



5 Factors Driving Digital Payments Growth

June 3, 2020

While we sometimes find compelling investment opportunities in obscure corners of the market, we also discover them by looking closely at something that is an integral part of our everyday lives.

Such is the case with the [global digital payments industry](#), the multifaceted and complex financial transaction ecosystem that allows individuals around the world to pay for goods and services without using cash.

One thing that makes digital payments particularly compelling for fundamental managers focused on finding sustainable sources of value creation is that it represents a truly enormous addressable market that continues to expand due to strong, durable secular tailwinds.

Many analysts estimate global business-to-consumer (B2C) digital payments volumes to be more than \$30 trillion.

Trends driving the growth of this market are numerous, and are even more important as individuals further embrace all things digital in the wake of the COVID-19 pandemic. Below we discuss five: a shift away from cash, the growth of e-commerce, usage by small and midsize businesses (SMBs), underpenetration in international markets, and government support.

1. A Shift Away from Cash

The global shift away from using cash is a rising tide that is lifting all boats within the payments industry. From 2012 to 2017, the volume of global payments using credit or debit cards (which represent the vast majority of

digital, or noncash, payments) grew at a 6% compound annual growth rate (CAGR), and the percentage of transactions conducted via cards increased from about 34% in 2012 to 42% in 2017.^[1]

Global Card Purchase Volume and Card Penetration (ex-China, Nominal, in Trillions, Constant Currency)

Driven by forces such as increased internet access and mobile phone adoption, the growth of e-commerce, government policy, as well as globalization and demographic trends, the ongoing shift toward noncash transactions benefits all segments of the global payments industry.



Source: WEO, World Bank, Nilson, corporate reports, Bernstein estimates, as of 2017.

In addition to the expansion of e-commerce and increased internet access in emerging markets, digital payments volume growth is also supported by in-store retail purchases that increasingly rely on cards and “digital wallets.”

Other secular trends supporting the growth in digital payments include the penetration of mobile phones globally; a younger, more tech-focused consumer population; online gaming with in-app purchases; growth in domestic and global travel; ridesharing services (as well as pay-per-minute scooters and motorized bicycles); and peer-to-peer payment systems (e.g., Venmo).

2. Growth of E-commerce

E-commerce is driving digital payments volume growth in two ways: consumers make more purchases because of the convenience of buying online or via mobile apps, and, relative to in-store purchases, a significantly higher percentage of e-commerce transactions is completed using a credit or debit card.

While e-commerce benefits all segments of the payments industry, it is especially important for merchant acquirers, which are the entities that enable merchants to accept credit cards and other forms of digital payments.

We will discuss merchant acquirers in great detail later in this series, but for now, suffice it to say that when evaluating merchant acquirers, we pay close attention to a company's exposure to e-commerce, as we believe that it represents one of the most powerful and durable growth drivers in digital payment volumes.

3. Usage by SMBs

In addition to the growing volume of transactions, merchant acquirers can drive revenue by providing higher-margin, value-added services. These opportunities are especially prevalent when serving SMBs.

We discuss SMBs more later in this series, but for now, just understand that merchant acquirers can bundle ancillary services—such as inventory management software, working capital loans, faster payment receipts, targeted marketing, and loyalty programs—into systems designed to meet the needs of SMBs.

4. Underpenetration in International Markets

Digital payments penetration in most international markets trails the levels seen in the United States. This is especially true in emerging markets, providing significant room for volume growth as countries such as India shift to a digital economy.

5. Government Support

By and large, governments are supportive of the transition to digital payments because it improves tax collection and reduces the size of the black market economy that depends on cash. Furthermore, governments support efforts to extend banking services to under- or unbanked populations.

Global Industry, Regional Trends

These factors explain why the digital payments industry represents a truly enormous addressable market that continues to expand due to strong, durable secular tailwinds.

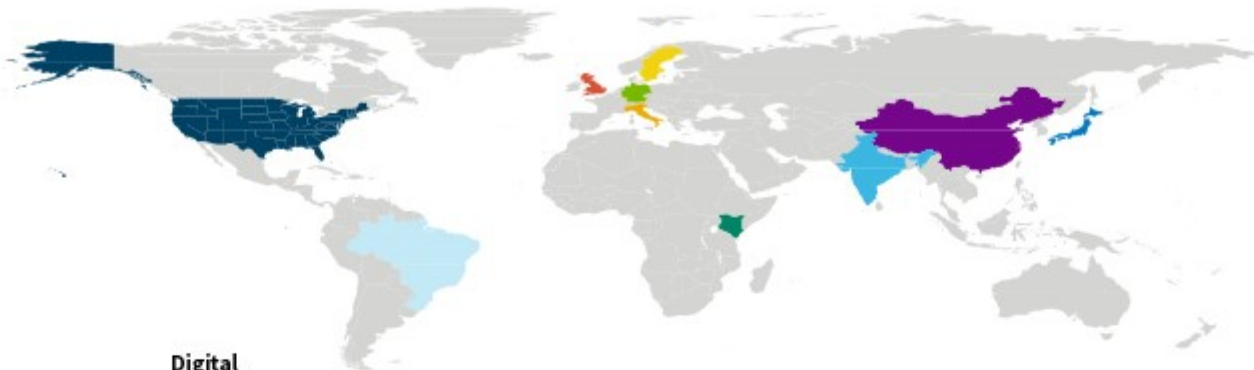
But the industry is also compelling because penetration varies significantly across regions and countries, creating opportunities for fundamental managers to find value.

For example, the United States is a more mature market with high penetration levels, while usage in Europe varies drastically by country. In emerging markets, penetration is typically low, providing a long runway for growth.

Country-specific differences, shown below, provide insights into the nature of various opportunities around the world.

Assessing a World of Opportunity

Major variances in penetration rates, as well as marketplace, regulatory, and cultural differences, mean that the digital payments industry faces different growth trajectories and risks around the world.



Country	Digital Payments Penetration	Interesting Characteristics
United States	61%	Credit issuers charge high fees that help fund rewards and loyalty programs that are much more generous than what are offered in Europe.
Brazil	30%	Credit cards are extremely popular among Brazilian consumers, but merchants must wait up to 30 days to receive their payments.
Italy	26%	Cash is predominant, often as a means to avoid taxes. The government wants to accelerate digital payments penetration, but at a low cost to merchants.
Sweden	62%	Digital payments penetration in Scandinavia is among the highest in the world, a result of early adoption and the region's culture.
United Kingdom	60%	The U.K. government, along with the broader European Union, has implemented interchange limits on issuers that are much lower than in the United States.
Germany	16%	Despite having a highly advanced economy, digital payments adoption is low because of consumer behavior and the fact that one of the largest payment methods isn't available online.
Kenya	15%	Nearly 50% of Kenya's GDP is processed via the country's mobile-based M-Pesa payments system. This has helped push the percentage of Kenya's population with access to formal banking services up to 83%.*
India	6%	India is a sleeping giant in terms of digital payments, with a huge unbanked population. The government's investment in building a real-time payment infrastructure has attracted major investments from the world's largest fintech players.
China	47%	Alipay and Tenpay, which use a closed-loop system, currently capture more than 90% of China's digital payments market.
Japan	20%	Cultural aversion to borrowing limits the current use of credit cards, but the government is pushing digital payments, targeting 40% penetration by 2025.

Sources: For Brazil, China, and Kenya, Edgar, Dunn & Company, as of 2017. For other countries, company reports, Moffett Nathanson estimates and analysis, Visa Investor Day, Nilson, IMF, World Bank, OECD, U.S. Bureau of Economic Analysis, U.S. National Health Expenditure Accounts, as of 2016.

* CNBC Africa. "M-Pesa has Completely Changed Kenyans' Access to Financial Services." April 3, 2019.

Up Next

Disruption is always a consideration when analyzing an industry, and this threat varies significantly across the segments of the digital payments industry. But there is nothing overpriced or inefficient about the current system that would make it ripe for disruption. In our next post, we explain why.



Digital Payments Series

Part 1: [Why We Find Digital Payments Compelling](#)

Part 2: [5 Factors Driving Digital Payments Growth](#)

Part 3: [Disruption and Growth in Digital Payments](#)

Part 4: [Follow the Money in Digital Payments](#)

Part 5: [More Competition for Merchant Acquirers](#)

Part 6: [Digital Payments Issuers Face Regulatory Risk](#)

Part 7: [Networks: The Rails That Connect Digital Payments](#)

[1] WEO, World Bank, Nilson, corporate reports, and Bernstein estimates.

Global Research Analysts Drew Buckley, CFA, and Kwesi Smith, CFA, contributed to this blog post. Daniel Hill, CFA, is a research analyst on William Blair's Global Equity team.

Disclosure:

This content is for informational and educational purposes only and not intended as investment advice or a recommendation to buy or sell any security. Investment advice and recommendations can be provided only after careful consideration of an investor's objectives, guidelines, and restrictions.

Information and opinions expressed are those of the authors and may not reflect the opinions of other investment teams within William Blair Investment Management, LLC, or affiliates. Factual information has been taken from sources we believe to be reliable, but its accuracy, completeness or interpretation cannot be guaranteed. Information is current as of the date appearing in this material only and subject to change without notice. Statements concerning financial market trends are based on current market conditions, which will fluctuate. This material may include estimates, outlooks, projections, and other forward-looking statements. Due to a variety of factors, actual events may differ significantly from those presented.

Investing involves risks, including the possible loss of principal. Equity securities may decline in value due to both real and perceived general market, economic, and industry conditions. The securities of smaller companies may be more volatile and less liquid than securities of larger companies. Investing in foreign denominated and/or domiciled securities may involve heightened risk due to currency fluctuations, and economic and political risks. These risks may be enhanced in emerging markets. Different investment styles may shift in and out of favor depending on market conditions. Individual securities may not perform as expected or a strategy used by the Adviser may fail to produce its intended result.

Investing in the bond market is subject to certain risks including market, interest rate, issuer, credit, and inflation risk. Rising interest rates generally cause bond prices to fall. High-yield, lower-rated, securities involve greater risk than higher-rated securities. Sovereign debt securities are subject to the risk that an entity may delay or refuse to pay interest or principal on its sovereign debt because of cash flow problems, insufficient foreign reserves, or political or other considerations. Derivatives may involve certain risks such as counterparty, liquidity, interest rate, market, credit, management, and the risk that a position could not be closed when most advantageous. Currency transactions are affected by fluctuations in exchange rates; currency exchange rates may fluctuate significantly over short periods of time. Diversification does not ensure against loss.

There can be no assurance that investment objectives will be met. Any investment or strategy mentioned herein may not be appropriate for every investor. References to specific companies are for illustrative purposes only and should not be construed as investment advice or a recommendation to buy or sell any security. Past performance is not indicative of future returns.

Copyright © 2020 William Blair & Company, L.L.C. "William Blair" is a registered trademark of William Blair & Company, L.L.C. No part of this material may be reproduced in any form, or referred to in any other publication, without express written consent.