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Apple in Payments

Winning by Influencing

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Winning by Influencing

Over the past few months, Apple has made three significant announcements that shed new light on its payments strategy. But they also raise questions for other payments players that they must speedily resolve.

Apple said it had:

- discontinued Apple Pay Later, with no new loans originated since August 2024;
- introduced installment payments in Apple Wallet, with Synchrony, Citi, and Affirm as initial partners in the US, and various banks in other markets, including ANZ in Australia and HSBC and Monzo in the United Kingdom; and
- agreed to open near-field communication (NFC) and secure element APIs to developers in Australia, Brazil, Canada, Japan, New Zealand, the UK, and the US. Developers will need to enter commercial agreements with Apple to get access.

Apple's decisions are connected to each other and reflect dynamics shaping the payments space. First, tech companies and balance sheet businesses do not go particularly well together – indeed, Apple's partnership with Goldman (which was providing the balance sheet for instalment loans) is winding down[1]. Second, The European Union has required Apple to open up its NFC chip following the Digital Markets Act, and Apple proactively did so in seven additional countries. That put the onus on Apple to continue adding features to its Wallet, which will help it differentiate in an inevitably more competitive landscape. Partnerships with card issuers and buy-now-pay-later (BNPL) players are a counterbalance to the company's recent decision to discontinue Apple Pay Later. And of course, BNPL businesses will likely benefit from, and be willing to pay for, the broader merchant acceptance that Apple Wallet will provide. Apple's overarching aim in this context is to strengthen its iOS ecosystem and proprietary products, which these moves seem set to accomplish.

In this article, we explore Apple's announcements in more detail and examine the implications for different markets and players. In summary, we believe that:

A. Impacts will vary by market, but those with a **high iPhone market share, high contactless penetration, and a high share of card payments** will be most affected. These include the US, UK, Canada, and Australia.

B. While there are opportunities for third-party wallets such as PayPal and Cash App Pay, **they need to provide consumers with a compelling reason for switching** from Apple Wallet.

C. Banks are unlikely to launch their own wallets, though **there is an opportunity for consortium-based solutions such as Paze.** They also have a chance to **drive higher share of wallet of their proprietary cards** by initiating NFC-based payments from their mobile apps.

D. **BNPL players will be the biggest winners**, as their presence in the Apple Wallet offers potentially ubiquitous acceptance — albeit that they will have less flexibility to manage transaction economics.

E. Several **merchants will likely launch wallets** to drive consumer loyalty, personalized offers, and seamless checkout experiences.

F. This is another reminder that **payment networks have remarkably strong moats.**

1. Apple Pulls Plug on Goldman Credit-Card Partnership, The Wall Street Journal, Nov 28, 2023.

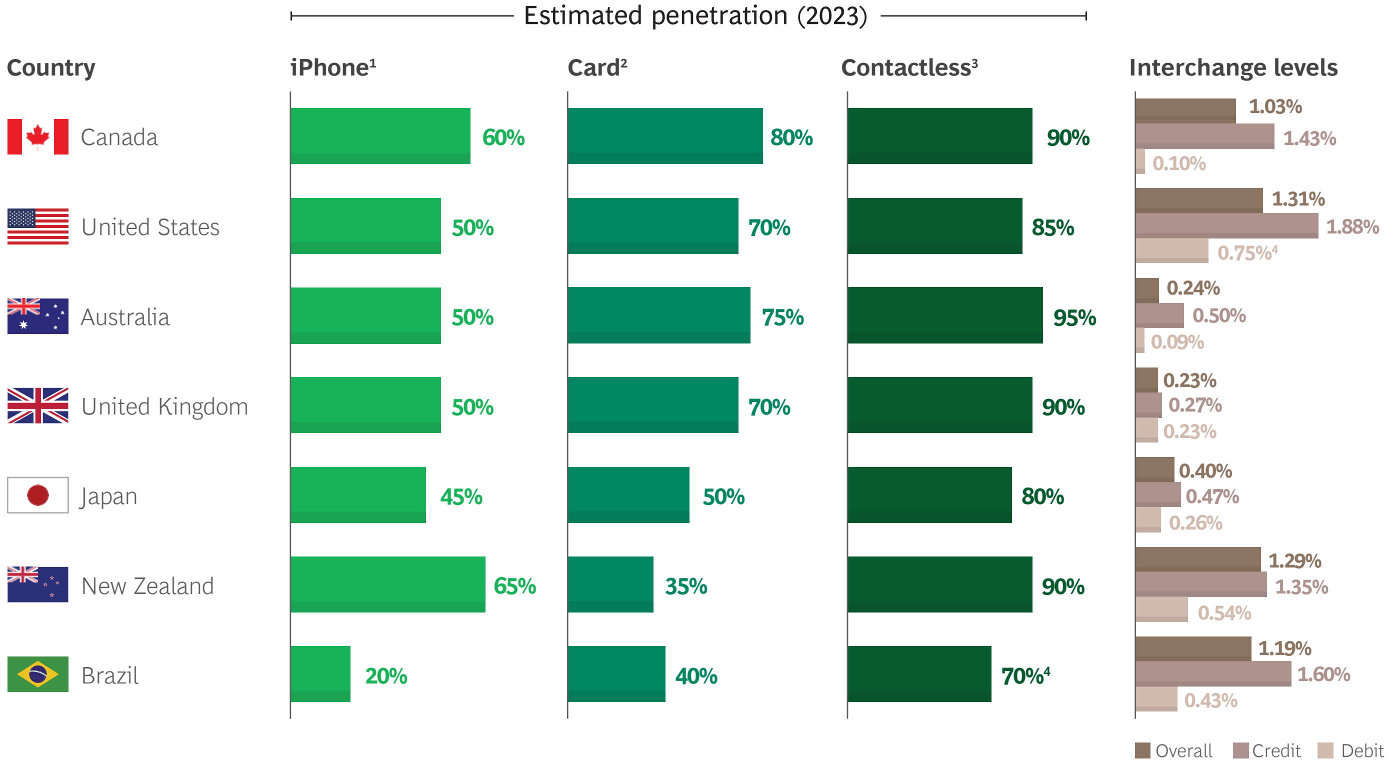
A. Impacts Vary by Market

The impacts of Apple's strategic reset vary significantly by market. Markets with high iPhone market share, high contactless penetration, and a large share of card payments will be most affected – including the US, UK, Australia and Canada. (See Exhibit 1.) These are where new wallet providers do not have to worry about merchant acceptance or issuing a new payment methods to consumers, thus reducing barriers to entry. Other markets may not see significant near-term impacts, but the shifting landscape will doubtless boost other initiatives. In Brazil, for example, PIX may ramp up efforts to be accepted at contactless terminals, expected in any event in 2025.

In favorable digital wallet markets, Apple's move raises important questions. Can third-party wallets meaningfully challenge Apple Wallet's dominance? Which wallets are best positioned to leverage the opportunity? And how will different payments actors — such as BNPL providers — capitalize on the shift?

To compete effectively, third-party wallets will certainly need to match or exceed the Apple Wallet's user experience. Further, any new entrant will need to offer real value to both merchants and consumers. For merchants, this could mean incremental traffic, lower transaction fees, and higher conversion rates. For consumers, features such as personalized offers, loyalty rewards, and pay with points[2], alongside an excellent user experience, will be necessary additions.

Exhibit 1 - Apple plans to open its NFC technology in 7 countries outside the EU



Sources: Global Data, Visa Q2 '23 earnings call, UK Finance, Payments Canada, Reserve Bank of Australia, Central Bank of Brazil, Payments NZ, BCG Global Payments Model, BCG Analysis.

[1]Consumers with iPhones vs. not.

[2]Credit, debit, charge and prepaid card volume as a % of total retail volume.

[3]% of merchants with NFC enabled terminals.

[4]Blended average of exempt and non-exempt Debit.

2. Apple Newsroom update, June 11, 2024.

B. Opportunity for Third-Party Wallets

Opening NFC to third-party developers creates a significant opportunity that could dramatically shift the digital wallet landscape. While Apple Pay currently dominates offline transactions in the US and PayPal remains a leader in e-commerce payments, there is much to play for. (See Exhibit 2.)

The following companies, among others, are well-positioned to benefit from the newly democratized NFC landscape—but they also face potential headwinds:

- **PayPal:** PayPal is the longstanding leader in e-commerce digital wallets but has lost significant share to Apple Pay and Shop Pay of late. Recent developments present an opportunity to push into the offline world – a key growth vector for the company. Arguably, it is the best prepared of all wallet providers, with payment credentials for 426 million consumers and installment products including Pay-in-4 strengthening the company's loyalty/offer infrastructure. It is also building out a merchant-centric ecosystem including an advertising platform. The company could drive consumer preference for its wallet with targeted offers and rewards and is proactively promoting PayPal Everywhere with a 5% cashback offer on the PayPal debit card in the US.

  But PayPal has significant questions to address. First, how does it deploy assets such as Honey – an offers platform for online shopping – for in-store shopping? Second, how will it make the economics work, given it may not control merchant pricing? Third, can it scale consumer credit, given its reliance on partners? And finally, how would these shifts converge with the existing PayPal Everywhere strategy?

Exhibit 2 - Apple (POS) and PayPal (eCom) duopoly in C2B use-case today

Market data

		Mobile-first wallets			Third-party wallets			P2P platforms with emerging C2B capabilities		Merchant wallets	
		Apple Pay	Google Pay	Samsung Pay	PayPal	Paze	amazon pay[5]	Cash App	venmo	Walmart Pay	Starbucks
US Payment volume		~$725B[1]	~$50B[1]	~$30B[1]	~$340B[2]	N/A	~$30B[1]	$248B	$270B	~20B	~7B
US number of accounts (2023)		~55MM[1]	~30MM[1]	~20MM[1]	~200MM[3]	~150MM	~180MM	56MM (Largely P2P volumes today)	83MM (Largely P2P volumes today)	~55MM	~33M
Major funding methods	Linked bank accounts	✓	✓	✗	✓	✗	✗	✓	✓	✗	✗
	Linked cards	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
	Account balance	✓	✗	✓	✓	✗	✗	✓	✓	✓	✓
Offer financing	3rd party	affirm, citi, synchrony	affirm	✗	WebBank	✗	affirm, citi, CHASE	afterpay[4]	✗	affirm	✗
	Owned	Used to but no longer	✗	✗	✗	✗	✗	✗	✗	✗	✗

Sources: Company websites, GlobalData, eMarketer, PULSE network debit issuer study, Statista.

[1]Estimates, data not reported.

[2]Estimated based on PayPal's US TPV minus P2P TPV and unbranded volumes.

[3]Based on an estimate of 60% share of US users for PayPal wallet.

[4]Announced plans to add to CashApp card but haven't launched yet.

[5]Amazon Pay volumes on third party merchants.

- **Cash App:** Owned by Block (formerly Square), Cash App has a user base of 80 million and more than 4 million merchants using Square terminals. In short, Cash App is already a wallet with offline acceptance at Square merchants, and NFC gives it broader merchant acceptance. It has a Pay-in-4 offering via Afterpay but no installment products. In addition, Block has been investing in connecting Cash App with Square sellers through its rewards program Boost, as well as in integrating Afterpay.

  The biggest consideration for Cash App would be how to achieve wallet penetration outside its core ecosystem. That is, how will Cash App Pay stand out from others in e-commerce or categories outside core Square verticals? And how would this play into its 'ecosystem of ecosystems' narrative and priorities?

- **Amazon Pay:** Amazon has a lot of experience in the payments space, both on and off its website. It has already begun to experiment with in-store payments at Whole Foods and owned Amazon locations. Given its scale in ecommerce and clear desire to continue investing in payments, it could leverage its existing strategy for a broader wallet play. Additionally, several merchants that sell on Amazon have physical stores, and this offers an opportunity for Amazon to forge richer partnerships by connecting online and offline experiences, for example through personalized offers when the customer is in the physical store.

  Still, while Amazon has the scale to drive targeted offers and a robust ads platform, large merchants such as Walmart and Target will look to push their own wallets (see below) and will not wish to enable a competitor. In that context, can Amazon create a seamless experience for customers to 'clip' offers in store? And should it only focus on merchants that sell on Amazon and have physical presence?

- **Shopify (Shop Pay):** Shopify's Shop Pay has gained rapid popularity as a faster checkout option for online merchants, largely within Shopify's ecosystem. It now has a chance to expand its payments services to a broader range of merchants, including those operating offline. This could allow Shopify to position Shop Pay as a comprehensive consumer-facing offering, allowing it to expand into a much larger consumer payments and lending market.

  The big question for Shopify is one that is fundamental to its identity. Currently, Shop Pay's success is deeply tied to that of Shopify's merchants, and the consumer value proposition is more servicing oriented than shopping oriented (for example, a consumer can track all orders from Shopify merchants in one place). Building a general-purpose consumer payments wallet will likely require a fundamental rethink of what Shop Pay seeks to be five or more years from now, alongside significant investment in marketing and consumer adoption.

C. Banks Have an Opportunity

Banks will likely face challenges creating winning proprietary wallets because many competing card issuers won't allow their cards to be part of it, meaning consumers would be unable to consolidate their payment credentials in one wallet. However, there are two key opportunities:

1. Banks could create a consortium-based solution such as Paze in the US. In high-interchange markets such as the US and Canada, banks could fund adoption and use of these wallets through direct incentives. In other markets, banks could replicate the ads and offers playbook that PayPal and others will likely follow. These wallets would also find it easier to add bank instalment lending payment options.

2. Banks could enable their mobile apps to initiate NFC-based payments to drive higher usage of their proprietary cards. To encourage adoption, they could create features around the payment experience and integrate them into their mobile apps (and not in third-party wallets), including offers from merchants, card-linked offers, integration of local ID cards, or passes and tickets. These could be especially attractive in markets such as Australia, where Apple Wallet is less feature-rich than in the US (no Apple Cash, no driver's licenses).

D. BNPL Players Are The Biggest Winners

Affirm's new partnership with Apple to offer installments in the Apple Wallet represents a foundational shift in Apple's strategy. Not only can Affirm consumers now seamlessly use Affirm at all merchants, but consumers can also sign up for Affirm through Apple Pay[3].

Other BNPL players such as Klarna will need to decide whether to follow in Affirm's footsteps and partner with a wallet (Apple or another) or to make their own play at a wallet offering. The biggest challenge they face is that they prohibit any other payment method (for example, credit cards), which limits their utility.

BNPL players have been handed a significant opportunity, because Apple's move offers them ubiquitous acceptance - despite some challenges on merchant-level economics. For example, Affirm's merchant acceptance will grow in number from about 290,000 to about 10 million. On the other hand, BNPL players will need to rely on network economics, at least as a starting point[4]. The pricing of a BNPL player to a merchant is tied to its pricing to consumers, so a merchant would pay more for a 0% APR offer to a consumer than for a 3.99% APR offer. In a world where the BNPL player has the same merchant revenue for every consumer, many consumers could receive higher APR offers than they may have received otherwise. Still, BNPL players will be able to see where consumers are using their products and prioritize merchants to strike deals with – consumer usage data will significantly enrich their sales pipelines. Finally, the new landscape presents a possible Pay Now play for these companies to attract rewards card users — for example by offering competitive cash back or rewards. In effect, they could create a fully deconstructed credit card.

The broad merchant acceptance of instalment payments will push card issuers to consider making their post-purchase instalment options available at point of sale. In the US, Synchrony and Citi are early-movers and we expect many other issuers will follow. This represents a downside risk to spreads from potential cannibalization of revolve balances. The question is whether card issuers can make it up on volumes, for example by encouraging more erstwhile transactors to take out instalment loans, or through new revenue streams.

E. Many Merchants Will Launch Wallets

We expect many merchants to add NFC payment functionality to their proprietary apps and partner with lenders to offer Pay-in-4 instalment plans within their wallets. Most large merchants have enabled contactless payments in their stores but have hesitated to integrate payments with their standalone apps, reflecting the need to invest in new acceptance infrastructure such as QR codes at point of sale. The ability to drive consumer loyalty through in-app rewards, personalized offers, and seamless checkout experiences will be attractive to many retailers as it will drive both increased consumer engagement and operational efficiencies (for example, faster checkouts). For retailers with co-branded credit card programs, there is an opportunity to drive tender preference and create a new channel for card customer acquisition.

On the other hand, merchants such as Starbucks and Dunkin Donuts have already invested in QR-code based infrastructure and have prepaid wallets. We do not expect them to switch to NFC-based payments - largely because it is unnecessary. Currently, they also benefit from lower interchange fees on debits, because prepaid cards consolidate multiple $5 transactions into one $25 transaction – which will go away if they allow individual transactions to settle. Additionally, they would lose out on revenue and liquidity from stored balances in the wallet, as well as breakage income from unused balances.

3. Affirm Newsroom, September 16, 2024.

4. Based on disclosures by Marqeta, we believe that Visa is powering Affirm in the Apple Wallet and hence transaction economics would be determined by the Visa Interchange Rate Schedule.

F. Payment Networks Remind Everyone That They Have Strong Moats

Where a third-party wallet provider leverages an NFC chip and contactless infrastructure, it is almost inevitable that the transaction will be settled over the Visa or Mastercard network. For example, a BNPL player's ability to serve customers while embedded in the Apple Wallet almost certainly requires use of Visa or Mastercard Installments, especially in mature card markets such as the US, Canada, UK, and Australia.

In markets such as Brazil, where PIX has been growing rapidly, there is a play for third-party wallet providers to leverage a PIX contactless payment solution, set to be launched in 2025. They could collaborate with merchant acquirers and terminal manufacturers to ensure technical feasibility and create a consumer value proposition that drives adoption. Arguably, given the dominance of Android in the Brazil market, this could have been achieved before Apple's announcement. Still, Apple coming on board likely accelerates the trend.

Where Does Apple Go From Here?

While Apple is opening its NFC capabilities to third-party developers, it is unlikely to sit by as other wallets attempt to take market share. We expect Apple to double down on its Wallet offering, expanding into new financial services at point of sale and embedding itself further into consumers' lives. The Apple Wallet today already offers many features in addition to payment cards (among others), including:

- Airline boarding passes
- Gym and club memberships
- Access to office buildings
- Driver's licenses in several US states

Apple's rich functionality is a tall order for new wallet providers to match (one reason we expect a heavy focus on incentives to drive switching). Apple could also build out an ads-and-offers ecosystem within its Wallet, especially if it can drive seamless consent-based data sharing in an open banking world. In short, it unlikely wants competitors to dominate – despite commercial agreements that create revenue neutrality – because it would reduce switching costs associated with the iOS ecosystem.

Apple's recent announcements remind the world of its ability to have a major impact on industries without necessarily being an active participant. The company's planned changes do not necessarily disadvantage any particular aspect of the payments value chain. But they do reshape competitive dynamics in multiple places. Third-party wallets, BNPL players, and merchants should all benefit, as should consumers. Payment networks like Visa and Mastercard should emerge stronger, because the new landscape entrenches their presence in card payments and sets them up to dominate POS instalment payments over time. Banks should also benefit if they play their cards right (pun unintended).

The good news for incumbents is that the payments value chain remains largely intact. And the even better news for those willing to adapt and innovate is that Apple has created an environment for them to do so. Incumbents could not have asked for anything more and the challenge now is to make their good fortune count.

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