ENDPOINT

Enthusiasm for swing-for-the-fences, exotic payments startups has waned.

The Fundamentals Still Apply

Want to start—or bet on—the next big thing in payments? Forget glitz and glamor and focus on startups that address pressing problems with substantial and realistic solutions, argues Eric Grover.

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Successful payments fintechs such as Adyen, Ant Financial, Klarna, Stripe, and Square have generated enormous excitement. With the arguable exception of Ant Financial, they all employ traditional business models, and enhance, and in places stress but don't disrupt, the existing payments ecosystem.

There have also been notable fintech disappointments. Hyped mobile-payments venture Powa Technologies went belly up. In 2014 Mozido's seductive mobile-commerce story was valued at $2.4 billion in a round in which Mastercard, Wellington Management, and Julian Robertson participated. Former Mastercard chief executive Bob Selander sat on its board. Now it's on a life-support from Brevet Capital. And the SEC is suing Mozido's founder, Michael Liberty, for defrauding investors. Ballyhooed Softcard and MCX both folded.

Nonetheless, capital continues to be put to work in fintech. In the first half of 2018, $58 billion was invested globally across 875 deals.

Enthusiasm for swing-for-the-fences, exotic payments startups, however, has waned. And the euphoria stemming from the belief that cryptocurrencies and distributed digital ledgers would upend the reigning payments ecosystem has ebbed. Ripple XRP at 33 cents, Bitcoin at $3,659.82, and Ethereum at $127.16 are down 88%, 79%, and 91%, respectively, from their January 2018 peaks.

Closer to terra firma, a handful of interesting early-stage payments ventures worth watching are Modo, Marqeta, Beyond, RS2 North America, and Veem. All address big opportunities or problems, and rely on proven business models.

None, however, proposes to fundamentally upend the current ecosystem. If one could genuinely disrupt the status quo, that could be huge. But regnant systems work well and enjoy enormous network effects.

Sleepy Oligopoly

Modo is a payments-and-value hub headed by payments savant Bruce Parker. The secret sauce is its transaction and intelligent-gateway ledger and its abiding interoperating philosophy.

Modo is being used by Fidelity National Information Services (FIS), Deutsche Bank, Klarna, Verifone, and Etihad Airlines to connect to and transact with a web of interconnecting traditional payment networks, alternative-payments systems, and proprietary rewards programs, taking the burden off of banks, merchants, and processors. In November, 2018 Modo closed a $13 million A round led by Deutsche Bank.

Marqeta is a self-described new-age card-issuer processor. Taking a page from Stripe, it styles itself as developer-friendly, intimating traditional processing behemoths aren't as agile or flexible and are, therefore, not best-suited for developing nontraditional payment-card applications.

Entry barriers in issuer processing, which is dominated by First Data, FIS, and Total Systems, are significant. There haven't been new entrants in decades. Building delivery systems requires time and resources. Even then, no large bank will outsource credit-card processing to a challenger unless and until it has scale clients.

The potential market is immense and growing. There are 1.3 trillion U.S.-issued general-purpose payment cards. Marqeta enables new use cases and, consequently, more virtual and physical cards, like debit cards for spending Square Cash. It isn't, however, fit for purpose for traditional credit-card programs end-to-end, yet.

Whether the upstart can move upmarket to challenge incumbents remains to be seen. At a minimum, Marqeta promises to give the sleepy issuer-processing oligopoly a jolt.

Stickier Merchants

Heartland Payment Systems founder and CEO and philanthropist Bob Carr launched merchant acquirer Beyond in 2017. The acquiring industry continues to consolidate. In 2016, Global Payments acquired Heartland.

But entry barriers and regulation are relatively modest. Small enhancements can be enormously valuable. While processing for gargantuan retailers like Walmart and Carrefour provides razor-thin margins, the opportunity to provide services on top of and around payments to SMEs is immense.

Carr brings his philosophy of owning the sales channel, transparent pricing, and supplying additional services around payments, making for stickier merchant relationships and more sustainable economics. Beyond acquired software enterprise PeachWorks to bolster its integrated-payments offer for restaurants.

RS2 is a card-management software and processing company headquartered in Malta. It's been around for decades, strongest in emerging markets. In 2018, it launched a North American venture headed by Daniela Mielke, a Visa, PayPal, and Worldpay veteran.

Historically, RS2 underperformed against its worldwide opportunity, partly because of its tumultuous early years. Charismatic entrepreneur and founder Reinhold Schaeffter got tangled up selling and buying back RS2, and the enterprise was starved of capital. Now it seems to have found its footing.

RS2 North America is focused on merchant processing for smaller acquirers for which speed and flexibility matter, but which may have misgivings buying processing from competing fully integrated acquirers.

There should also be opportunities to serve smaller credit-card issuers looking to better compete with giants like Citi and Capital One. That's a longer sell, and demonstrating regulatory compliance is a big deal. If RS2 gets traction, it should spur incumbents to better performance.

With globalization, cross-border retail, commercial, and money-transfer payments are growing at a robust clip. Delivery is more challenging, fees richer, competition less, and entry barriers higher, than in domestic markets.

Most cross-border commercial payments are made directly or indirectly through correspondent banks and the near-monopoly global interbank-payments network Swift, over which 3.5 billion payment messages were sent in 2018 through November, up 10.5% year-over-year.

Traditional Model

Focused on helping SMEs with cross-border payments, Veem started out publicly embracing blockchain. That, combined with a big market problem, was a good theme off which to raise venture capital. It has sensibly pivoted, however, broadening the payments systems employed, including Swift. Veem's business model is traditional, taking account, transaction and foreign-exchange fees.

A host of firms including Swift and correspondent banks, Payoneer, CurrencyCloud, Earthport (Visa), Western Union, Ripple, Flywire, Mastercard, and PayPal address cross-border payments. There won't be one or even several winners. Interoperability is vital. For Veem, channels to originate small merchants and compliance, at scale, are critical.

The fundamentals still apply. Payments ventures need to serve real needs and earn fees from someone. DT