When Collaboration Makes Sense – And When It Doesn't

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Through the years, the network game hasn't changed. Payment systems need volume, and that means interoperability with other networks. The key is to be smart about it.

The payments world is a patchwork of overlapping and interdependent networks. For success, networks need a path or paths to critical mass. For most, leveraging directly competitive and adjacent systems is essential.

In payments, network effects and habit matter enormously. The most feature-rich, secure, or cheapest payment system in the world is worthless if only one consumer or business uses it. By contrast, systems with billions of users are compelling, notwithstanding imperfections.

To boost usage, networks partner, often ceding some control and economics. In free-market capitalism, no relationship, however one-sided, is consummated unless both parties calculate that they'll profit.

But payment-system relationships evolve based on changing relative power and interests. For example, imagine a world where 50% of Mastercard transactions were initiated over Apple Pay. Those able to shift payments share command better economics, so, at a minimum, Apple would take a bigger bite of interchange.

While there are hundreds of national retail-payment schemes, only a handful of systems are or aspire to be global. Mastercard and Visa are the only genuinely planetwide retail-payment systems.

They command the lion's share of cross-border retail payments in every country except China, Iran, North Korea, Sudan, Syria, and the part of Ukraine occupied by Russia. Their open model leveraging tens of thousands of banks to deliver payments to end users has been the most successful payments-system strategy ever.

The Open Approach

Visa's visionary founding chief executive, Dee Hock, evangelized a system of enforced cooperation for core delivery systems, rules, and brand, and decentralized freedom to compete and innovate for banks. For networks leveraging third parties, more partners and greater share dispersal are better than less.

Hock liked biological metaphors. In a May 21, 1985, talk given after he retired, he counseled, "The trick for an evolving organism is to assume whatever form best serves function in the changing environment."

His creation continues to evolve. In 2008, Visa changed governance, went public, and became less bank-centric and decidedly more enterprising. But it retained balance and tension between central control and licensees' decentralized competition and innovation.

In the cross-border interbank payments sphere, Swift took a similar open approach. The Swift network, and correspondent banking, enjoy near ubiquity worldwide and a near monopoly.

As was the case with Mastercard and Visa, an initial public offering transforming Swift from a bank cooperative into a commercial public enterprise would unleash value and wouldn't have to alter the balance between central control of delivery systems and rules, on the one hand, and decentralized competition and innovation, on the other.

Adjacent networks could encroach on Swift's turf. For example, Mastercard's ownership of a real-time automated clearing house system, Vocalink, suggests a path to real-time interoperability between the world's interbank-payments networks.

Google Vs. PayPal

Alipay, American Express, China UnionPay, Discover, JCB, PayPal, and WeChat Pay are tier-two, or aspiring, global retail-payment systems. All have opened up, working with third-party networks, processors, issuers, and/or wallets to extend their reach.

And, powerful technology platforms are wading into payments, leveraging existing networks and processors. Tech colossi Google, Apple, Facebook, and Amazon have further ambitions in payments to enhance their platforms.

However, Google's Tez, launched in India in September 2017, is a payment scheme in its own right. It's free for merchants and consumers and harnesses the National Payment Corporation of India's real-time ACH and Unified Payments Interface scheme.

It's being rebranded Google Pay for international expansion. Existing payment systems, as well as banks, should worry. If arguably the world's most powerful tech platform could scale a payments network monetized through advertising, it would be a scary competitor.

The European Union's PSD2 regulation mandates that banks provide free payments and harvesting of consumers' payments data. Most businesses aren't going to be able to persuade consumers to let them initiate payments against their current accounts and harvest their data. But Google likely will. Amazon too.

Moreover, directly or more likely through existing payment systems, these companies have the wherewithal to exploit the coming pan-EU patchwork of application programming interfaces for initiating payments and data harvesting. If Google Pay (Tez) gets traction beyond India—say, within the EU—it would roil the reigning payments ecosystem.

To be sure, notwithstanding its enormous success elsewhere, Google's payments efforts have underwhelmed since Google Checkout's 2006 launch. Still, with its portfolio of globally dominant search, smart-phone-operating-system, browser, online-video, and email assets, the tech giant's payments efforts shouldn't be taken lightly. Perhaps Google Pay will be the charm.

E-commerce phenom PayPal has been on a tear, embracing interoperability. Originally, PayPal was a closed-loop general-purpose payment system, relying, however, on card and ACH networks, and ultimately banks, to fund transactions. To increase network mass, it's been opening up, though in fits and starts and not always successfully.

PayPal's initial attempts, in 2012, to deliver acceptance through U.S. acquirers and the Discover network came to naught. Finally, in 2016, PayPal reached a modus vivendi with Mastercard and Visa, agreeing not to discourage their use and to use their tokens for proximity payments at the physical point of sale.

Now it's working with giant credit card issuers like Bank of America, Chase, and Citi to enroll new PayPal subscribers. Chase and Citi cardholders will be able to spend their reward points at PayPal merchants. In August, it cinched a deal with Brazil's Bank Itau to promote PayPal to its cardholders and offer PayPal acceptance through Itau Unibanco's Redecard multibrand acquirer.

It's established interoperability with mobile-payment system M-Pesa and massively extended its money-transfer delivery footprint with a deal with competitor Euronet.

PayPal also agreed to accept China's Baidu Wallet, which claims 100 million users. However, as China's dominant e-commerce payments dragons Alipay and WeChat Pay build acceptance abroad, the Baidu relationship's promise diminishes.

Some of these relationships are close calculations. Is there any doubt what Mastercard chief executive Ajay Banga or Visa CEO Al Kelly would do with an "Extinguish PayPal" button, with no antitrust risk?

The Fly in the Ointment

America's number-four card network, Discover, for more than a decade has doggedly pursued a strategy of network reciprocity and transforming itself into a semi-open-loop system. It has reciprocal acceptance with a host of networks including China UnionPay, JCB, Rupay, PayPal, Elo, and Eufiserv, for which in 2017 it processed $14.2 billion in total volume.

The fly in the ointment is that, absent cobranding and co-signage, consumers and merchants are unaware.

When there’s uncertainty, transactions don’t happen. Connected mobile wallets could enable acceptance alerts for cardholders and merchants to signal acceptance. Some network relationships will lose value regardless. Notably, UnionPay is expanding U.S. acceptance, reducing its need for Discover.

Even cogent partnering will struggle to overcome network effects enjoyed by larger payment systems in well-served markets. Since 2006, Discover has used third-party acquirers to provide acceptance, enabling a U.S. acceptance network that is close to parity with Mastercard and Visa.

As the weaker network, however, while still growing, Discover is losing share, dropping from 5.5% of general-purpose U.S. credit-card purchase volume in 2006 to 3.8% in 2017. At the same time, though, Discover’s open, brand-neutered Pulse debit network, generating 11 basis points of yield on payment volume, increased share from 2.2% of purchase volume in 2006 to 4.2% of total volume in 2016.

Like Discover, American Express is semi-open, but because of higher interchange and cardholder spend, it’s enjoyed greater success in rewarding third-party issuance.

Initially closed-loop systems Alipay and WeChat Pay built momentum on Alibaba and Tencent, respectively. Outside China, however, like UnionPay, they’re partnering with third-party merchant acquirers.

Promiscuous Partnering

Challenger cross-border systems and free domestic person-to-person platforms have chipped away at traditional money-transfer networks’ transaction economics. Western Union’s, MoneyGram’s, and Euronet’s compliance coverage and promiscuous partnering on the send and receive sides of their networks give them moats for now.

No cryptocurrency has achieved critical mass or relevance in retail or P2P payments. Cryptocurrencies’ best path to building usage is to leverage established systems. For example, Xapo cleverly enabled users to spend Bitcoin in fiat currency with a debit card using Visa's network.

However, in January, 2018, Visa killed the program. Ripple is trying to get in the door by providing cross-border payments messaging to banks, with a view to their ultimately using its XRP currency.

Payment hubs' raison d'être is to lower the cost and time to mass payment-system interoperability. For example, ModoPay enables banks, processors, and merchants to plug into a host of traditional payment networks and nontraditional currencies, such as loyalty points—all with one connection.

The Final Lesson

But many payments coalitions fail.

The Euro Alliance of Payment Schemes attempted unsuccessfully to build critical mass in Western Europe by interoperability between national networks Electronic Cash, PagoBancomat, Multibanco, Euro 6000, and Link, and pan-European Eufiserv. None of the stakeholders, however, was willing to invest meaningful resources building EAPS's value proposition and brand. None had skin in the game.

The grand coalition of U.S. merchants, MCX, had Money2020 keynotes three years running. It attempted to build a merchant-centric payment system, CurrentC, to take a pound of flesh from American Express, Discover, Mastercard, PayPal, and Visa. There were several problems.

Notwithstanding the zeal of MCX members—Walmart in particular—to reduce payment-acceptance costs, there was never a compelling use case for CurrentC. Additionally, merchants don't play well together. While many have their own highly successful retail credit card programs, they have no history of successful collaboration in general-purpose payment systems.

Similarly, the joint venture of giant carriers AT&T, T-Mobile US, and Verizon, Softcard, which was piloted in Austin and Salt Lake City, fizzled. The venture sold the remnants to Google. While some carriers individually have developed successful payment systems in emerging markets—for example, M-Pesa, Airtel Money, and Ecocash—their efforts in mature payments markets, individually and collectively, have largely failed.

In 2003, the behemoth European mobile network operators Vodafone, Orange, Telefónica, and Deutsche Telekom's T-Mobile, and the world's largest payment processor, First Data, attempted to develop a payment network called Simpay. It never found a path(s) to spend-and-acceptance critical mass. In 2005, they pulled the plug.

Still, the final lesson is that even the world's most powerful payment networks can benefit from astute collaboration with facially competing systems. And for weaker systems, it's critical. If interoperability boosts network reach and transactions and maintains, or better yet enhances, brand visibility, it's worthwhile even at the cost of sharing economics.