



GLORY

Electronic Payments – Not As Cheap As You Think

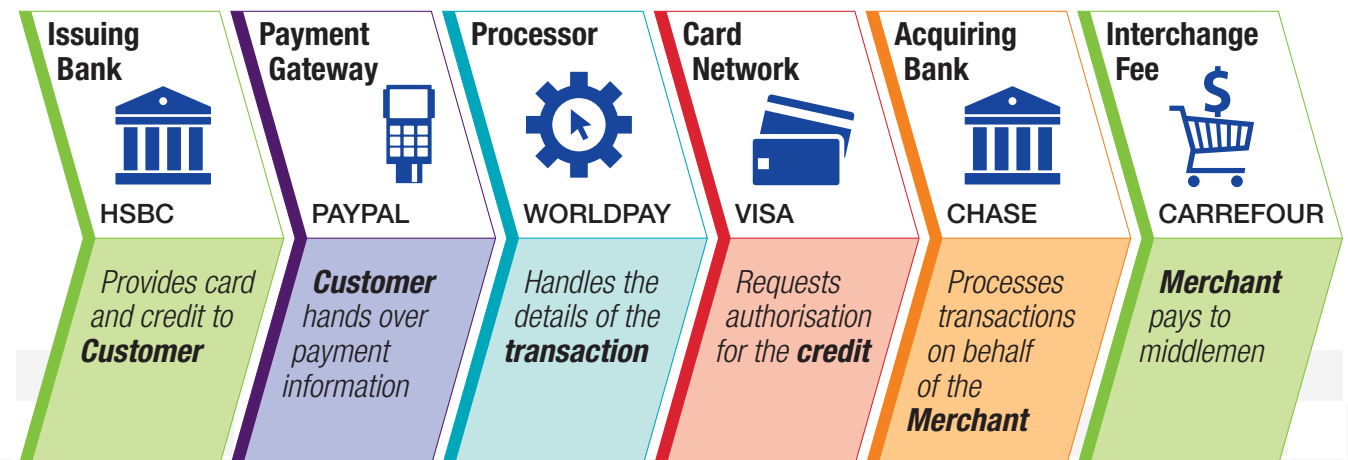


THE CARD PAYMENT VALUE CHAIN

In today's convenience-centric world, consumers are increasingly choosing digital payments (card and mobile) as viable alternatives to cash payments in retail transactions. They are prepared to trade off sharing personal buying data for "free" transactions with their favourite merchants.

The digital payments value chain allows us to understand key players and processes. You will see that nobody in the card payment value chain offers their service for free, and that these costs ultimately do impact the consumer in the form of increased prices, interest costs, and other fees.

Fees are levied all along the chain. At one end there are the fees and interest paid by the cardholder – the customer. At the other end, fees are deducted from the requested payment amount that is ultimately passed on to the merchant.



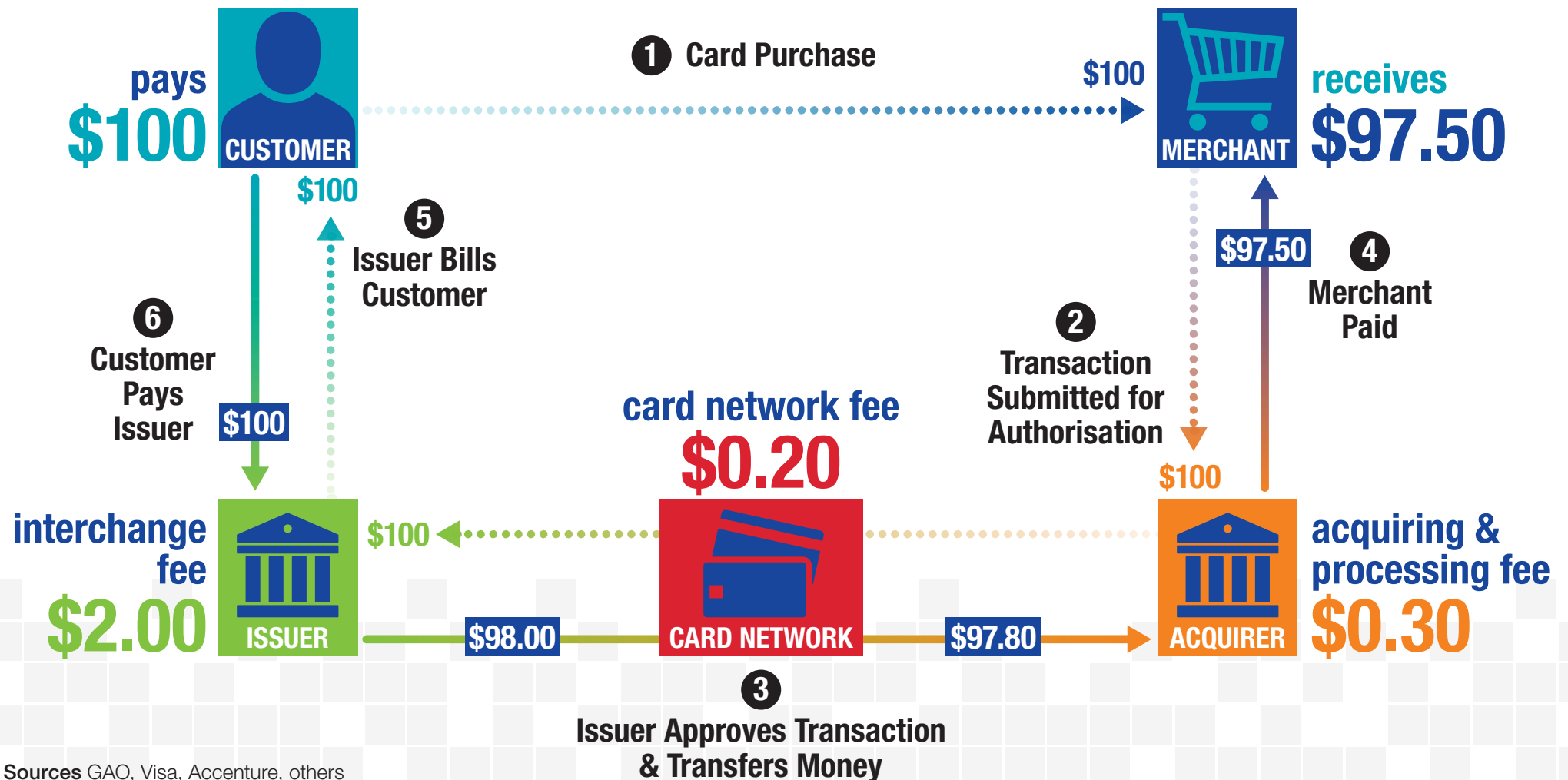
Sources CB Insights, GLORY

There are several elements that combine to form the Merchant Service Charge – some of these are published and clear, but **others are less transparent**. More sizeable fees are also charged to the Merchant for reversing transactions and so forth. When you put everything together, it forms an entangled and complex fee structure.

Some banks tell merchants to budget for between 2.5% and 3% of the transaction valuable, but with so many variables, this is only ever a rough guide.



THE FOUR-PARTY SCHEME



Sources GAO, Visa, Accenture, others

THE FOUR-PARTY SCHEME EXPLAINED

The diagram on page 4 is a simplified and illustrative indication of the flows and fees in a four-party scheme.

The customer initiates the payment request, which is passed through the scheme all the way to the Issuing Bank. The Issuer approves the transaction, and transfers funds – but note that they transfer funds minus the interchange fee.

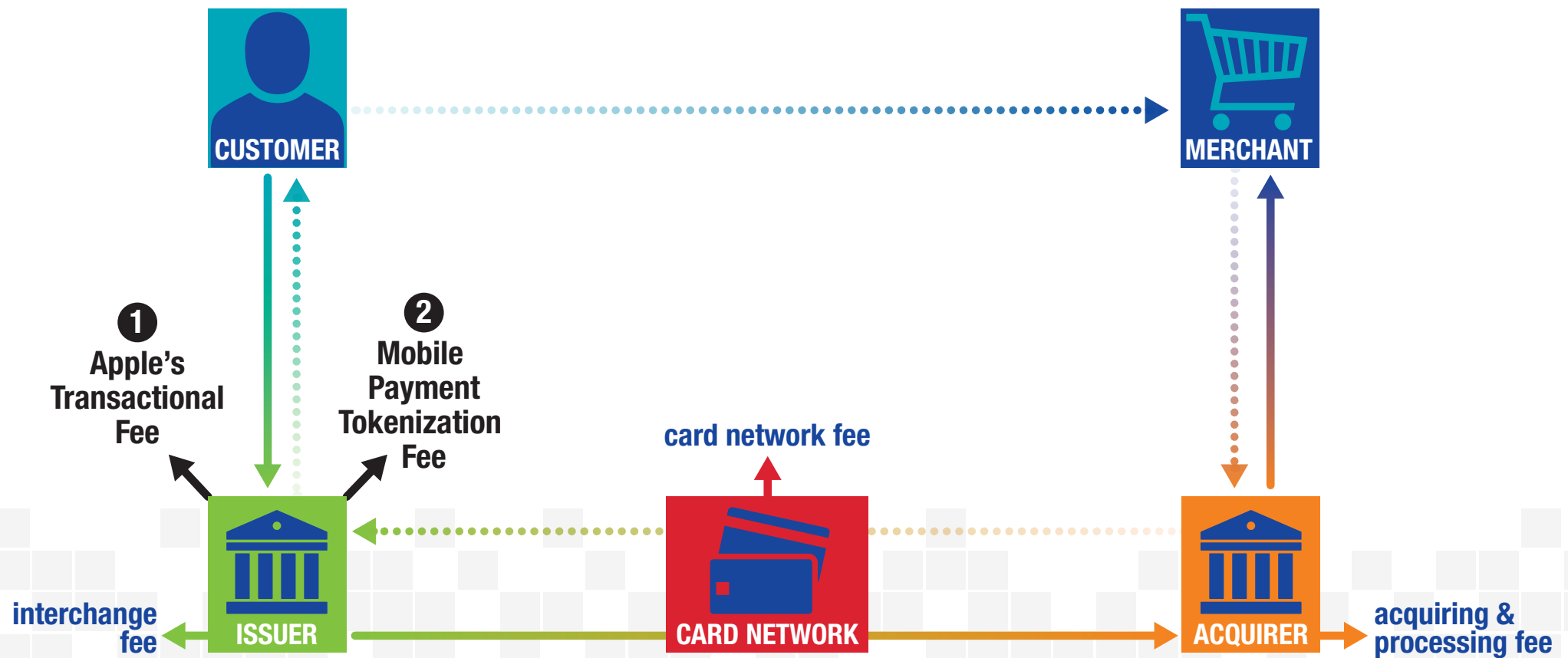
As the monetary funds pass back through the scheme to the Merchant, each party deducts their share. By the time the Merchant receives the funds, a combined 2.5% in this example has been deducted from what the customer paid.

So, the Customer pays \$100 at the store, but the merchant only receives \$97.50 – **card payments are far from being a free or ultra-low cost payment method from their point of view.**

But now, take the example of **Apple Pay**; Another party, another fee – although not published, Apple is said to receive 0.15% of the transaction value, so that's another 15 cents in our customer's \$100. So our merchant in this case would receive \$97.35... or even less, because there is another fee, as the Issuer takes a payment for the **mobile payment tokenization**.

Tokenization is the process of protecting sensitive data by replacing it with an algorithmically generated number called a token, which is then used to prevent credit card fraud. In credit card tokenization, the customer's primary account number is replaced with a series of randomly-generated numbers, or "token". This token then passes through the various wireless networks needed to process the payment without actual bank details being exposed. The actual bank account number is held safe in a secure token vault.

FOUR-PARTY SCHEME WITH TOKENIZATION



GIVING FREEDOM TO THE CONSUMER

With tokenization integration as seen on page 6, the solution is smart, elegant and flexible – leveraging the existing four-part infrastructure to achieve its goals.

But with even higher overall fees, the question is: why would a merchant ever want to accept this method of payment? And the answer is simple – because their customers want to use it.

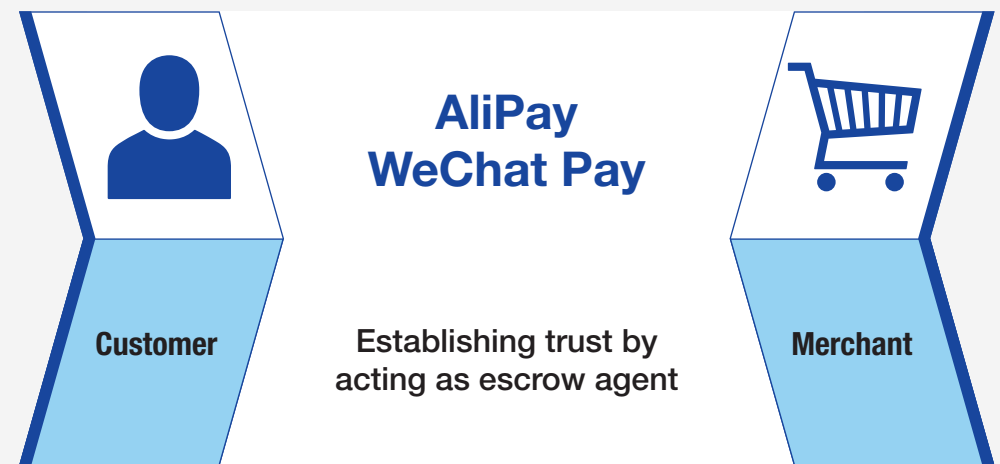
Offering payment method choice is increasingly not optional for merchants – whether that payment method is card, contactless or cash. To stay competitive, they must offer flexible and desired methods of payment or our consumer may shop elsewhere.

Due to the high costs incurred across the network to merchants, regulation has grown in recent years, notably within the European Union. In 2015, EU legislation was introduced, known as The Interchange Fee Regulation (IFR), which brought major changes to the way card schemes operate by introducing caps on the interchangeable fees applicable to cards. Their restriction means the weighted average interchange fees must not exceed 0.2% (0.3% for credit). But with the increased use of mobile payments which command other fees, its overall benefit to merchants has been diluted.



A DIFFERENT APPROACH

There are moves towards a cheaper and more efficient solution, notably the digitization of payments in China with AliPay and WeChat Pay. These brands do things differently. They saw the four-party model and believed there was a better approach. They thought the fees were unreasonable and exploitative towards merchants – so challenged this model and successfully disrupted the process. These models don't sit on the back of a card network like many other eWallets. Instead, they look back to their origins as an **online payments escrow agent**. The consumer pays AliPay, and AliPay in turn pays the merchant once the customer confirms completion of purchase. It's a trust thing.



Source cbinsights.com

SO WHAT ABOUT CASH?

Despite the competitive edge, mobile payments and eWallets still command fees, albeit smaller than their traditional card network counterparts, to use their network or service. On the other hand, for cash payments, the costs can be much lower. Firstly, anybody can accept and transact with cash, whether you are a small business, an individual or a large corporation. The basic cost of me handing you a \$100 bill? Zero. Only the energy to extend my hand. It is 100% free to transfer from one party to another in the simplest sense.

So, where the cost of cash lies is in cash handling efficiency, minimising the risk of accepting counterfeits as well as eliminating any potential shrinkage. Automating cash handling in stores can reduce these costs by up to 80% or in some areas up to almost 100%, but perhaps more importantly **cash automation can help retailers generate extra revenue**. Cash makes money, smart retailers are already exploring different initiatives such as “cash back”.



FINAL THOUGHTS

Cash is a competitive payment mechanism, and with the right technology, is able to reach levels of automation which can rival electronic payments in terms of costs and efficiency. Automating cash processes at the POS help to increase efficiency, enhance security and release staff to focus on the experience they deliver – which ties in to overall customer satisfaction, and only helps to further drive sales growth.

Efficient cash handling keeps stores and merchants running, reduces the number of CiT journeys, increases store profitability and for some retailers, generates extra revenue. Meanwhile, although we have seen electronic payments are not cheap, it is about **giving freedom to the consumer to choose which payment method they can use**, or which one better fits their needs, however retailers today are paying the costs of the consumer convenience. Electronic payments are convenient, but with convenience comes a price. Electronic payments are not cheap.



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