Postcard from Money 20/20 Europe in Amsterdam…

Signs of a gathering storm

Yann Sénant, Stefan Dab, Alvaro Vaca, Kunal Jhanji, Angelo Meregalli, Carlo Bravin, Max Nitsche, Akos Turny, Enrique Velasco-Castillo

June 2022

Over 6,500 delegates gathered in Amsterdam this week, as the European edition of Money 20/20 took place once again in its traditional summer cadence. Although only nine months separated last September's special edition of the show to this one, the mood among attendees had clearly changed, from unabated optimism at the prospect of a post-pandemic recovery, to a more sober tone this year. The drastic change in outlook from the combined effects of prologued supply chain shocks, rising inflation, and geopolitical instability, evinced the impending storm.

Yet despite the changing outlook, Money 20/20 continues to be the pre-eminent European fintech event, bringing together players as diverse as bulge bracket banks (JP Morgan, Goldman Sachs, Citi, Barclays), regional champions (e.g. Santander was present with PagoNxt), PSPs (Worldline, FIS/Worldpay, Nexi, Stripe), regulators, fintech start-ups and scale-ups and, of course, investors. These are the key topics this year.

Is the party over for Fintechs?

The mood has visibly changed for fintechs, signalling the end of the regime of recent years characterized by high valuations, easily accessible funding, and the search for growth above profitability. Many investors in particular clearly stated the need to "dramatically reduce the burn rate", and "turn to profitable business models" as they reassess the prospects and viability of fintechs across the board. There was a palpable sense across the exhibition floor that many of the companies on display had solutions looking for problems (e.g. POS terminals for crypto payments) that would face profitability challenges were it not for the abundance of investors' cash.

However, while attendees talked about the prospects of a coming recession in key markets and a global economic crisis, the reality is that most of the fintechs in the show were founded in the last booming decade and have not experienced anything similar before. Those companies will have to learn how to operate in the new macroeconomic environment, manage lower growth and new risks, and prepare for a reduced influx of funding and capital investments. Amidst the turmoil brought by the new environment, we are probably heading for accelerated consolidation with the winners emerging stronger: many companies will not survive, but this will also present attractive M&A opportunities for well-capitalized players with sound business models.

The most compelling participants have developed best-in-class solutions in operational areas like AML, fraud prevention, authentication, or payment infrastructure that solve clear frictions for consumers, merchants, and PSPs. Companies that have built an attractive proposition in these areas (e.g. Banking Circle, PPRO, Featurespace, True Layer) will need to grow their niche to profitably scale.

As we enter the new era of market instability, investors and market players will need to go back to basics: focus on areas with sizeable revenue pools, bring compelling end-user propositions, build tangible advantages, and remember that in lending there are inevitable credit losses (and the last one to the party gets the lemons).

The European Payment Initiative is at a crossroads

BCG's Alvaro Vaca moderated a panel that discussed the prospects for a pan-European payments scheme and rails. The panellists—Daniel van Delft, CEO at Currence (which runs the iDEAL scheme in The Netherlands); Martina Weimert, EPI Interim Company CEO; and Nicolas Kozakiewicz, Executive Advisor at Worldline—agreed on the need for a larger European means of payment to compete with innovation against technology giants. European consumers and merchants would benefit given the large mobility in Europe (beyond the Euro zone)—mobility which is yet to manifest in terms of payment interoperability.

The European Payment Initiative (EPI) has shifted focus from becoming an alternative card scheme towards developing a consumer wallet that would bring new use cases, particularly for merchants—a group that Ms. Weimert would like to see become part of EPI's governance model. She also outlined key pain points and needs to be solved. For merchants: single integration, cost-effectiveness, and ease of adoption. For consumers, Ms. Weimert highlighted their desire for greater control over what payment means they can use in a wallet and the range of interactions that it enables, based on EPI's consumer research in nine countries. However, it remains unclear how EPI v2 will tackle these in its product while differentiating from existing solutions, and whether this is truly the most important problem to solve for European payments.

This view of an all-encompassing European wallet was not shared by other panellists: Currence's Mr. van Delft would rather start small, leveraging existing local schemes and select use cases to then scale the solution across the region.

The greatest roadblocks for EPI are political in nature. While Ms. Weimert called for some type of support from public institutions (given their goals of ensuring European payments autonomy and self-reliance), other panellists were concerned that this would set the stage for potentially unfair competition from EPI.

The future will tell whether this approach can progress, or whether European consumers and merchants will likely pursue other avenues.

Embedded finance was the buzzword of the event—the potential is there, yet clear business models were missing…

BCG research substantiates the high long-term potential for embedded finance in a world where software and digital platforms become ubiquitous customer interfaces. As expected, there was plenty of talk about Embedded Finance—much of it lacking in substance, however. Value propositions were vague: "industry-specific solution to remove friction from payments", "finance at the point of need", "access to finance when needed at the lowest cost". Omar Haque, Head of Group eCommerce at Nexi Group, pointed out that "39% of retailers don't know what embedded finance is," which comes as no surprise as attendees struggled to articulate what, if anything, is radically different from POS lending and other solutions that have existed for many years.

Except for a few leading players, business models seemed as vague. Even for existing and emerging solutions like cash advances and instant settlement for merchants (especially SMEs selling on platforms like Shopify), and BNPL/instalment lending for consumers (more on BNPL below), there was a lot of ambiguity on how the participants we talked to would manage and distribute risks and extract value while not providing the capital. For many the challenge will be not to end up with just incremental developments—underpinned by improvements in approval rates thanks to contextual, real-time data on revenue streams, improved risk management models, and money management intermediation—rather than a step change in the way consumer and merchant finance is underwritten and distributed.

Despite the shortcomings, Embedded Finance has long-term potential, will certainly attract investors and perhaps—despite the changing environment—high valuation multiples for those players that can achieve profitable business models.

… while competition heats up as BNPL matures

Attendees were in broad agreement that Buy Now-Pay Later (BNPL) solutions are here to stay. Widespread adoption has validated consumers' desire for simple and transparent finance solutions seamlessly integrated with retailers' purchase flows.

But BNPL players were also still trying to make sense of what the combined effects of the challenging macroeconomic environment, increased regulatory scrutiny, and Apple's launch of its own consumer finance subsidiary and BNPL product (announced the night before the start of the event) will mean to their businesses. Players that had prioritized growth above all other considerations were already showing strains—industry darling Klarna, for example, raised funding in May at a one-third lower valuation than previous rounds and is laying off ~10% of its workforce.

Lower valuations, higher costs of funding, deteriorating loan books, stringent regulation, and competition from tech giants will dampen growth prospects. Skilful risk management, competitive pricing, and seamless customer experience are now table stakes for BNPL players to defend their market share. Meanwhile, the basic deferred BNPL product (funded by, and distributed via, merchants) itself faces increased competition from 'reverse BNPL' solutions from Affirm, Zilch, Australia's CommBank, and now Apple—debit cards that can be used at any Visa or Mastercard-accepting merchant and which enable users to pay in instalments after making the purchase.

This environment represents a unique opportunity for banks to catch up in certain markets. Banks can use their scale in issuing and risk management capabilities to embed BNPL-like features into their card products, or benefit from opportunistic M&A deals to grow their customer base. We are already starting to see some of the forward-thinking banks (such as Barclays) starting to take note of the opportunity available to them as a result of changing market conditions and making moves.

From Open Banking to Open Finance?

Several panels touched upon Open Banking, and the mood from attendees veered between frustration at the seemingly glacial pace of evolution and cautious optimism at the potential.

The frustration stems in part by the mismatch between Open Banking as a regulator-driven, prescriptive set of rules, and the dynamic needs of consumers, merchants, and banks. Nilixa Devlukia, Founder & CEO at Payments Solved, highlighted PSD2's "success in bringing new actors into the market" and enabling "more customer choice," but stressed that PSD2 only set the groundwork for what should be built through future regulation: addressing challenges around functionality, lack of access, and standardisation.

Meanwhile, industrial players are focused on product and execution instead of rules: "nobody cares or talks about open banking anymore"—quipped Tink's co-founder and CEO Daniel Kjellén in a panel with Visa Europe's CEO Charlotte Hogg (Tink was acquired by Visa in a deal completed last March). Rather, it is about providing more choices to customers, and solving problems in digital lending, payment initiation, faster onboarding, and better user experiences. The "world has changed but the needs are basically the same," he added.

On the other hand, the steady growth in volumes from Payments Initiation, albeit from a very small base vis-à-vis cards (this year Tink reached 4M Open Banking payments/day according to Mr. Kjellén), and VRP's potential underpins much of the optimism. VRP was seen by panellists as the most attractive opportunity for banks, replicating the card-on-file model for e-commerce. Account holders provide consent for the use of their bank details only once, and merchants can then re-use those details for subsequent transactions. But the eventual success of VRP will also depend on strong security and governance models. Worldline's CEO, Gilles Grapinet, pointed out that PSD2 had been a "leap of faith" in security terms, as key payment details such as the IBAN are neither encrypted nor tokenised, compared to cards online which are "never in the clear." Mr. Grapinet suggested that future regulation like PSD3 may come in favour of IBAN tokenisation. In the meantime, industry solutions may have to step in to fill the gap.

Beyond regulation, the success of Open Banking (and Open Finance beyond it) is ultimately conditioned on the ability to provide better propositions than the robust solutions that exist today (card-on file, direct debit, etc.). Another factor will be the existence of real-time payment rails and infrastructure capable of supporting the most relevant use cases, solving for competition against card schemes, and accelerating adoption. Clear incentive models and public-private initiatives may need to evolve to address those challenges.

CBDCs: a matter of time

Central Bank Digital Currencies (CBDCs) are "an inevitable evolution", said Brunello Rosa, CEO & Head of Research at Rosa & Roubini Associates at a panel discussing Project New Era (a quasi-CBDC initiative led by The Payments Association, paywith.glass and other private industry stakeholders, and supported by BCG).

Faced with advanced CBDC pilots in markets like China (which may boost the internationalization of China's currency), and the emergence of stablecoin players (which could present systemic risks and reduce Central Banks' ability to implement monetary policy), the question for panellists was no longer *if*, but rather *how* and *when* will CBDCs emerge. BCG's Kunal Jhanji shared the view that a UK Digital Sterling would need a multi-year assessment to validate use cases and ensure full alignment between public and private stakeholders. This view was shared by Nicole Sandler, Head of Digital Policy at Barclays, who stressed the importance of avoiding reputational risk and ensuring that the design of such an instrument mitigates potential risks to commercial banks (such as the potential reduction in commercial bank deposits due to capital flows to CBDCs).

What does that mean for payments? During the panel about European payment rails (see above), Martina Weimert stated that the Digital Euro would be yet another "currency" to integrate in the wallet, rather than a competing rail itself. Closer alignment between industry stakeholders on the design and attributes of CBDC is needed, as Central Banks emphasize its fundamental nature as a form of money, while industry players focus on the infrastructural aspects.

Overall conversations were converging around the fact that CBDC and cryptocurrencies would likely co-exist, while stablecoins may face more uncertainties going forward.

Other highlights and topics to watch

- **Rise of the Orchestration layer**: a few years back fintechs were focusing on solutions and offerings to disintermediate the value chains. As a result, the market is full of different solutions and platforms and becoming more fragmented. This complexity, especially in large verticals with highly custom needs such as airlines or connected cars, has led to the emergence of orchestration players that help merchants abstract that complexity away. We've seen a similar phenomenon in SME acquiring and that model is now being applied to increasingly large merchants with complex payment needs. Barclaycard Payments CEO, Rob Cameron, articulated the orchestration layer advantages for large and complex merchant categories such as airlines and suggested that outcomes such as higher authorisation rates, better, smart routing would drive tangible outcomes.
- **Software is (still) eating acquiring**: Banks face an uphill battle to compete in acquiring, as best-in-class software solutions further encroach on the market. There will not be many successful players next to companies like Adyen, Stripe, Square, or PayPal, whose businesses are still very solid despite falling valuations.
- **Digital identity's role in the physical world and metaverse**: It was clear through the various sessions and the conversations at the conference that digital identity will be critical to getting the customer experiences right, not only in today's world but also in eventual virtual worlds (such as the Metaverse) where consumers will potentially need to manage their various avatars through a single underpinning access mechanism.

* * *

This wraps up another edition of Money20/20 Europe. If you would like to discuss the above—or anything related to payments—we encourage you to contact the authors at the email addresses below. We would be delighted to have the opportunity to bring the right Payments experts to you and exchange perspectives.

Yann Sénant, Global Head of Payments – Senant.Yann@bcg.com
Stefan Dab, Co-founder of BCG Payments practice – Dab.Stefan@bcg.com
Alvaro Vaca - Vaca.Alvaro@bcg.com
Kunal Jhanji - Jhanji.Kunal@bcg.com
Angelo Meregalli - Meregalli.Angelo@bcg.com
Carlo Bravin - Bravin.Carlo@bcg.com
Max Nitsche - Nitsche.Max@bcg.com
Akos Turny - Turny.Akos@bcg.com
Enrique Velasco-Castillo - Velasco-Castillo.Enrique@bcg.com