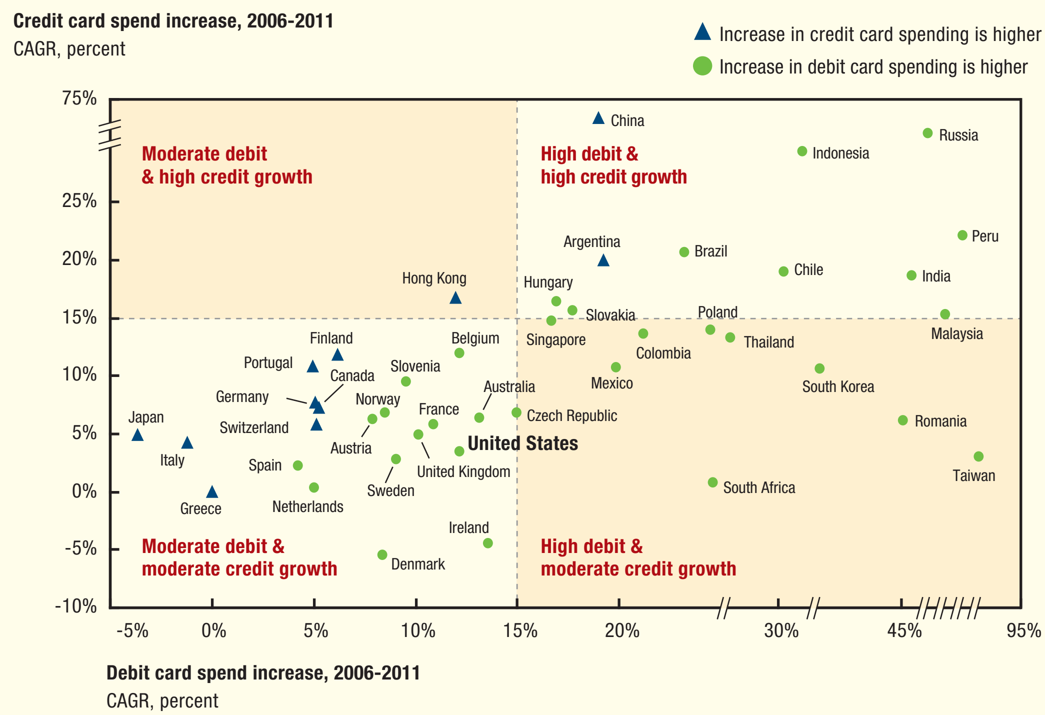
Most of the developed markets continue to be dominated by debit cards. Even in the U.S., UK and Korea, where credit cards have been dominant, credit cards have been outpaced by debit cards of late. In the United States, for example, debit card spending increased at a CAGR of 12 percent between 2006 and 2011, while credit card spending increased at only 3 percent during the same period (Exhibit 2).

Just 10 nations account for more than 80 percent of global credit card issuing revenues. The United States and Brazil are the largest of these by revenue, accounting for more than half of global revenues (Exhibit 3). Despite the economic crisis, credit card revenue has continued to increase. This is largely due to growth in Brazil, China and other emerging markets (China and Brazil accounted for 74 percent and 271 percent respectively of the absolute growth between 2009 and 2011).

It is worth noting that behaviors and growth drivers differ widely across emerging markets. In Brazil, interest rate revenue contributes 73 percent of credit card issuing revenues (issuers levy high interest rates to compensate for high risk). In China and most of Asia, credit cards are built almost exclusively around transactions. In China, 68 percent of credit card issuing revenues derive from fee income (annual subscription fees and interchange fees), a stark contrast from the Brazilian model.

Exhibit 2

Debit card spending has grown faster than credit card spending



Source: McKinsey Global Payments Database; McKinsey Global Payments Map

On the other hand, in the U.S., the most significant credit card market in the world, credit card revenue declined between 2009 and 2011, as customers cut back on debt and issuers slashed credit lines and eliminated accounts. Recently, the share of transaction fee income has increased, however. This is due to flat interest income from revolving loans and transaction growth.

We anticipate revenues from global credit card issuing will increase from $328 billion in 2011 to $445 billion in 2016, a CAGR of 6 percent (Exhibit 4, page 38). Credit card fee revenues will increase faster than credit card interest revenue. While fees are expected to grow at a CAGR of 9 percent between 2011 and 2016, we expect that interest income will increase at a CAGR of 5 percent in the same period. Whereas fees accounted for 42 percent of the global credit card issuing revenues in 2011, they are expected to account for 47 percent in 2016.

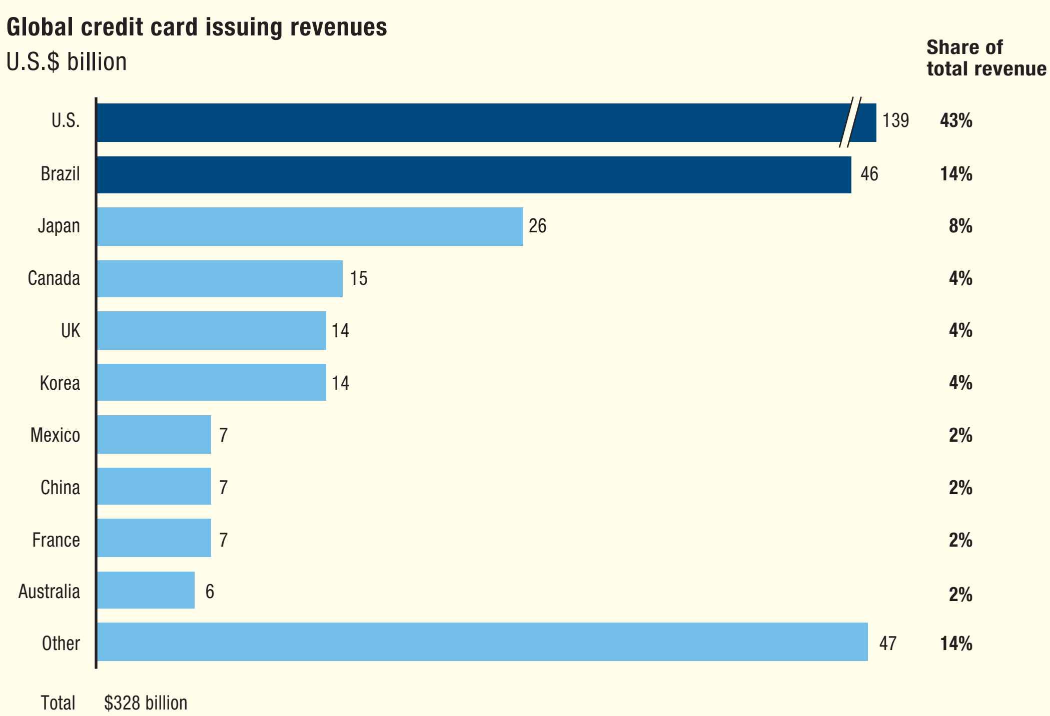
Emerging economies will be the primary drivers of credit card revenue. Brazil and China, growing at 14 percent and 29 percent CAGR respectively, will account for 50 percent of total global growth. Argentina, India and Indonesia will also experience high growth in credit card revenue. Australia, Canada and the United States will continue to grow as well, albeit at a much slower pace than the emerging markets.

The shift in trade to Asia is accelerating

Top-level global trends show that international trade is growing faster than global GDP. In 2012, exports represented 31 per-

Exhibit 3

Ten countries contribute more than 80% of global credit card issuing revenues



Source: McKinsey Global Payments Map

cent of world GDP, up from 20 percent in 1990. We expect the share of exports relative to GDP to continue to rise, reaching 36 percent by 2020. The long-term growth in international trade can be attributed to the growth of the middle class in emerging markets (especially in Asia) and trade liberalization, among other factors.

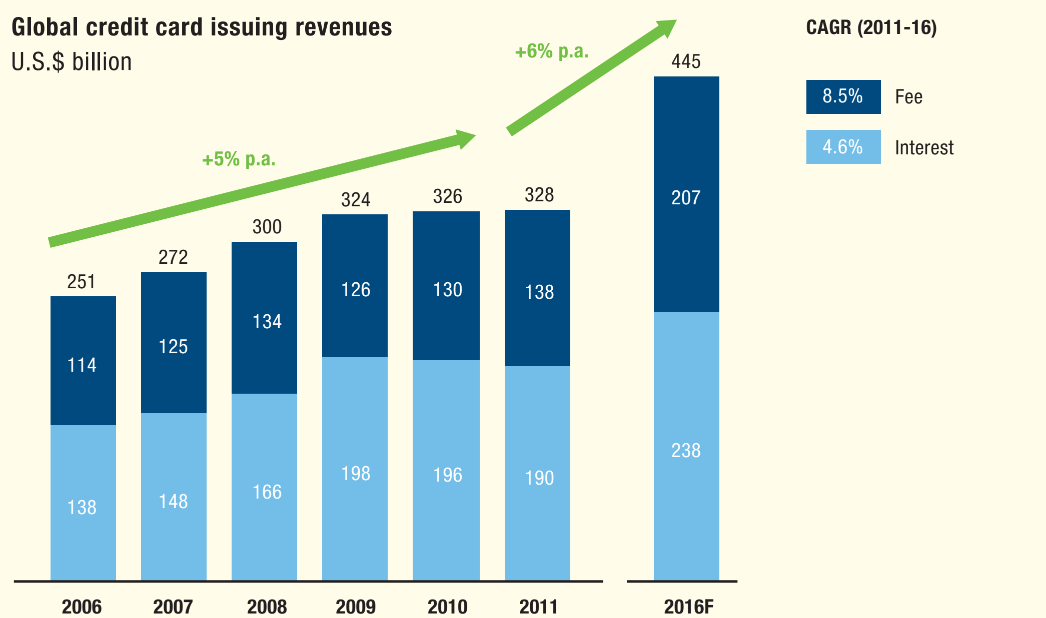
Asia is the undisputed center of global trade growth, and is expanding trade rapidly into Africa and other emerging markets. According to HSBC Global Research, growth in Asia has contributed more to global GDP growth in each of the past five years than the European Union, Japanese and U.S. markets combined. In fact, 2013 will be the year of the "big cross-over," when emerging markets will generate more than half of global GDP, based on purchasing-power parity.

McKinsey's granular trade analyses show that intra-Asia trade already contributes more to global trade growth than intra-Europe trade. If growth continues at this pace, Asia should surpass Europe by 2016 as the largest regional trading area, altering the structure of the trade finance industry.

The emphasis is increasingly on corridors linking Asia to fast-growing markets in Latin America, Africa and the Middle East. Trade among these emerging markets grew by an impressive 14 percent between 2007 and 2012 (while trade among developed countries grew by 1 percent). Asia's impact on growth in Africa is particularly striking: Trade between Asia and Africa grew twice as fast at that with Europe, in absolute terms; Asia is on track to replace Europe as Africa's main trading partner by 2017. China alone accounts for 16 percent of all African trade, compared with 9 percent for the United States and 6 percent for France, Africa's second- and third-largest trading partners.

Exhibit 4

Credit card fee revenue will grow faster than credit card interest revenue



Source: McKinsey Global Payments Map

Even with the steady, long-term rise of open accounts, the traditional trade finance (documentary) business is unlikely to fully benefit from overall trade growth. Therefore, banks should take the perspective of corporate CFOs, making their risk mitigation solutions simple, straightforward and cheaper. A fully electronic risk mitigation procedure (e.g. the Bank Payment Obligation, which is an initiative of both SWIFT and ICC) could help meet this need. Additional working capital solutions are also required, especially for SMEs. Enhanced and simplified supply chain finance solutions could also help plug the working capital gap, generating additional revenues on open account transactions. (Today these already account for 75 percent to 85 percent of all trade transactions, depending on the region.)

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Payments are expected to grow at a healthy 5 percent until 2016, but this growth will not be evenly distributed. The developed markets will grow at a more modest pace. Future growth, furthermore, will be driven more by transactions than in the past. What does this mean for banks and issuers? Retail banks need to join the digital revolution, tapping into such additional revenue streams as advertising. They must have the right solution for their markets (such as credit cards in North America and Latin America). Commercial banks should ensure that they are providing working capital solutions for their SMEs. Global commercial banks should ensure that they are well positioned to capture growth in Asia and other emerging markets. In short, the future is bright, but only for players that are innovative, nimble, and attuned to the digital revolution in payments.

The McKinsey Global Payments Map provides granular information on global payments transactions and revenues. It offers extensive detail about payments business in 43 countries.

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