



# McKinsey on Payments

<b>Foreword</b>	<b>1</b>
<b>Forging a path to payments digitization</b> The social cost of cash is high wherever it predominates. Moving to a digital payments market can stimulate economic growth and facilitate financial transparency.	<b>3</b>
<b>The role of data analytics companies in mobile commerce</b> Data-rich companies—including banks and retailers—can use their assets to add value and secure their competitive position in the new digital order.	<b>10</b>
<b>Disruption brings opportunity in merchant payments</b> As the payments environment evolves, financial institutions and merchants will have many options for collaborating on approaches that create real value.	<b>17</b>
<b>The battle for the point of sale</b> Payments service providers are offering an array of products that are reinventing the point-of-sale experience.	<b>24</b>
<b>Driving merchant services and digital commerce: Findings from McKinsey's 2012 U.S. Small Business Acquiring Panel</b> Small merchants not only account for the largest portion of merchant acquiring, they also play a major role in the current trend toward digital payments.	<b>30</b>
<b>Payments regulation: A catalyst for innovation</b> Payments regulators are beginning to recognize their role in attaining a balance between protection and growth.	<b>38</b>
<b>The U.S. payments industry at a glance</b>	<b>46</b>

# The U.S. payments industry at a glance

The stiff headwinds that continue to confront the U.S. payments industry are evident in the latest release of McKinsey's U.S. Payments Map, which reveals a second consecutive year of revenue decline—the first two in the profit pool model's 20-year history. McKinsey forecasts continued rough waters, but our model identifies opportunities for payments providers to optimize their returns in a difficult environment, and to target still-meaningful areas of growth.

## A look at 2011

- U.S. payments providers earned revenue of \$280 billion in 2011, down nominally from 2010 and continuing a retrenchment from a high-water mark of \$294 billion in 2009.
- Net interest declines were the primary cause of 2011's revenue weakness. The historically low rate environment continued to depress demand deposit account (DDA) net interest margins (NIMs) despite all-time high consumer and commercial DDA balances. Consumer credit cards absorbed the largest hit to net interest income, due in large part to a 5 percent drop in average card balances.
- Nonetheless consumer credit cards remain the largest revenue product, comprising more than 40 percent of overall revenue. The product has returned to pre-recession profit margins, albeit on a smaller business. Outstanding card balances have stabilized but remain 17 percent below the highs established in 2008. Delinquency rates continue to improve, and are now at all-time lows.
- Consumer DDA—the second-largest product—faces multiple challenges. Along with the NIM environment, overdraft regulations continue to suppress fee income, and debit interchange regulations that took effect in late 2011 will have greater impact in 2012. Profitability fell slightly, as cost savings from branch reductions (over 1,800 closed in 2011) did not fully offset the billions of dollars in foregone overdraft income.
- Cash remains the vehicle for nearly half of transactions, primarily small value consumer point-of-sale transactions. However, 80 percent of the dollar value is carried by check and ACH—the primary vehicles for larger-ticket business payments.

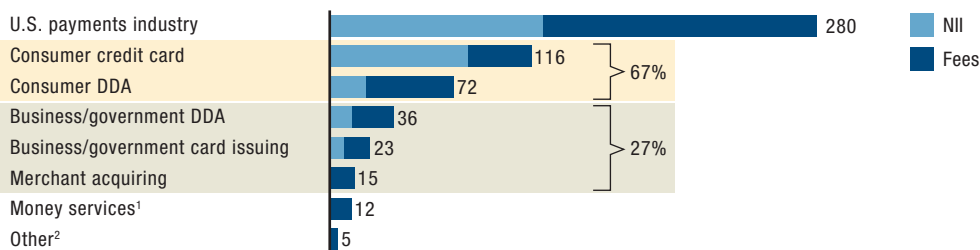
## Looking ahead

- Over the next five years the longstanding declining trend in check volumes will continue, albeit at a slower rate. By 2015, business checks will provide the majority of remaining paper.
- Double-digit growth rates in prepaid and debit cards will moderate, consistent with the products' maturation curves. PIN debit will gain share relative to signature as a result of debit interchange regulation (Reg II).
- The rapidly evolving mobile e-wallet space could comprise as much as 7 percent of point-of-sale volume by 2016.
- The industry will generate \$60 billion to \$70 billion of new revenue by 2016. A meaningful share will stem from an interest rate recovery, placing a premium on balances. Transaction fees and credit cards (both consumer and business) offer significant growth opportunities. Banks will struggle to replace past revenue opportunities in penalty and account fees, however.
- The fastest-growing revenue segment is money services (primarily products like prepaid and check cashing services addressing needs of the underbanked), which is expected to grow by over 35 percent between 2011 and 2016, with general purpose reloadable prepaid and payroll cards leading the way.

## Financial institutions and other providers earn \$280 billion in fees and net interest income from payments services to U.S. payers and payees

### 2011 U.S. payments industry revenues

U.S.\$ billions



**Consumer** general purpose credit card issuing and consumer checking account for most payments industry revenues

**Commercial** payments services generate 27% of revenues

**Money services**, typically products for underserved customers, is a small but growing segment

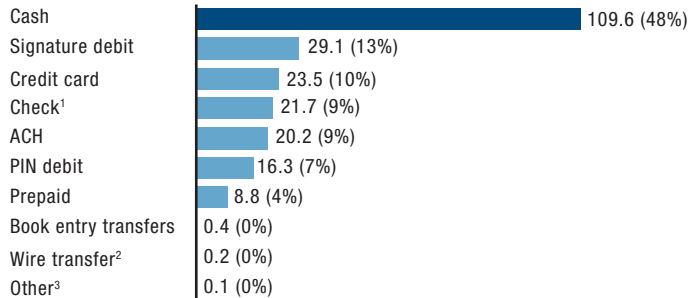
<sup>1</sup> Includes prepaid cards, electronic money transfer (EMT), non-bank check cashing and money orders.

<sup>2</sup> Includes armored transport, check verification/guarantee, travelers checks and ISO ATM fees.

## Cash dominates transaction counts, while ACH represents most dollar flows

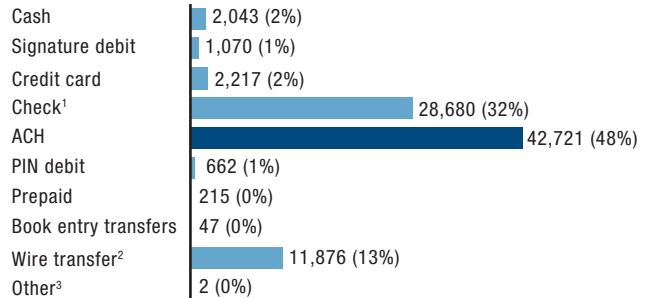
### 2011 U.S. transactions

230 billion total



### 2011 U.S. dollar flows

\$89.5 trillion total, \$ billions



<sup>1</sup> Reflects checks paid, not checks written. Checks converted to ACH are counted in ACH.

<sup>2</sup> Excludes vast majority of wire transfer dollars in an effort to approximate customer payments activity rather than financial institution settlement.

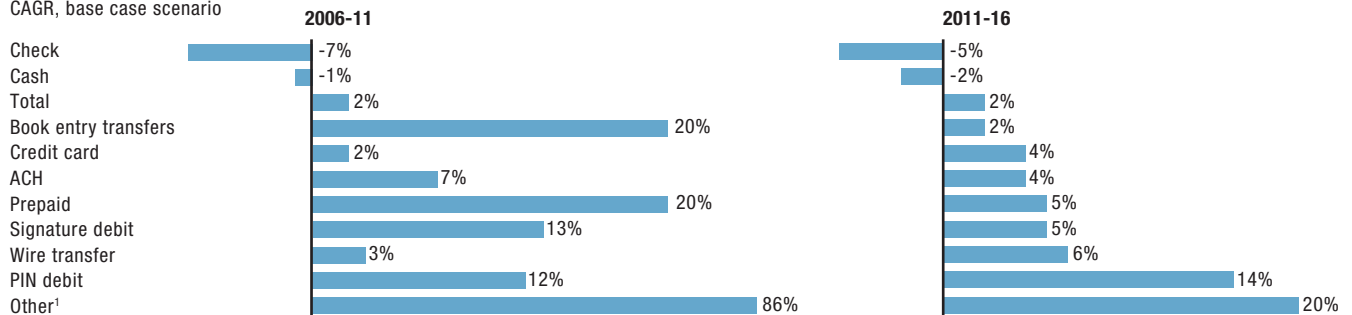
<sup>3</sup> Includes deferred payments services (e.g., Bill Me Later) and cell phone/other bill charges.

Source: McKinsey U.S. Payments Map, Release Q4-2012

## Check decline will decelerate and ACH and signature debit growth will mature, while PIN debit will gain from Reg. II

### U.S. payment transaction growth

CAGR, base case scenario



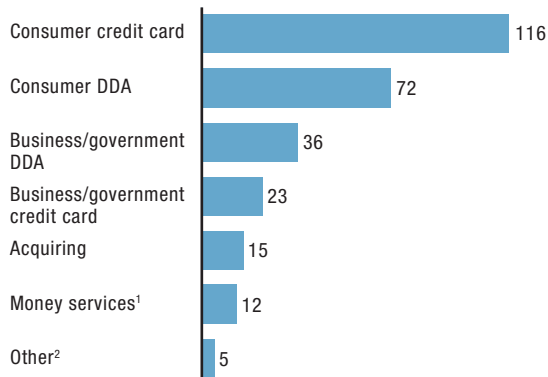
<sup>1</sup> Includes deferred payments services (e.g., Bill Me Later), and cell phone/other bill charges.

Source: McKinsey U.S. Payments Map, Release Q4-2012, base case scenario

## Growth in U.S. banking revenues will rely increasingly on deposits, credit card transactions and prepaid cards

### 2011 U.S. payments revenues

U.S.\$ billions



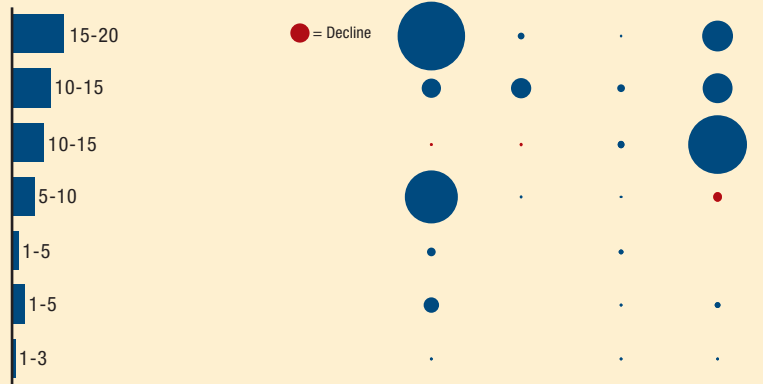
<sup>1</sup> Includes prepaid cards, EMT, non-bank check cashing and money orders.

<sup>2</sup> Includes armored transport, check verification/guarantee, traveler's checks, ISO ATMs, deferred payments and phone/other bill charges

Source: McKinsey U.S. Payments Map, Release Q4-2012, base case scenario

### Net new revenue 2016 versus 2011

U.S.\$ billions



<sup>1</sup> Includes prepaid cards, EMT, non-bank check cashing and money orders.

<sup>2</sup> Includes armored transport, check verification/guarantee, traveler's checks, ISO ATMs, deferred payments and phone/other bill charges

Source: McKinsey U.S. Payments Map, Release Q4-2012, base case scenario

For more information on McKinsey's U.S. Payments Map, please contact Ryan Cope (ryan\_cope@mckinsey.com) or David Stewart (david\_stewart@mckinsey.com).