FINTECH Trend: Digital Payments

At the one-year mark of the Covid-19 outbreak in the US, digital payments seems to be one of the few beneficiaries of this global pandemic. For us, a recent Visa study crystalized the road to recovery. The survey found that 82% of SMB's have adopted new digital technologies and more than half of consumers are using contactless payments.

In 2019, only 19% of all credit and debit cards were equipped for contactless payments at the POS (point of sale). It is now estimated that just over half of all cards in the US will be able to use NFC (near field communication) or contactless payments by the end of this year (per the Aite Research Group). Touchless commerce will slowly begin to overtake the process of inserting your card into a reader or even handing your card over to have its mag stripe swiped by a cashier. By 2030, Aite believes that "Digital and contactless payments will be the dominant payment." We have seen this transformation happening at a slow and steady pace. It reminds us of a saying regarding trends in the payment industry: It is more of an evolution, than a revolution.

Before COVID-19 made everybody "germ paranoid", contactless payments were a convenience and an improvement to the payment process. NFC technology has been around for years, but COVID-19 has pushed both consumers and merchants to adopt contactless payments. Digital payments continue to steal market share from traditional cash transactions, and the trend does not appear to be fading. As we enter 2021, the consumer behavior trend from cash towards digital payments is only strengthening.

The use of contactless cards and mobile wallets for payments has experienced accelerated growth, especially during this global pandemic. Consumers simply want to avoid those sometimes grimy POS terminals. Recent Mercator Advisory Group data found that consumers have been switching to contactless as a new way to pay and those who used contactless prior to the onset of the pandemic, are now using it more. The only inhibitor to growth seems to be consumers' lack of awareness, but this can be addressed with some TV advertising.

One area where we believe contactless use will flourish is public transit. Who wouldn't want to avoid the turnstiles or payment points on subways, trains and buses? While ridership is signficatanly down in cities like New York City, as commuting to work is still low, public transportation entities are making changes. The Metropolitan Transportation Authority in New York took the opportunity to upgrade and modernize its 472 subway stations and their 5,800 buses to now accept contactless, "tap-and-go" technology (called OMNY). This will quickly replace the 1990's MetroCards that all of us have used for years. Once ridership returns, these are transactions that will be occuring or "riding" on our payment rails.

Consumers & Merchants

The shopping experience is driven by consumers and merchants. Consumers demand convenience, safety and prefer not to be surcharged. Merchants need to be able to sell to any customer, anywhere around the world, with any tender type, from any payment node. Acquirers and payment processors need to re-architect their platforms to satisfy both ends.

From the consumer perspective: Visa found that because of safety concerns, consumers stated that they would prefer to use contactless payments 65% of the time. Consumers do not want to touch cash, pens and keypads, and nearly half (47%) claim they will not shop at stores that aren't contactless-enabled. Only 16% of those surveyed said that they would revert post-pandemic to their old methods of payments. Consumers are insisting that the stores they shop at are willing and able to accept digital payment, which is driving merchant adoption.

From the merchant perspective: In June of 2020, just 3 months into the pandemic, only 20% of SMB's surveyed had offered contactless payments. Now, Visa has found that 39% of its SMB's have started to accept new digital forms of payments and 74% expect consumers to continue preferring contactless payments. This unfortunately is much more complicated than simply getting a merchant to say "yes" and agree to accept digital payments. A merchant's back office needs to be ready for the change. There is a necessary investment to get the POS (point of sale) devices and software ready for contactless. There is required training for their staff and cashiers, to walk consumers through a transaction. Also, accounting systems and infrastructure needs to be properly enabled to handle various inventory issues. SMB's need to understand the steps necessary to meet security and fraud management needs, digital backend payment operations, contactless acceptance, payments via mobile devices, as well as BNPL (buy now, pay later).

The US isn't the only country adopting contactless measures. 97% of SMB's in the UAE are digitally enabled, as well as 96% of SMB's in Hong Kong. Clearly, companies are pivoting to meet a new digital-first era. Visa, Mastercard and PayPal remain the trusted engine of commerce and both are introducing new programs to assist consumers and merchants in adapting to this new environment. We talked about contactless payments in our 3rd quarter newsletter, as well as our 4th. In our opinion, it remains one of the best new technologies to come to market in years.

Are you using contactless payments when you shop in a store? Do you "tap & go" with your credit card? Are you utilizing your iPhone's mobile wallet to pay at Starbucks, Panera Bread or your local grocery store? If you aren't, don't worry. You will be, once you get comfortable with how easy and convenient it is.

The same thing happened a couple of decades ago when people had been more comfortable writing paper checks. When was the last time you wrote a check at the grocery store? It took some time for debit and credit cards to become accepted, but now using them seems second nature.

We saw this Carl Richards picture recently, and it seemed to perfectly fit the trend we are seeing in contactless and digital payments. Each and every day, consumers are making a small adjustment in how they pay for goods and services. One day, it will seem normal to pay for everything with your phone.

Some payment networks are permitting and accepting QR (quick response) codes. While some are saying that this trend will fade once the global pandemic recedes, we disagree. In our opinion, both consumers and merchants will embrace and advocate the simplicity of both card-based and mobile-based technology. Contactless payments received a material lift from this global pandemic, and we believe that the migration will continue. Heck, even our parents are comfortable making mobile-based payments!

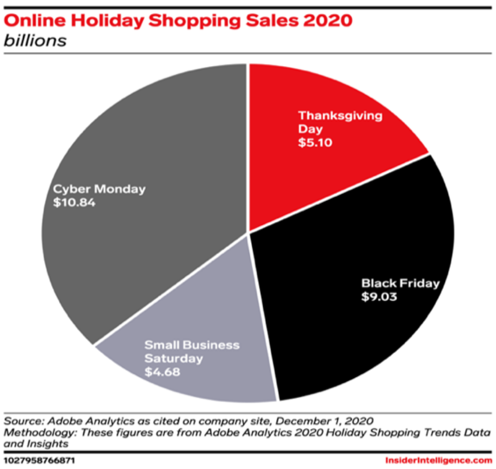
Shopping

Wait a second! How does shopping become a FINTECH topic? Well, we define FINTECH as ***"anything utilizing technology to improve an established process or procedure."*** It is clear to us (and probably to you too) that COVID-19 has changed how we shop and moved many of our purchase transactions to contactless or online. In our opinion, the shift towards digital payments and eCommerce has been accelerated (by a few years) due to the global pandemic.

For us, we believe the payments industry represents the quintessential FINTECH business. Each day, digital payments (contactless, mobile-based, cards, etc) continue to steal market share from cash and paper checks. This is a secular trend that should remain for decades to come. The future of digital payments is being shaped now with the adoption of contactless payments, new digital transactions such as BOPIS (buy online, pick up in store) and decreased friction within the broader payments ecosystem.

If we analyze the spending trends from the 2020 holiday season, it becomes crystal clear to us how the eCommerce and retail environment has been altered. Sensormatic Solutions uses cameras and software to track visits to thousands of malls and shopping centers. It reported in-store foot traffic declined by (31.3%) this year. The number of in-store shoppers on Black Friday was down (37%) versus a year ago. On Super Saturday, one of the most important days of the holiday shopping season, foot traffic fell by (39.1%). According to Mastercard SpendingPulse, holiday retail sales (excluding autos and gas) were quite strong. The traditional holiday period,which runs from November 1st through December 24th, which saw a +2.4% increase versus last year. However, eCommerce sales grew by +47.2% year-over-year. If one looks at the 75 days of Christmas (from 10/11 to 12/24), retail sales grew +3.0%, whereas online sales were impressively up +49.0%. According to ACI Worldwide benchmark data, the worldwide eCommerce number of transactions grew +24% in December. Steve Sadove is the CEO and Chairman of Saks 5th Avenue, and he said, "American consumers turned the holiday season on its head, redefining 'home for the holidays' in a uniquely 2020 way. They shopped from home for the home, leading to record e-commerce growth."

As this pie chart from Adobe Analytics shows, on Cyber Monday, US retailers pulled in a record $10.8 billion in online sales, up +15% versus 2019. This was the biggest US online shopping day ever. In addition, the total spending during 2020's holiday season exceeded the $100 billion threshold, nine days faster than last year. Although total retail sales were down on Black Friday (November 27th), it still remains the most popular day to shop, in terms of dollars spent. The third biggest day for shopping was Saturday December 12th, which became the last day where many retailers could "guarantee delivery" by Christmas.



<u>Some interesting holiday metrics: (per Adobe & ACI)</u>

- US consumers spent an average of $312 on holiday gifts, down (14%) versus last year

- Home furniture sales grew +16.2%, with +31.0% growth online
- Home improvement sales grew +14.1%, with +79.7% growth online
- Apparel sales fell (19.1%), but had +15.7% growth online
- Department sales declined (10.2%), but had +3.3% online growth
- Jewelry sales fell (4.3%), but had online growth of +44.6%
- Overall Retail eCommerce transactions increased +31%, with 90% growth in the gaming sector
- Travel spending fell (76%) in December

According to Adobe Analytics, US online sales between November 1st and December 22nd rose +32.4% to $172 billion. This year, the vast majority of our holiday gifts were conveniently delivered to our house. In the retail landscape, it really is a tale of two vastly different environments. The "e-economy" and eCommerce are here to stay. As small businesses suffered and many unfortunately closed, the US Census reported that 74% of new retail business created in the since April were not brick-and-mortar retailers, but more virtual storefronts.

We don't know about you, but we are very happy about <u>not</u> visiting our local mall.

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