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Financial Services

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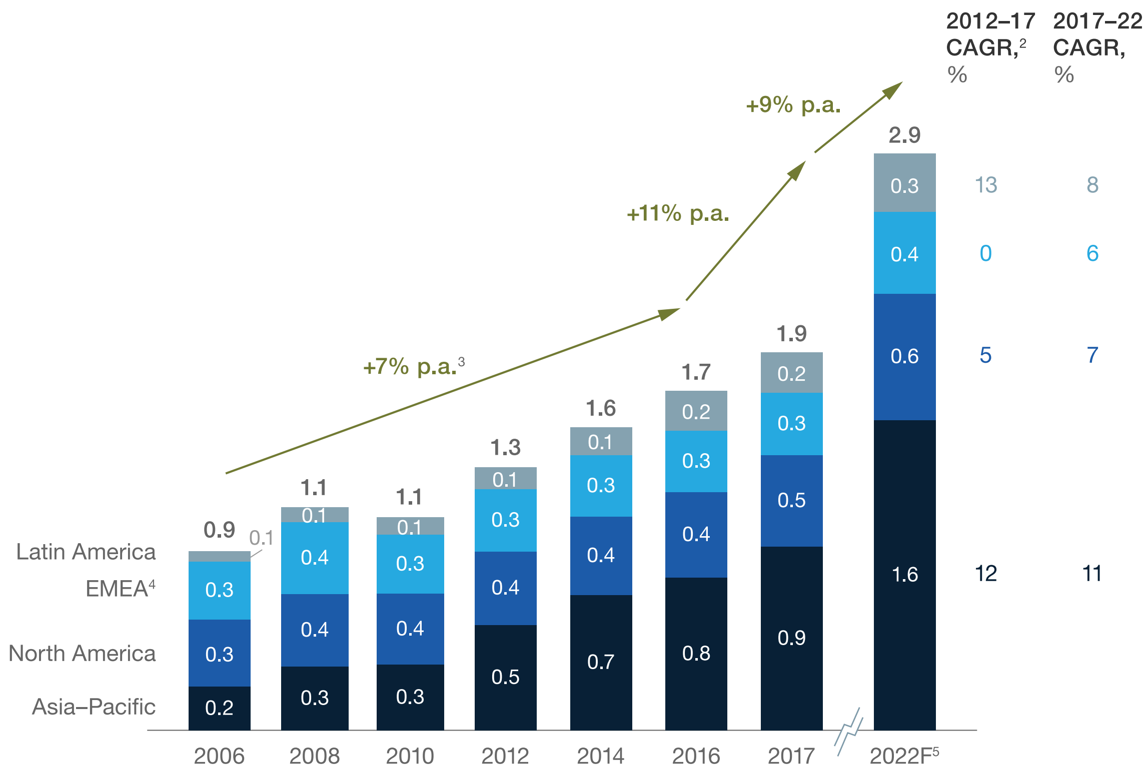
Global payments revenues swelled to $1.9 trillion in 2017, the best single year of growth in the last five years (Exhibit 1). In last year's report, we forecast that payments would become a $2 trillion business by 2020. Indeed, 2017's market performance was so robust—its 11 percent growth rate fueled by continuing strength in the Asia–Pacific corridor—that global revenues are poised to surpass that $2 trillion threshold in 2018, and to approach $3 trillion within five years.

Exhibit 1

Global payments revenues grew 11 percent in 2017, the highest rate in the last five years.

Global payments revenue, $ trillion[1]



[1]Figures may not sum, because of rounding.
[2]Compound annual growth rate.
[3]Per annum.
[4]Europe, Middle East, and Africa.
[5]Forecast.

McKinsey&Company | **Source:** McKinsey Global Payments Map

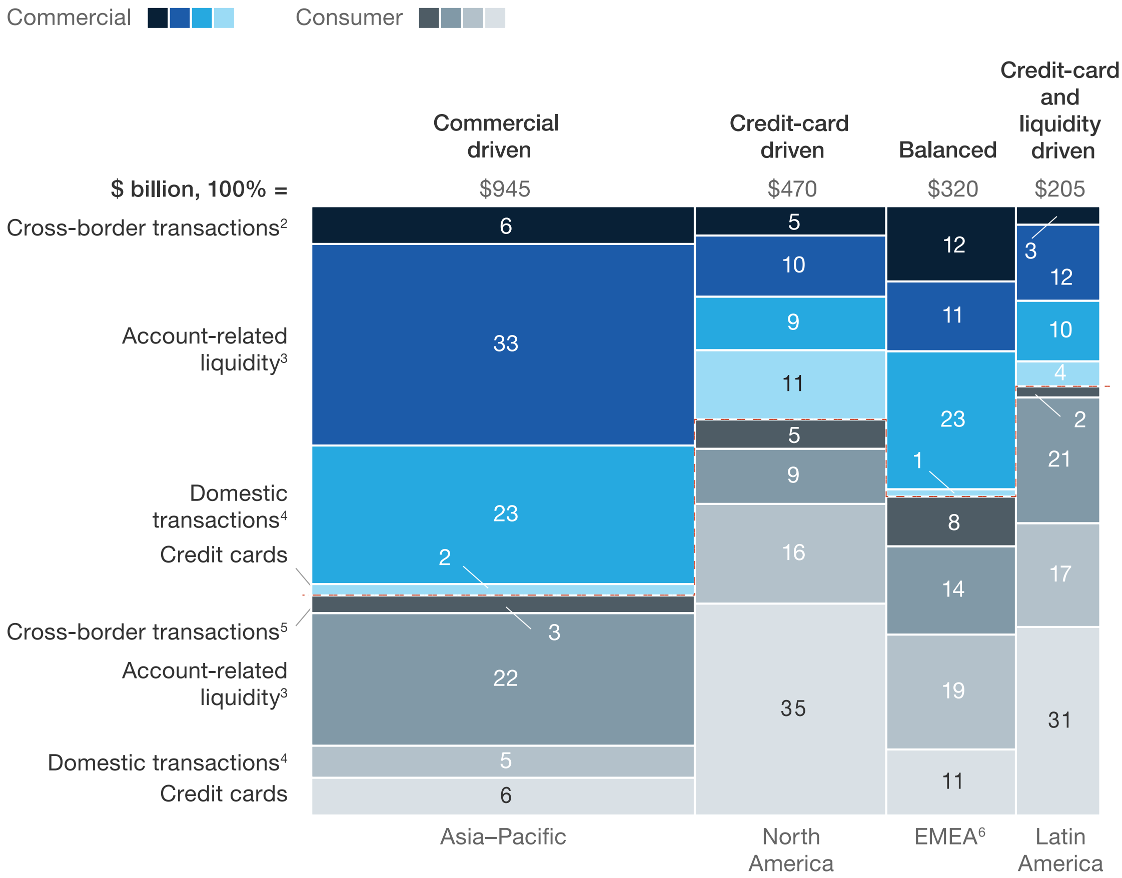
This rapid growth makes payments an expanding and increasingly important component of the broader banking industry. After an extended period in which payments generated roughly 30 percent of overall banking revenues, this metric has turned sharply upward. The continued prominence of payments in banking revenues might come as a surprise, given the continued pressure on payments fees—increasing competition and regulatory pressure—and ongoing low-interest-rate environments in many developed economies. In contrast, the trend makes sense, given healthy underlying fundamentals, including electronic-transaction and digital-commerce growth, and increasing cross-border activity. The growth of the payments component also points to the imperative for financial institutions to develop and continually refresh sound payments strategies to remain competitive in a market being reshaped by technology, new competition, and customer demands.

Not surprisingly, global payments revenue growth is dominated by the Asia–Pacific region, as has been the case for several years. At more than $900 billion, the region now accounts for nearly half of global payments revenue—compared with less than a quarter just six years earlier—as well as four-fifths of recent growth (Exhibit 2).

Exhibit 2

Asia–Pacific dominates the global payments revenue pool.

Payments revenue, 2017, %[1]



[1]Figures may not sum to 100%, because of rounding.
[2]Trade finance and cross-border payments services (B2B, B2C).
[3]Net interest income on current accounts and overdrafts.
[4]Fee revenue on domestic payments transactions and account maintenance (excluding credit cards).
[5]Remittance services and C2B cross-border payments services.
[6]Europe, Middle East, and Africa.

McKinsey&Company | **Source:** McKinsey Global Payments Map

Remarkably, double-digit growth has continued even as the base of business has grown. The 20 percent growth rate for 2017, driven largely by liquidity factors, was Asia–Pacific's strongest ever. Although our forecast calls for inevitable moderation, revenues in the region should continue to grow at low double-digit rates over the next five years, still considerably faster than any other region.

Latin America's payments sector has been the fastest-growing among the major regions in the recent past (albeit off the smallest revenue pool); but growth rates flatlined abruptly in 2017. We expect the region to return to average annual growth of 8 percent over the next five years, second only to Asia–Pacific. While several Latin American countries continued to deliver double-digit growth in 2017, Brazil's payments sector—the region's dominant revenue engine—was hampered by regulatory action targeting credit-card rates (Latin America is reliant on interest for two-thirds of its card revenues). Credit-card annual percentage rates (APRs) in Brazil fell by more than 60 percentage points as a result of actions restricting the duration of high-cost revolving credit lines. The plan is expected to reduce delinquency rates but will also reduce average APRs, which remain among the world's highest. Latin America's underlying fundamentals remain solid, particularly for domestic payments.

Revenues in Europe, the Middle East, and Africa (EMEA) were similarly near flat, continuing a trend that has persisted for the past decade. The developing nations of Africa and Eastern Europe have generated high single-digit growth, offsetting nominal declines in Western Europe. Fee revenues have been the primary factor in the growth that has occurred, while a persistent environment of low interest rates—reaching negative levels in some cases—acts as a drag on growth. A return to a stable rate environment combined with continued transaction growth will result in revenue growth in the middle single digits for Western Europe until 2022, while Africa and Eastern Europe are likely to continue at their present pace. At the same time, individual companies in the European payments arena, such as Adyen and Wirecard, are finding growth areas that lead to substantial valuations.

On the surface, cross-border payments might appear to comprise a low single-digit share of global payments revenues. However, once liquidity factors such as net interest margins are excluded—as many institutions do in analyzing their own payments P&Ls—this growing category of transactions account for a larger share (roughly one-quarter) despite increasing competition from new entrants and solutions. Cross-border transactions also continue to generate unusually high margins for payments products and serve as a foundation for a broader array of client services.

After a period of tepid results, following the financial crisis, North America's overall payments revenue growth returned to a healthy 7 percent in 2017, and is poised to continue at a similar pace over a five-year horizon. Credit cards comprise more than half of North American payments revenues, far more than any other geography, and will continue to grow faster than other products. More surprising is that the drag on North American revenue growth, from the temporary slowdown in credit-card usage following the financial crisis, has only recently lifted.

The jump in global revenues in 2017 is a direct reflection of an improved global economic scenario, reinforcing the close link between growth in GDP and payments revenue. According to World Bank data, in 2017, global nominal GDP grew at 6.0 percent year over year, compared with 1.5 percent in 2016. During the same periods, payments revenue increased in similar proportions, from 7 percent in 2016 to 11 percent in 2017.

Comparing payments revenues across regions, we observe that payments revenue per unit of GDP (a measure of the cost of payments for consumers and businesses) in Asia–Pacific and Latin America is

50 to 60 percent higher than for Europe and North America. In addition, the share of electronic payments transactions in Asia–Pacific and Latin America is 60 to 65 percent lower than in Europe and North America. In other words, payments are significantly costlier for the economy in Asia–Pacific and Latin America, because the cost of processing cash and check payments is higher, as are the fees paid by consumers and businesses.

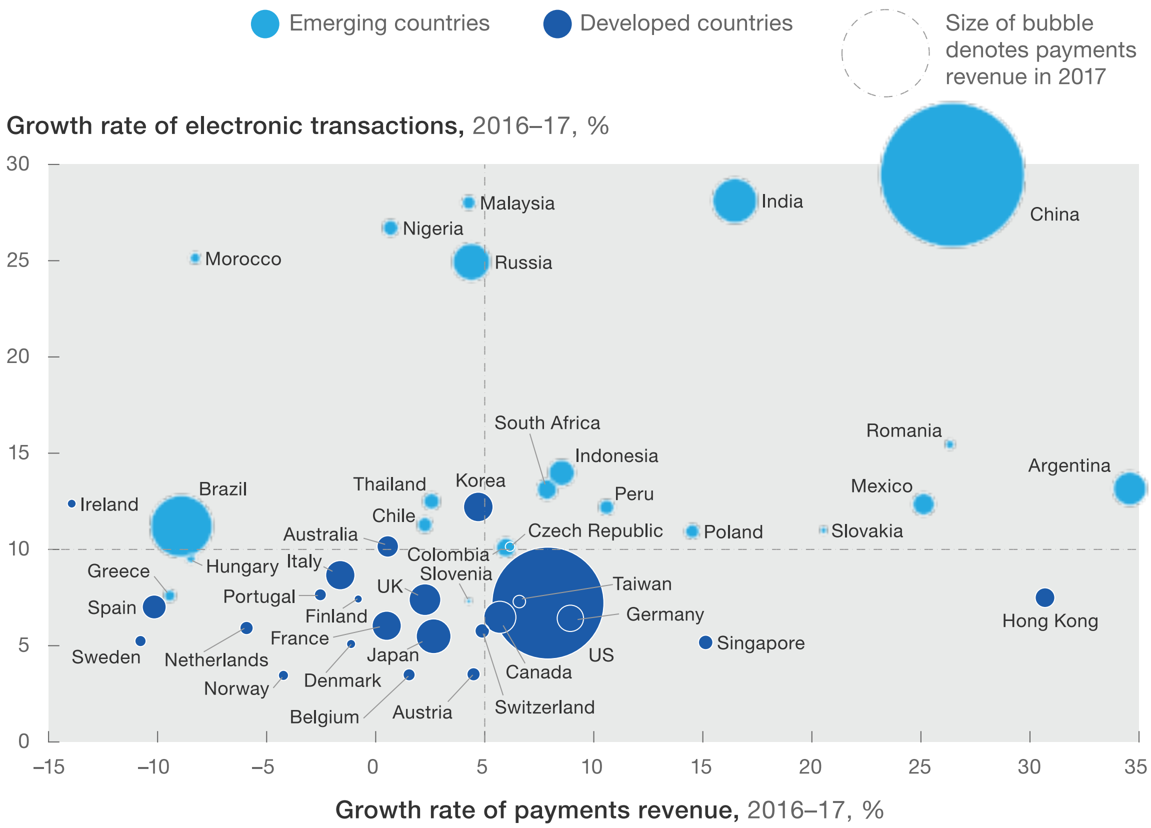
Transaction dynamics remain strong

Although the strong recent growth in global payments revenue has been broad-based and diverse, an increasing share is related to transactions. This is a positive development for banks and payments providers, as transaction revenues are more predictable and sustainable, and more readily controlled by financial-services firms. Transaction-based revenue now accounts for 40 percent of global payments revenue, up from 37 percent in 2012. We expect this share to grow to 46 percent by 2022, even in an improving rate scenario.

More specifically, while the overall number of transactions continues to increase, the true revenue driver is the electronification of transactions—namely, away from cash—which more than offsets the downward pressure on fees (Exhibit 3). Over the past five years, the share of the world's transactions carried out in cash has fallen from 89 to 77 percent. At the same time, the share of combined debit- and credit-card use has nearly doubled, from 5 to 9 percent. The decline of cash usage globally is expected to be even more pronounced over the next five years, due to an increasing range of payments options, the push toward real-time payments, the growth of digital commerce, and continued regulatory focus on payments electronification.

Exhibit 3

Countries with high revenue growth are also characterized by rapid electronic-transaction growth.



McKinsey&Company | **Source:** McKinsey Global Payments Map

Given that the Asia–Pacific region accounts for more than 60 percent of the world's population, it is not surprising that it is responsible for two-thirds of global transactions. The fact that Asia–Pacific still lags behind other regions in overall electronification at only 21 percent (despite more than doubling since 2012) illustrates the region's ongoing growth potential. The move away from cash, as witnessed in markets such as China, will serve as the single-largest cause of global electronification. The share of electronification in China has increased more than tenfold over the last five years, from 4 percent in 2012 to 34 percent in 2017.

Meanwhile, North America has become the first region to execute more than half of its transactions electronically. At 450 electronic transactions annually per capita, it far and away leads other regions on this dimension. Meanwhile, individual European countries, such as Sweden and Norway, are executing no more than 20 percent of their transactions in cash, while generating 520 noncash transactions per capita per year.

The shifting digital landscape

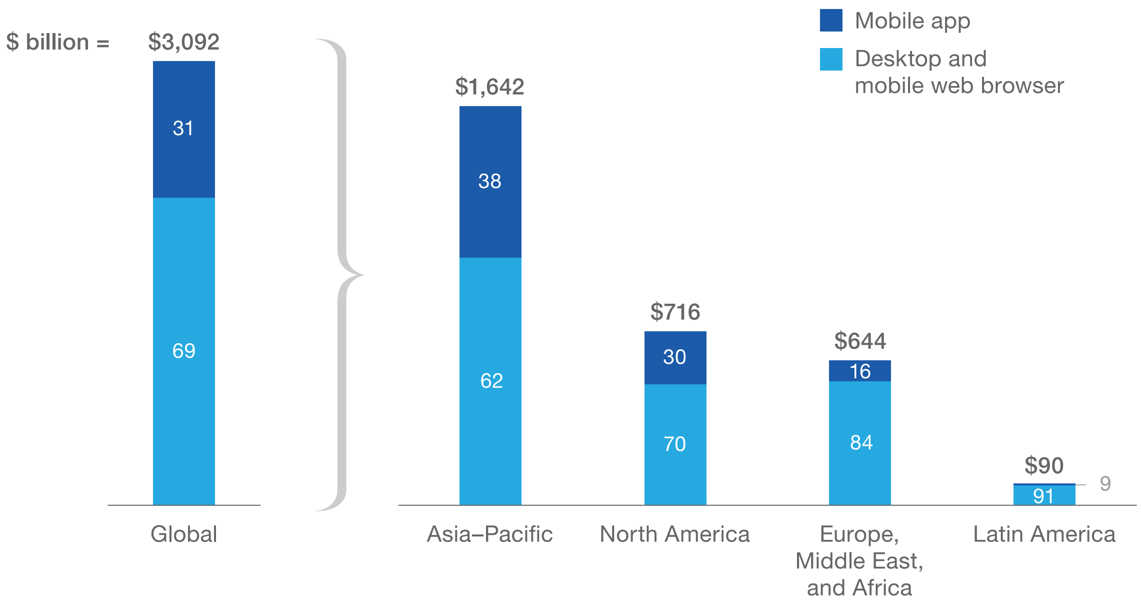
The growing popularity of alternative payments solutions, and digital commerce in general, further contributes to the electronification trend. Global digital commerce volume exceeded $3 trillion in 2017 and will more than double by 2022. Asia–Pacific already comprises more than half of this $3 trillion and, due to the fast-growing Chinese market, will increase its share to nearly 70 percent by 2022. Mobile commerce, including in-app payments and mobile browser payments, is the dominant factor driving strong digital commerce growth, due to rising smartphone adoption, an increasing shift toward online shopping, and improvements in network bandwidth. Mobile commerce accounts for 48 percent of digital-commerce sales globally as of 2017, and is forecasted to reach 70 percent by 2022 (tripling to $4.6 trillion).

Consumers and merchants alike are increasingly embracing app-based commerce and in-app payments, with retailers ramping up investments in mobile apps with innovative use cases to provide omnichannel shopping experiences for customers. Globally, mobile apps accounted for more than 30 percent of total digital-commerce volume in 2017, and they are expected to continue strong growth across all regions (Exhibit 4). Digital wallets are estimated to have added approximately 40 billion to global payments revenues in 2017.

Exhibit 4

Mobile apps accounted for more than 30 percent of global digital-commerce volume in 2017.

Global digital commerce, volume breakdown, 2017, %



McKinsey&Company | **Source:** GCI Analytics by McKinsey

The outlook for in-store commerce varies significantly by country and region: in countries with near-field-communication infrastructure, tap-and-pay will drive growth; in the United States, in-store app use will grow as consumer use of order-ahead increases; and in emerging markets, the introduction of new payments solutions will influence how people pay. In the United States, in-person use of digital wallets will increase at a 45 percent compound annual growth rate to reach nearly $400 billion in annual flows by 2022. Although most of this growth is expected to be on "pass through" wallets like Apple Pay, private-label wallets such as Starbucks and Walmart Pay—both of which have enjoyed impressive early adoption—will also continue to increase in popularity. Even with these gains, however, digital wallets will comprise less than 10 percent of US consumer in-person point-of-sale payments in 2022. Lack of ubiquitous merchant acceptance will remain a barrier, along with the continued percentage of consumers who do not know how to use their mobile phone to pay at the point of sale.

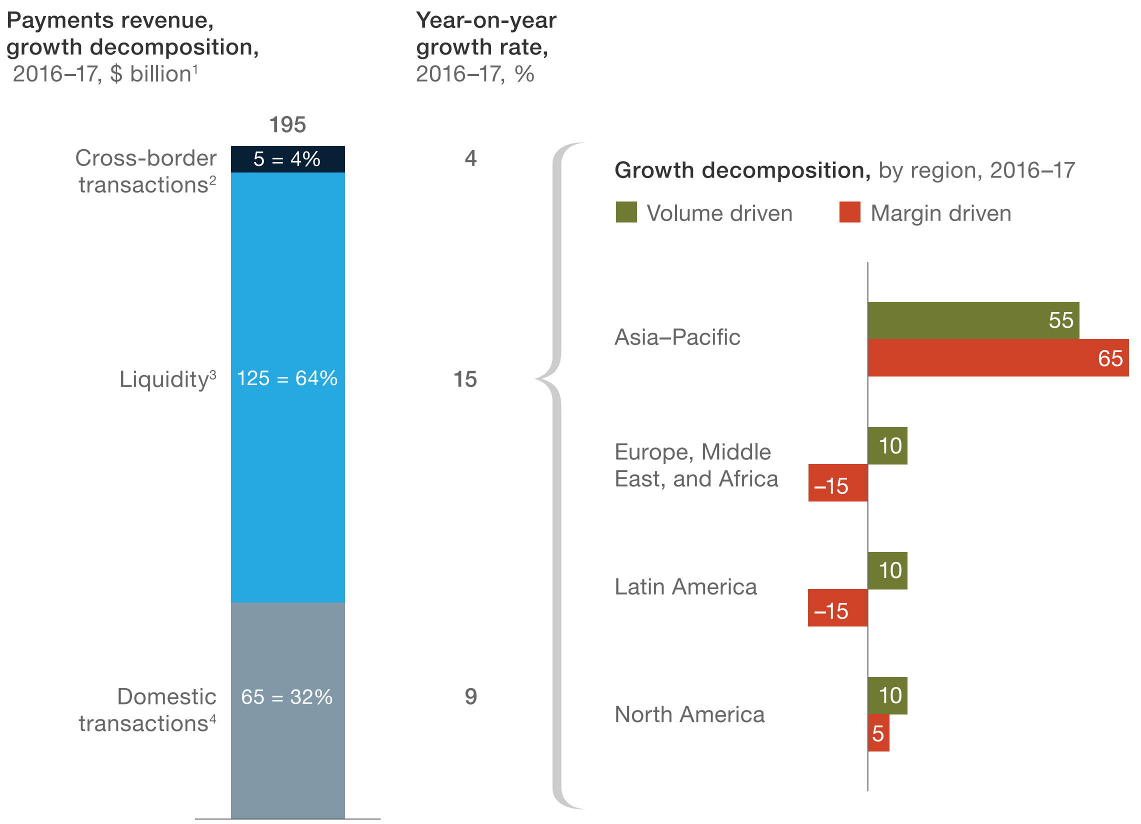
In the United Kingdom, a total of 38 million contactless transactions were conducted using a mobile device in 2016 (representing roughly $358 million in spending). While this is significant in absolute value, it accounts for only 1.2 percent of in-store payments, indicating a huge opportunity for growth. China leads on this front with 40 percent of in-person spending already on mobile digital wallets. However, unlike the United States, almost all of this is on closed-loop systems like Alipay and WeChat Pay. China's ratio is projected to continue to increase to nearly 60 percent by 2022. Within the same region, Japan remains a largely untapped market. Research has found that close to 70 percent of Japanese consumers across all age groups still prefer to use cash when making in-store purchases, mainly due to security concerns with mobile payments. It is interesting to note, however, that despite the preference for cash, prepaid-card solutions like Suica have found high adoption in Japan. In the third section of this report, we look in more depth at the digital landscape.

Liquidity factors vary by region

Strong transaction fundamentals notwithstanding, global liquidity income (inclusive of current accounts, transactional savings accounts, overdrafts, and credit-card lending net interest income) contributed the majority of 2017 growth, and continues to represent roughly half of total payments-related revenue (Exhibit 5). This growth (15 percent in 2017, compared with an average of 6 to 7 percent from 2012 to 2017) is the result of both balance growth and interest-margin expansion. Both current account deposits (8 percent) and average balances for payments-related lending products like overdrafts and credit cards (4 percent) registered growth in 2017.

Exhibit 5

Growth in liquidity revenues accounted for nearly two-thirds of global revenue growth in 2017, but with regional nuances.



[1]At fixed 2017 $ exchange rates.
[2]Trade finance, remittance, and cross-border payments services.
[3]Net interest income on current accounts, overdrafts, and credit cards.
[4]Fee revenue on domestic payments transactions and account maintenance.

McKinsey&Company | **Source:** McKinsey Global Payments Map

The interest-margin story is more nuanced and regional in nature. Global lending margins contracted, in part due to the regulatory actions in Brazil noted earlier. However, margins on current account balances expanded globally, and since these are ten times the size of credit balances, the combined effect was favorable. Nonetheless, following Europe's liquidity-revenue decline, Asia–Pacific accounts for 95 percent of global liquidity-revenue growth owing to the region's disproportionately large current account balances and higher-interest-rate environment. At the same time, North America and Latin America (except Brazil) saw 2017 upticks in net interest income.

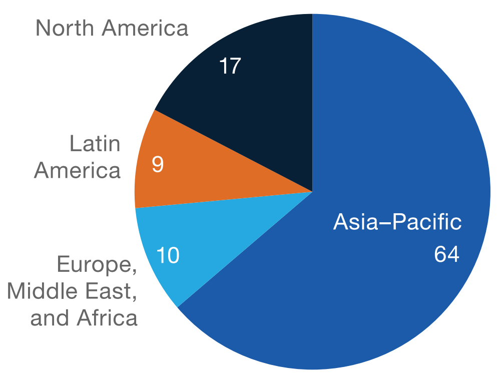
Continued growth opportunities

The projected global average annual growth for payments revenue of 9 percent through 2022 translates to roughly $1 trillion of net new revenue available to financial institutions and other financial-services firms. Although nearly two-thirds of new revenue will be created in Asia–Pacific, roughly $200 billion of new opportunities in both Latin America and EMEA will emerge (Exhibit 6). Roughly half of this new global revenue will stem from transaction growth (both domestic and cross-border) and related fees, opening opportunities for a larger group of firms in the increasingly open banking landscape. Such revenue streams are both more sustainable and predictable than those driven by interest rates and account liquidity, categories which presently comprise approximately 50 percent of the revenue pool.

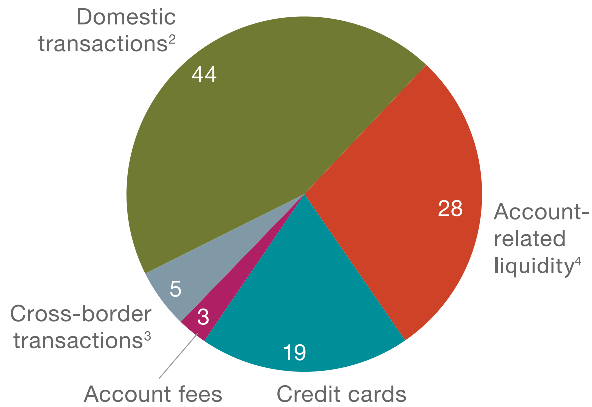
Exhibit 6

Asia–Pacific and domestic transaction revenues will drive revenue growth.

Payments revenue, growth decomposition,[1] 2017–22, %



Payments revenue, growth decomposition,[1] 2017–22, %



[1]At fixed 2017 $ exchange rates; 100% = $1,022 billion. Figures may not sum to 100%, because of rounding.
[2]Fee revenue on domestic payments transactions.
[3]Trade finance and cross-border payments services, including remittance services.
[4]Net interest income on current accounts and overdrafts.

McKinsey&Company | **Source:** McKinsey Global Payments Map

As of 2016, commercial-payments revenues surpassed consumer revenues. More specifically, the prominence of business-to-business payments continues to grow. In the third section of this report, we explore how global transaction-banking incumbents can maintain their leadership role in an increasingly digital environment.

China will continue to be the driving force for revenue growth (albeit at a slower pace than in recent years) for Asia–Pacific as well as the world. At current fee levels, China alone will generate half a trillion dollars in net new annual payments revenue by 2022—as much as all non-Asia-Pacific countries combined. While China will still account for four-fifths of new Asia–Pacific revenue, countries such as India and Indonesia will contribute a greater share of growth as well, driven by both account-related liquidity and fees from electronic transactions. Another encouraging sign is that the composition of Asia–Pacific's new revenue is shifting toward more sustainable transaction sources and away from liquidity-driven ones. By 2022 Asia–Pacific will join EMEA and North America in generating the majority of its payments revenue through fees.

The $2.9 trillion of global payments revenue anticipated in 2022 represents a significant share of overall banking revenues. Naturally, growth will be unevenly distributed by country, by instrument, and by segment (retail versus corporate, as well as the subgroups within both). In EMEA, for instance, payments will continue to represent a stable one-quarter of banking revenues. The rapidly growing payments market in China and other Asian economies, meanwhile, will push payments to more than half of Asia–Pacific banking revenues—a level already reached in recent years in Latin America.

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