# Existing Titans Will Trounce Payments Disruptors

by Eric Grover

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As banks, battered by regulators and lawsuits, limp into 2014, the payments industry is on a roll. Delivering a surfeit of secure and convenient electronic products consumers take for granted, payments are enjoying solid growth, an unprecedented wave of innovation and hype about the prospect of fundamental disruption.

Open networks such as MasterCard and Visa were the greatest payments innovation of the last century. Consumers can pay and obtain credit and cash worldwide, whereas only a couple generations ago, they carried cash and traveler's checks.

Three decades ago retail payment networks, excluding American Express, were bank cooperatives. Today, unshackled from bank association governance, they've become more enterprising as enablers of innovation rather than restrictive gatekeepers.

Now cryptocurrency Bitcoin, Google Wallet, mobile-card-acceptance phenom Square, merchants' digital wallet consortium MCX, PayPal and joint telecommunications venture Isis spur talk about upending the existing payments industry and titans.

However, while there is reason to look forward to greater utilization, inclusion and an enriched electronic-payments experience over the next decade, fundamental disruption is unlikely.

Mobile ubiquity's a big deal. Mobile phone subscriptions mushroomed from 12 million in 1990 to 6.8 billion in 2012 . In 2013, smartphone shipments surpassed dumb-feature-phone shipments. Exploiting mobile internet-connected processors will enable hundreds of millions of small, casual and third-world merchants to accept electronic payments, greasing the skids of commerce.

In developing markets, mobile enables delivery of electronic-payment products to new consumers. In some deep-emerging markets, mobile-operator-centric networks like M-PESA, competing primarily with cash in Kenya, have stolen a march on cards. In the U.S., mobile enhances value for existing cardholders and strengthens incumbent payment systems.

Consumers continue to carry plastic cards as payment keys. Lafferty World Cards Intelligence estimated there were 9.6 billion general-purpose payment cards in 2012. These cards are a convenient, habitual form factor for consumers and merchants.

Increasingly, consumers will use cloud or handset electronic wallets in addition to and in lieu of cards to manage payment credentials and a trove of loyalty programs and promotions. No matter how successful however, a decade hence, digital wallets, plastic cards and cash will still coexist. And a change in the preferred form factor, should it occur, isn't disruptive.

A host of innovative payment service providers are enhancing the most lightly regulated side of the system: card-acceptance for merchants. But building new payment schemes from scratch in well-served markets is tough.

The payment-system graveyard includes Revolution Money, Debitman, Pay by Touch, Flooz, Beenz, Mondex, CyberCoin, Digicash and First Virtual. Quixotic venture-capital-backed Dwolla challenging the ACH and retail-card networks is likely to join them. Its strategy – competing by being cheaper for merchants rather than providing more value to consumers – has virtually always failed and the incumbents enjoy powerful network effects.

Notwithstanding appealing to libertarians distrusting government fiat money and grey-and-black-market actors, cryptocurrencies won't achieve critical mass competing with established retail-payment and money-transfer networks, or, as a store of value, with financial and hard assets including gold.

History shows, if cryptocurrencies start to get traction, governments will suppress them. Back in 2007, gold-backed digital currency E-gold was charged with money laundering and facilitating child pornography. Founder Doug Jackson and three directors ultimately accepted a plea bargain. The Feds also attempted, unsuccessfully, to seize its gold.

Liberty Dollar, an issuer of gold and silver coins and certificates, was convicted in 2011 of distributing coins resembling the U.S. Mint's. Prosecutor

Anne Tompkins called it "a unique form of domestic terrorism." That government equates citizens using gold coins to blowing up buildings is disturbing. Child pornography and terrorism accusations are calculated to intimidate currency-competition champions.

The biggest potential threat to the existing payments hierarchy, other than government, are gargantuan networks Google, Facebook, Amazon, Apple and mobile-phone operator and retailer consortiums. These companies have sufficient heft to try to make their own branded payments ecosystem and relegate MasterCard and Visa to backend payment utilities.

However, if Amex, MasterCard and Visa protect their brands at the point of transaction, they will maintain payments dominance, with innovation flourishing at the networks' edge. And overseas they will continue to win share from national networks, like France's Cartes Bancaires and Canada's Interac, absent government protectionism.

China, the most egregious example of this protectionism, continues to flout its 2001 World Trade Organization commitment to open up its domestic payment-card market by 2006. Notwithstanding its 2012 loss of a U.S. WTO complaint, there has not yet been a single domestic Amex, Discover/Diners Card, Japan Credit Bureau, MasterCard or Visa transaction in China.

Washington posts the paramount risk to payments innovation and competition. The payments industry needs to make an affirmative case in the public arena for the freedom to compete, innovate and deliver value. To paraphrase Milton Friedman, it must create conditions where the costs of bad policy cause even the wrong politicians and regulators to make the right decisions.

With light regulation, increasing network competition and dynamism, greater nonbank participation, mobile phone ubiquity, and a tsunami of innovation, the next decade should be a payments-industry renaissance, but familiar names will remain at the core.

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