

Apple Pay as Enhancer, Not Disruptor: Contrary to many prognosticators, Apple Pay is likely to enhance the existing payments system rather disrupt it

by Eric Grover

Banking Strategies

October 22, 2014

Apple's unveiling of its long-anticipated mobile wallet, Apple Pay, provoked reactions ranging from giddy exuberance to muted fear. Activist investor Carl Icahn in a letter to Apple CEO Tim Cook speculatively gushed that [Apple could generate \\$2.5 billion in payments revenue if it reaches 30% of all U.S. credit and debit card spend by 2017](#). A bit over the top, but wow. In *BAI Banking Strategies*, consultant Steve Mott [declared that "the credit card system is broken" and enthused about how Apple "just blew up the credit card model," which he termed a "positive for banks."](#)

More measured and putting the best possible face on it, [Wells Fargo & Co. Chief Financial Officer John Shrewsberry said Wells was participating as a hedge](#). Worrying about the threat, e-commerce phenom PayPal ran a combative ad in the *New York Times* ("We the people want our money safer than our selfies ...") mocking Apple for a lack of security.

If Apple Pay succeeds there will be winners and losers, though, with the Cupertino, Calif.-based computer giant choosing to leverage rather than try to disintermediate the existing system, not so many of either as one might expect.

Path to Acceptance

General-purpose card networks constituted the greatest payments innovation in the 20th century. [Americans made 74 billion payments in 2012 using general-purpose credit, debit and prepay cards](#) testifying to the system's success. The system enjoys powerful network effects, whose enormous utility consumers and merchants alike take for granted. Any

challenger must be compellingly better in key aspects and forge a path to critical mass of spend and acceptance. Attempts to upend the existing system are difficult. In the U.S., consider the fate of Revolution Money and Debitman; in Europe, the Euro Alliance of Payment Schemes, SimPay and Monnet also failed, the last two before even getting out of the gate.

In contrast, Apple astutely embraced the existing payments ecosystem.

The siren promise of digital wallets is a connected platform for better managing payment credentials, proprietary loyalty and reward programs while reducing friction and bridging gaps between e-commerce, mobile-commerce and payments at the physical point of sale (POS). Accessing payment keys from smartphones offers potentially enhanced security which, while a plus, won't by itself move consumers to use digital wallets in lieu of plastic. Pay by Touch going belly up vividly demonstrated that better security and being cool aren't sufficient. Mondex, Digicash, First Virtual and Cybercash were putatively more secure than traditional credit cards, yet all failed.

Apple Pay's use of fingerprint authentication, tokenized payment credentials and one-time codes to bolster security, while nothing new, does give these authentication methods some impetus. Paramount, however, Cupertino's wizards must incent consumers to use their wallet. Even diehard iPhone enthusiasts won't stampede to use Apple Pay without greater ease of use and rewards. In mobile commerce, an integrated, low-friction-payments experience is likely enough. However, at the physical POS, the existing system is habitual and low-friction for consumers and merchants. There, perhaps with retail partners, Apple needs to deliver compelling benefits to change behavior.

Excepting retail cards, bank issuers own cardholder relationships and capture the lion's share of payment-card revenue. Apple Pay decidedly is not good for them. Banks would prefer that their customers use their own mobile wallets not Apple's.

If Apple Pay is successful, it will erode the primacy of bank payments relationships, increasingly relegating financial institutions to a kind of back end utility. Off the starting blocks, Apple is capturing a piece of interchange

much as powerful cobrand credit-card partners do. Banks, like mobile network operators before them, have accommodated themselves to the market reality. Apple can, or at least credibly threaten to, move consumers' spend and, consequently, can demand fees for permitting banks to participate in Apple Pay.

Cheerleaders suggest that Apple's wallet will accelerate the conversion of cash to electronic payments and, because in the U.S. most iTunes accounts are funded with credit cards, spur credit over debit, thereby benefiting banks. Possibly. But the lion's share of Apple Pay transactions will be payments that would have occurred anyway, by an iPhone user swiping or inserting a piece of plastic. Apple's wallet is unlikely to materially alter the half-century trend of electronic payments taking share from cash and checks.

Whether or not it increases card-payment volume, Apple's wallet, if it takes off, will surely come back for another bite at the apple by demanding a bigger piece of banks' payments revenues.

Sitting Pretty

While the networks would prefer a host of smaller innovators on the edge of the network, rather than Gargantuanas like Apple, they're still sitting pretty. Processing of Apple Pay tokens by American Express, MasterCard and Visa will boost revenue for those networks, reinforce their positions at the heart of the payments ecosystem and help fend off unwanted direction from Washington about enhancing payments security.

For merchant acquirers, increases in transaction growth and complexity at the POS are a plus. And they are already rushing to support in-app Apple Pay integration for a host of mobile applications and services. At the physical POS, near field communications (NFC) and Apple Pay acceptance will ride in the slipstream of acquirers' rollout of EMV chip cards.

Merchant reactions have been mixed. The digital-wallet consortium [Merchant Customer Exchange \(MCX\)](#) aims to lower payment costs. Apple's wallet is about enhancing the iPhone platform and Apple customer relationships, not lowering merchant costs. Keen on promoting MCX wallet [CurrentC](#), Walmart said it won't accept Apple Pay. At the physical POS, Walmart knows that consumers will simply swipe a card. But in competitive

retail sectors, consumer payment preferences reign. If and when a critical mass of consumers prefers to use digital wallets, most merchants will accept them.

While Apple Pay is formidable competition for the host of digital wallet providers, it will also spur activity, particularly within Google's more open, host card emulation-supporting ecosystem.

Apple Pay highlights the existing retail payment system's openness to new and nontraditional players bent on enhancing it rather than on fundamental disruption. Hopefully Apple's digital wallet won't disappoint.

Mr. Grover is principal with Minden, Nev.-based [Intrepid Ventures](#), which provides corporate development and strategy consulting to financial services, payment network, and processing businesses. He can be reached at Eric.Grover@IntrepidVentures.com.