ODYSSEY

WHITE PAPER | 2021

Payment services

THE RISE OF GIANTS

European Market Perspectives

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Axel Tombereau
CEO

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- Media & Digital Agencies

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INTRODUCTION

The rise of European giants

The payments industry outlook remains extremely positive in the mid-term, despite a sharp adverse impact from multiple Covid-19 crises in 2020. The promise of a sustainable double-digit market growth highly depends on the continuity of ongoing megatrends, such as the accelerated shift to digital payments, which are for most secured.

The rise of new European giants, such as Worldline and to a lesser extent Nexi, is the direct outcome of a decade of relentless efforts from a whole industry to successfully innovate and improve user experience. Less than ten years ago, only a happy few payment services providers were on investors' radar, and identifying leading players beyond country level was quite a challenge. The gradual emergence of pan-European leaders also results from the successful implementation of impactful organic growth, M&A, and partnership strategies by smartest industry players. Leveraging a whole ecosystem's strentghs to reach critical size has proven a valid operating model which lately inspired many other tech industries.

The advent of European champions is beneficial to the entire payments industry, which now enjoys augmented visibility and mesmerizing attractiveness. It also confirms that Europe has been developing a world-class payments ecosystem, cascading from the regulatory framework to a fabric of innovative startups. Such achievements were certainly a prerequisite to eventually enable Europe to play an instrumental role in the international payments' scene, predominantly led by US and Chinese behemoths.

Bringing the payments industry to next level

The rapidly-maturing payments industry has lately been exposed to steep changes in its nearby environment. A combination of various exogenous factors, including the Covid-19 pandemic, led payment services providers to swiftly adapt in terms of operations management and to demonstrate their strategic nimbleness.

Entering a new development stage, which is characterized by higher entry barriers among other features, the payments industry is now facing two major sets of challenges at least.

The first set of challenges consists of capturing incremental value for all stakeholders through continuous innovation, as a proliferation of new opportunities arise. An increasing porosity with personal finance applications on the B2C segment and with credit management solutions on the B2B segment may offer new levers for growth, which is expected to lead to an extension of the scope, role and offerings of the main payment services providers. The industry role in trade flows and capital distribution is increasing in parallel with the democratization of cross-border digital payments.

The second set of challenges for the payments industry is to entrench more firmly its global legitimacy through impactful initiatives, which will have to concretely confirm a nascent but fast-growing industry awareness of its societal role. For example, the European Digital Payment Industry Alliance (EDPIA) represent interests of Europe-headquarted independent payment services providers. The alliance, founded in 2020, already intends to contribute to European digital sovereignty, as transactional data is quite obviously of high strategic importance in this regard. As part of the legitimacy challenge, sustainability & carbon-footprint neutrality are becoming top priorities on the strategic agenda, all the more since the recourse to high power-consuming crypto-payments and of blockchain-based applications may intensify in the near future.

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COVID-19 IMPACT

The mulitple Covid-19 crises led to major changes in payments'operations and environment, which eventually accelerated the transition to the ‘new normal’.

Payments revenue decreased in 2020

Global payments revenue decreased by 7% to 10% in 2020 compared to 2019, a rather contained fall relative to other industries. In the payments sector, this decline nevertheless contrasts seriously with a recent history of solid growth.

In fact, the industry revenue lately suffered from its high correlation with GDP growth. The Euro area GDP’s contraction was indeed estimated at 11.5% in 2020 according to the OECD. Although payments revenue consistently outpaced GDP growth over the past decade, the gap has been shrinking over the years, mainly due to regulatory measures.

With lockdowns and social distancing measures, the combination of (i) increased uncertainty leading to savings vs consumption, (ii) eroding consumers’ purchasing power, and (iii) significant turbulences in retail and other industries adversely impacted the demand for payment solutions.

For example, series of lockdowns directly affected non-essential merchants, which are a vital outcome for the payment industry.

The shift to digital payments is accelerating

The pandemic context has dramatically urged both individuals and businesses to accelerate their use of digital financial services and contactless payments. Behavioral changes contribute to reshape the payments industry as pre-Covid trends are speeding-up. Indeed, consumers continue to drive major industry changes.

Albeit the for-long heralded end of cash is certainly not for 2021, a fast-paced decline in cash usage is noticeable in both mature and emerging countries. Cash usage actually dropped by 13% in volumes in 2020 according to GlobalData, partly as a consequence of Covid-19. It also dropped by 32% at the POS, according to FIS. Cash usage is not expected to bounce back, independently from the future Covid-19 path.

The gradual changes in the cash habits of end-consumers pertain to a secular trend initiated more than a decade ago, which has been accentuated across Europe since Q1 2021. The shift in favour of card payments has reached a certain threshold, as cash is now used in less than 25% of transactions in the UK, the Nordics, and the Netherlands and some other European countries.

Merchants and other businesses, though quite unprepared, suddenly adapted to the new pandemic-related environment through swift adoption of (i) online sales & (ii) cashless solutions. The soaring demand for e-commerce and m-commerce accelerated the need for digital payments. In stores, the massive adoption of contactless payments sets a new standard.

Overall, mutations in the operational environment and in the ecosystem of payments stakeholders not only tremendously hasted the shift to digital payments, but also enabled certain payments modes to gain substantial scale effects.
For example, the traction for digital wallet payments surged subsequently to the Covid-19 outbreak, as an appropriate response to the increasing need for peer-to-peer transfers, international money transfers, and online customer-to-business payments for essential services. Digital wallets now account for 26.4% of e-commerce payments in Europe, according to FIS.

Covid-19 accelerated both decline in cash usage and shift to e-commerce & digital payments

Covid-19 also fostered a European convergence in terms of payments' cultures, while diversity still remains perceptible among countries.

The Covid-19 pandemic contributed to somehow close the digital gap among European countries. Europe remains a mosaic of fragmented and heterogenous markets, with different growth outlook and payments behaviours.

>50%

Cash volumes decline in France and in the UK, 2020
Source: FIS, 2021

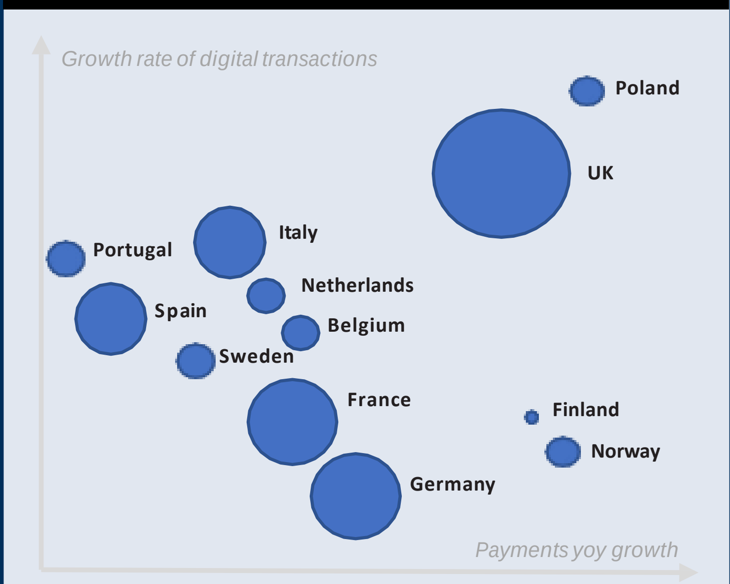
-33.6%

Cash usage at POS
2020 yoy growth in Europe
Source: FIS, 2021

+14.0%

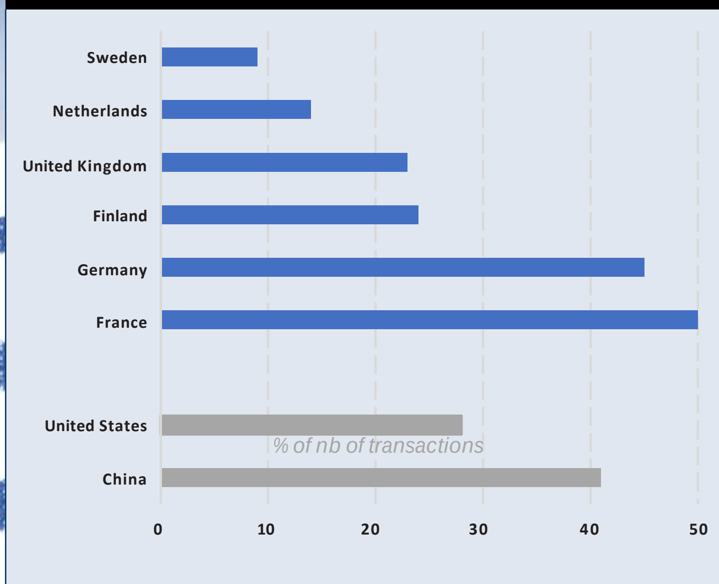
E-commerce market growth
Europe, 2016-2020 CAGR
Source: FIS, 2021

Pace of digital payments adoption (2018-2020)



Source: Odyssey based on FIS and McKinsey

Disparate cash usage by country (2020)



Source: Odyssey based on FIS and McKinsey

DECIPHERING THE MARKET

0.4

2020 Europe payments revenue, in $ trillion

Source:
Odyssey meta-research

21%

2020 **Europe's** share of global payments revenue

Source:
Odyssey meta-research

45

Billion retail transactions processed in the EU, worth 35 $ trillion

Source:
European Central Bank, 2020

>9%

2018-2021 Europe non-cash payments growth

Source:
Odyssey meta-research

Chart #1: Key industry figures

Chart #2: Snapshot of the payments value chain

A standard card payment illustrates the involvement of numerous parties, and reveals the industry complexity.

Source: Bluesnap

Merchant

Merchants sell goods or services in exchange of payment. Retail stores need to be equipped with payments acceptance systems.

Customer

Either individuals or corporations, end-customers purchase goods or services from merchants through card-based payments.

Card issuer

Card issuers are banks, issuing credit, debit, or prepaid cards to individuals or corporations, enabling them to make card purchases. As the process to authorize, clear and settle payments is complex, many issuers outsource its management to payment processors.

Acquirer

Acquirers are banks or payment institutions that provide merchants with access to the card scheme network and a merchant account.

Merchant gateway

The payment gateways enable merchants to collect and transmit card data and receive payment authorization. Some gateways also offer value-added services (loyalty programs, dynamic currency conversion…) . Ex: Stripe…

Card scheme

Card schemes settle card transactions through a separate batch payment system which set card scheme network rules and interchange fees, and act as custodians and clearing houses. Ex: Visa, Mastercard…

Clearing

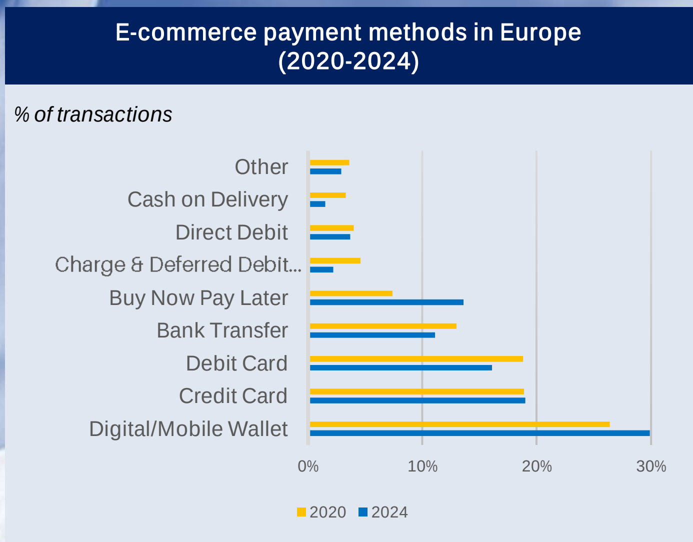
Clearing is a process through which a card issuing bank exchanges transaction information with a processing bank, through connection with the merchant card acceptance system to card scheme.

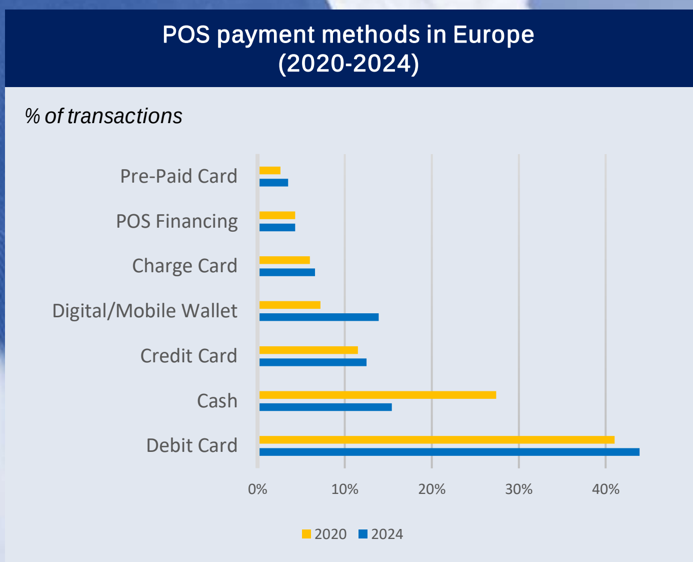
Settlement

Settlement is the exchange of funds between a card issuer and an acquiring bank to complete a cleared transaction and the payment to a merchant.

Source: Worldline URD, 2019

Chart #3 : Europe e-commerce & POS payment methods





Source: FIS, 2020

Chart #4: Focus on e-commerce payment methods in Europe

		Highest penetration rate	% of Europe e-commerce transactions
Digital wallets	Digital wallets allow consumers to securely store payment credentials to pay for purchases. Most popular wallets are both digital and mobile, and are accepted where commerce takes place: online, in-app or in-store. Digital wallets are for example the favorite payment method of pro gamers.	France Germany UK Spain	26.4%
Credit cards	Credit cards are issued by financial institutions affiliated with a global card brand network such as Mastercard, Visa, UnionPay, etc. Credit cards enable consumers to make purchases via an extension of credit from a financial institution, up to a certain limit.	France Norway Turkey	18.9%
Debit cards	Debit cards allow consumers to purchase by drawing funds deposited at their financial institution. Debit cards are issued by financial institutions affiliated with a global card brand network.	Belgium Denmark Ireland Switzerland	18.8%
Bank Transfer	Bank transfers allow consumers to make e-commerce purchases by paying merchants directly from their bank account. Bank transfers take place within retail banking applications, in dedicated bank transfer apps and directly via some e-commerce websites and apps.	Netherlands Finland	13.0%
Buy Now Pay Later	Buy now, Pay later (BNPL) services are post-purchase payments allowing consumers to make payments in interest-free instalments or pay off the invoice after a determined period. Popular BNPL services include Affirm, Afterpay and Klarna.	Sweden	7.4%
Others	Other payment methods exist, such as direct debit, cash on delivery, pre-paid cards and even postpay. Each of these methods separately account for less than 5% of transaction volumes in Europe.	Germany Denmark Sweden	15.4%
Crypto-currencies	A cryptocurrency is a digital or virtual currency that is secured by cryptography, which makes it nearly impossible to counterfeit or double-spend. Most cryptocurrencies are based on decentralized networks and blockchain technology.	Sweden Norway UK	0.1%

Source: FIS, 2020

RISING GIANTS

In such a volume-driven industry, the race for scale intensifies among rivalling players aiming at reaching a certain critical size. The ongoing wave of consolidation, which is fueled by both strategic acquirers and financial sponsors, is one of the main factors that explain the rise of European giants. Of course, the market growth acceleration is another factor that shall not be overlooked.

Worldline at the European pinnacle, Nexi in its growth wake

Three major M&A transactions that are reshaping the payments industry were completed in 2020, which will be remembered as the Covid-19 year. On October 30, Worldline closed Ingenico's acquisition for €7.8 billion after EU antitrust clearance. Nexi merged with SIA in October and with Nets in November. More than a coincidence, these hard facts simply reflect the payments market dynamics and resilience. Snowball effects are particularly noticeable as the acquired companies were initially consolidators themselves.

The transformative M&A strategies undertaken by listed companies Worldline and Nexi demonstrate the key role of external growth in the rise of giants. Disciplined bolt-on acquisitions complete the picture, on top of the abovementioned jumbo deals. Worldline's revenue, which amounted to €1.1 bn in the IPO year 2014, may land at a €5.3 bn pro forma estimate in FY 2020, a rise mostly driven by, but not limited to, M&A transactions. Nexi's revenue was close to €1.0 bn revenue in FY 2019, before reporting a € 2.9 bn pro forma revenue in FY 2020.

Chart #5: European giants, Worldline & Nexi

	Nexi	Worldline
Group's history	• Banking services (ICBPI, CartaSi)	• Tech services (Atos) • Processor (Banksys)
Products & services	• Omni-channel payments • Issuing & acquiring processing • Value-added services • Risk & fraud management • Others	• Omni-channel payments • Issuing & acquiring processing • Value-added services • Risk & fraud management • Others (IoT, SW licensing)
Core European footprint	• DACH (1) • Italy • Nordics • CEE (2)	• France • DACH (1) • Benelux • CEE (2)
Major deals	• SIA (2020) • Nets (2020)	• Equens (2015) • SIX Payments (2018) • Ingenico (2020)

(1): DACH = Germany, Austria, Switzerland
(2): CEE = Central & Eastern Europe

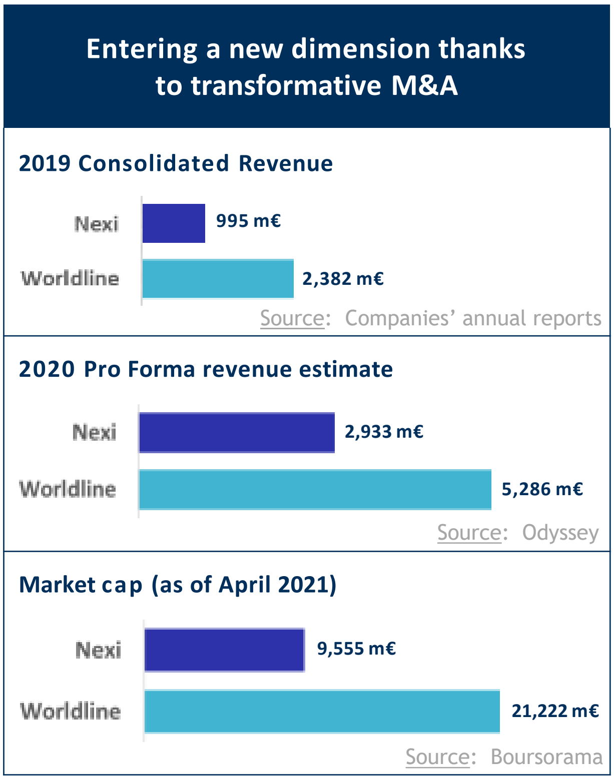


Chart #6: 2019-2021, the fast rise of giants (above)

Furthermore, the respective origins of these companies wield influence on their histories, paths, and market positions. Worldline was incepted within the bosom of Atos and Banksys inscribing technology and processing in its core DNA. Nexi was born from CartaSi and ICBPI, in the banking and scheme ecosystem.

Their different paths to success compel to further think on how convergence and interplay between the banking and tech galaxies are continuously shaping the payments industry, until a potential merger. Notwithstanding its strategic meaning and antitrust law, an acquisition of Nexi would not be out of reach for Worldline provided that very smart funding mechanisms be implemented. For now, Worldline is focusing on digital payments and announced a strategic review of its payment terminal business was on track to be completed this year.

An unprecedented bunch of forward-looking opportunities, which will be briefly depicted later on, become critical in the industry. The momentum for new offerings will enable industry players to design differentiated strategies and build unique selling propositions. So far, the main layers of solutions and services helped address standard banks' and merchants' needs through quite homogenous offerings.

Worldline is not only the European leader, but also a serious contender for world's top 3 payment services providers (PSPs). Claiming now a #4 position worldwide, Worldline now rivals with leading PSPs in the US and may feed a legitimate ambition to grow in North America.

The opportunity to move the strategic lens towards the gigantic US market would constitute per se another indication that the European payments industry is maturing at a fast pace.

A windfall for the whole industry?

The rise of European giants may provide the entire industry with cascading benefits. The advent of pan-European players is also a key milestone in the industry's structuring process, while newcomers reshape the competitive landscape.

First, reaching a certain size, larger PSPs can assume with upgraded credibility a prominent role in gathering industry players to express a unified voice on strategic, financial and societal matters. The industry's recent engagement in lobbying must grant the opportunity to implement a defensive strategy. Protecting the interests of PSPs and related payments players against a potentially disruptive competition coming both from adjacent industries and from non-European companies is not a side issue.

> The fast rise of European giants does not jeopardize the opportunity for newcomers to emerge, empowered by innovation and market growth.
>
> Smaller payment companies may even benefit from the positive impact of giants on the whole industry.

In a context of struggle for digital sovereignty, a major threat for Europe-native payments' players comes from the regional inlay of the GAFA's and BAT's sword arms in payments, from GooglePay to AliPay. Other massively-funded fintech companies and neo-banks may be tempted to penetrate the payments market as well.

On the one hand, intense competition fosters innovation for the benefit of end-consumers. On the other hand, there is no room for naivety on the overshadowing role these categories of new entrants might have in Europe.

First, reinforcing cross-border business cooperation, integrating EU policies and business strategies, and promoting virtuous partnership models between large PSPs and innovative startups may become a couple of pillars of a defensive strategy at European level.

Second, as the compelling equity stories of European giants put payment services under the limelight, the industry becomes increasingly enticing to financial sponsors. Private investors may frantically look for the next payment unicorns out of fear of missing out big opportunities.

The Wirecard's scandal was definitively an epiphenomenon that did not question the industry's foundations. As a consequence of their own success, European champions indirectly contribute to ease the access of payment startups and SMEs to additional financial resources, which is a first order issue in the international scene.

Fair enough, the voracious M&A appetite of both financial and strategic acquirers are likely leading to a scarcity of attractive assets remaining available in the European market, which may jeopardize the next steps in the structuring process. The rise of regional champions has reinforced barriers to entry in the European market. In spite of intense competition, the colossal potential for future developments still offer some space for innovative newcomers.

Indeed, European regulatory trends, embodied by but not limited to the PSD2 directive, still provide a valuable tailwind for newcomers focusing on delivering the best customer experience. By the way, a vivid memory from the 2008 Global Financial Crisis could be turned into a prediction. The Covid-19 crisis may indeed offer a unique opportunity for new business models, focused on customer's digital experience, to emerge.

INDUSTRY CHALLENGES

The first set of key industry challenges relate to the creation of incremental value for all stakeholders. Below are listed 5 examples of the main challenges in that field.

Foster financial innovation

The recent surge in new financial products in both B2C and B2B markets comes from the dazzling market encounter between emerging demand for customized solutions and an adaptive supply supported by tech and innovation.

The digitization of payments is indeed paired with a bold move towards bespoke financial services, specific to each end-customer and each transaction. The tremendous success of BNPL solutions may be only the tip of the iceberg.

Payment services providers may wish to considerably invest in open innovation to propose new financial solutions to their customers. In the curr ent context, both technology- and usage-based innovation proposals are in full swing.

Efforts to implement a close cooperation between larger PSPs and innovative startups shall not be reduced for the former to interface with new market dynamics. Corporate venture capital, strategic and commercial partnerships, or adhoc sandbox-like projects may now become some components of a more comprehensive open innovation strategy centered on services to customers.

Increase strategic agility

New market dynamics, which will be presented later, are very exciting. They impose payment services providers not only to make radical choices to design their own future, but also to remain extremely agile and to adapt to fast-changing market realities.

Strategic singularity may become a key expression in the industry in the opening decade, as the possibilities to operate in the payments market through differentiated approaches are expanding. Rather homogenous offerings and direct competition among larger players are gradually being replaced with clear-cut strategic choices to address specific categories of customers, supported by investments in distinguishing technologies.

To customize the strategic path of a given company, a smart injection of agility percolating throughout the entire organization seems needed. How to prevent the company's size from being a limiting factor to strategic nimbleness is nevertheless an open question to be addressed by various tech-intensive industries.

Sustain differentiation from banks

The main objectives of the PSD2 regulation, as set in 2015, were twofold: (i) to increase pan-European competition and participation in the payments industry also from non-banks, and (i) to strengthen customers protection & rights.

Subsequently to the first objective, the 2015-2020 period was effectively marked by an accelerated market penetration by newcomers, which have emphasized their differentiation from incumbent banks and financial institutions.

The fast digitization of payments and the growth of alternative payment methods have led to disintermediate banks to a certain extent. In addition, certain incumbent banks performed numerous divestments of their legacy payment branches over the past decade. Some other banks have initiated either disposal processes in their portfolio of payment activities or seek strategic partners to strengthen their development and growth capacities.

Paradoxically enough, the pendulum threatens to swing back as some growing companies may claim a bank status, which is foreseen as a precious ticket to offer online banking-like services. In Europe, some incum bent banks have acquired or partnered with innovative fintech companies, enabling them to glimpse at nextgen payment-related services.

Maintaining diferentiation from banks, but also from other Fintech companies, is then quite a challenge for PSPs in a competitive environment where historical boundaries are stumping.

The second set of key challenges refers to the industry societal role, which is emerging and might set new foundations. The creation of the European Digital Payment Industry Alliance (EDPIA), which represents independent PSPs across Europe, structures and unifies the industry to face these forthcoming challenges.

Act for European digital sovereignty

Processing highly-sensitive transactional data actually confers an increasingly strategic role to payment services providers.

First and foremost, securing payments data is a quite high cybersecurity stake, requiring (i) adequate defensive strategies, (i) in-house or externalised expertise in a domain where skilled resources are scarce, to say the least, and (ii) core tech investments in data hosting and protection. The decisions made in terms of cloud platform providers and data location are not neutral.

Second, at a more political level, the EDPIA could progressively extend the payments industry contribution to the digital sovereignty debate on other topics like the Digital Single Market or local competition with non-European giants (AliPay, GooglePay, Paypal…).

Monetary digital sovereignty is also becoming a hot topic. Let's mention the ongoing thoughts on creating digital or cryptocurrencies that could be backed by the European Central Bank as a potential game-changer for the industry.

Undertake **'extra mile'** ESG commitments

The increased environmental, social, and governance (ESG) awareness of PSPs' shareholders flows down the payments value chain. Awareness also obviously flows up from consumers and employees. End-customers' expectations in that regard can not be ignored any longer.

Klarna's recently announced that 1% of its new funding resources will be allocated to climate change initiatives. This unprecedented move reveals that impact strategies are nascent in the payments industry, and many of them are still reasonably awkward and inaccurate. Klarna has nevertheless set an example which may inspire the whole industry.

The payments industry meets all requirements to play a tremendous role in digital financial inclusion, by enabling access to payment solutions to fringes of population locked out of the conventional banking system. Inclusive finance is likely an ESG area in which payment players can yield the greatest impact.

The management of capital flows, even when limited to a high volume of micro-transactions, is a great responsibility in the struggle against widening financial inequalities.

Eco-friendly strategies and carbon-footprint reduction are not less important, as already mentioned.

UNLEASHING VALUE

After a decade of in-depth transformation, the payments industry has not reached yet its full potential in terms of stakeholders' value creation.

The prospective continuity in upgrading customers' payment journeys, well-anchored in solid market megatrends, may certainly not translate into a major paradigm shift for the industry.

Still, second order changes arise as new areas for future revenue growth are surfacing. Some of them may transform the revenue streams landscape. Some other may give birth to pioneering business models. Adaptive and agile strategies are more than ever essential to survive and thrive in the fast-changing environment, no to mention regulatory evolution.

Below is presented a selection of 5 canisters for untapped value: cryptocurrencies, DeFi & blockchain apps, transactional data management, personal finance & credit management.

Crypto-payments & related VAS

As a preamble, it is worth recalling that the underlying instrument or vector for payments is currency. Times are changing pretty fast in the digital age. The democratized use of cryptocurrencies in the legit economy occurs in the blink of an eye, while governmental institutions are still debating if cryptocurrencies, in the absence of better word, can be considered currencies.

In the payments industry, the acceptance of blockchain-based crypto-currencies as a valid payment means is becoming mainstream, in the wake of VISA, Paypal and other US companies.

As far as European PSPs are concerned, the question is not whether the processing of crypto-payments will become trendy or not, but rather to what extent they are prepared for managing the crypto-tsunami coming from the US.

Of course, the following scenario is subject to EU's approval, as payments are a regulated industry. Virtual asset regulation is a huge conundrum, especially at a regional level that encompasses subtle local differences.

The processing of crypto-payments would create an additional layer of complexity to handle for payments companies, and may require further investments in technological platforms, ranging from slight adjustments to a serious revamping depending on each context.

The future of payment services would then rely on the hybrid acceptance of both fiat currencies and some cryptocurrencies among thousands of others. Such a scenario is fully consistent with the rise of both digital payments and customized solutions to better serve customers' emerging needs.

The democratization of crypto-based payments would definitively be a change in-depth of the industry, without necessarily weaken its foundations. As only the underlying assets would change, the technical architecture leading to the delivery of payment services might remain valid, for most of it.

If such a big industry shift occurs, value-adding services (VAS) around payment service would become meaningful. First, a direct extension of existing VAS from fiat currencies to crypto currencies would be to implement. Second, innovating and proposing new VAS specifically designed for crypto-payments would come on top.

DeFi & blockchain apps

Decentralized finance (DeFi) is a blockchain-based form of finance that relies on disintermediated financial instruments and transactions, outside the traditional banking system. Instead, DeFi utilizes smart contracts, mainly contingent on Ethereum protocols.

Highly correlated with cryptocurrencies' history, DeFi is nonetheless a different topic with various consequences for payment players.

In fact, blockchain technologies and related protocols offer numerous specificities that seem to perfectly fit the payments market. For example, the promises of some blockchain applications are to transparently track transactions history, which will therefore enable issuers and acquirers to gain end-to-end visibility on transactions, to improve authorization rates, or to increase security and fraud detection capabilities. NuCypher for example provides cryptographic Infrastructure for privacy-preserving applications that might become useful to payment players.

Of course, the implementation of such technologies by PSPs is a double-edged sword, as it would also require massive investments to integrate blockchain-based applications into their infrastructure and platforms. These high power-consuming apps would also question their carbon footprint, and maybe their capability to instantaneously complete payment transactions, which is not systematical through blockchain.

The potential penetration of the payments industry by DeFi & blockchain-based apps also raise major concern on the future role of the traditional banking system, in a central position in the current state of the payments industry, but which might either be by-passed or become to a certain extent irrelevant. An aggressive innovation strategy and a sharp revamping of their tech platforms are two prerequisites to enable traditional banks to participate in this market evolution.

Transactional data management

First, PSPs process a considerable volume of transactional data in accordance with applicable regulations, such as GDPR & UK GDPR. As data is the new gold in most tech industries, it is key to raise the question on how transactional data would be turned into the next lever for value in the payment industry. Indeed, the potential of data has not been fully expressed yet.

For the record, to identify the most relevant opportunities, PSPs must first disregard personal data of end-customers, namely individuals, which are subject to strict data protection rules.

Many scenarios can be contemplated to explore the value creation potential of smart data management, and on some aspects, data monetization.

To scratch the surface of this strategic topic, PSPs incrementally manage their sales & customer relationship with merchants thanks to advanced data analytics, as occurring in many other B2B industries. The maturity of data management systems still offers some room for improvement to target and retain merchants, but also to better serve their needs.

In addition, payment gateways (Klarna, Ingenico...) and apps are a fantastic interface with end-customers, offering them integrated payment solutions. The management of data on capital flows, as well as the evolution towards AI-based recommendations on payments & funding may change the strategic profile of PSPs in the near future. For instance, data-enabled recommendations to merchants' customers on adaptive payment financing may become pretty standard tomorrow through payment gateways and next gen POS.

To sustain a competitive edge, PSPs may consider taking advantage of (i) new use cases, (ii) bespoke services to merchants, and (iii) augmented customer experience in a data-centric world.

Cash-flow management

Pushing the current boundaries of payment services in order to include cash-flow and working capital management solutions may also lead to unearth a new driver for growth.

Subsequently to an extension of their role through the widening of their offering, payment services providers are becoming strategic finance partners for both merchants and customers. Let's also not forget the needs of businesses such as SMEs, which are an important segment for PSPs.

PSPs are in fact at a strategic crossroads, considering the option whether to diversify in working capital & cash-flow management or not for the benefit of SMEs and merchants. A smart enrichment of their portfolio of offerings would likely enable them to access new pockets of growth and to entrench their market position. Unless most adventurous fintech players, operating on adjacent markets, cross the moderately-airtight boundary from the other side first.

A plethora of SaaS platforms dedicated to working capital and credit management solutions already exist in the B2B market. Despite multiple innovations, the most critical pain points for their customers remain to secure and accelerate invoice payments and receivables recovery. PSPs, with their expertise in transaction processing and fluid payments management, on top of their up-to-scale infrastructure, seem legitimate to eventually address such a compelling issue.

Personal finance

The intertwinement between payments and personal finance is another major trend that could seriously reshape the payments industry within the next five years.

End-customers such as individuals acquiring goods or services from a merchant, are increasingly looking for comprehensive and easy-to-use interfaces that would enable them to manage and control their cash-flows, on top of payment transactions execution. Mint, the omnichannel payment solution, is somehow on the verge of taking the leap on certain aspects.

The rising POS financing scene now brings consumer credit at the point of sales, which already represents 3.5% of global 2020 POS shares according to FIS. The spectrum of POS financing solutions is rapidly broadening, beyond Buy Now Pay Later (BNPL).

The increasing sophistication of payment solutions has to be supported by up-to-speed and scalable technologies. The previously exposed value-creating innovations mostly rely on the emergence of new services and features. Let's now explore a few breakthroughs that relate more directly to hardware and infrastructure.

ODYSSEY

Payments Platform as-a-service (PPAAS)

Worldline accelerates its strategy towards PPAAS, which empowers its partners to provide merchants with spearheading payment solutions.

This pioneering move aims at offering a comprehensive toolkit for merchants to design their bespoke payment solutions for the benefit of end-customers. Although the relevance of similarities is always limited, let's here notice a parallel with the online platforms proposed by leading digital services providers to enable corporate customers to design and implement their own process automation projects.

For now, PPAAS is reserved for larger payment services providers who can rely on solid infrastructure and are ready to deliver high-scale solutions.

PPAAS offerings are foremost a concrete example of how data management and customization are reshaping the supply of payment services.

Next-gen POS

At first sight, the future of points of sales (POS) might seem jeopardized, as payment terminals have been assimilable to legacy business since before the Covid-19 outbreak.

The situation is actually more complex, since the potential of next gen POS is certainly not limited to a straight transition from vintage payment terminals to mobile applications. Nex-gen POS may soon represent a significant market share in the payments space, because they are strategically positioned in between the real and digital world. They constitute thus a hybrid solution to help merchants pragmatically navigate their own online and offline payments, and to integrate their payment interface with other business software.

In fact, the combination of business management software and integrated payments solutions for merchants is common to the plethora of next-gen POS. Reliable interoperability with merchants' data analytics and CRMs may become key for top-tier POS providers to offer premium customer experience, as merchants' business is increasingly data-driven.

GROWTH DYNAMICS

Payments' market growth, and more generally, market evolution, is determined by a sum of exogenous and endogenous factors. Hereafter is a quick overview of 6 business drivers that belong to the second category, gathering industry-specific parameters that directly impact the payments industry's dynamics.

Consumer behaviour

The industry is unambiguously driven by demand. Consumers' behaviour sets the tone at two levels, basically through their (i) payment habits and (ii) interactions with banks and financial institutions.

Consumers refer to the population of individuals and corporations that are merchants' customers. Consumers embrace technological change, set or amplify market trends, and eventually request new payment solutions or modes. At the risk of a cliché, consumers are also increasingly making their decisions based on societal and environmental aspects. It also covers their choices in terms of banks, fintech and payment institutions.

The Covid-19 crisis demonstrated that consumer behaviour is a tremendous growth driver for digital payments. Consumers' expectations are high regarding online and mobile payments, and also seamless & customized experience.

Regulation

The tricky regulatory environment in which payment services providers operate is regularly evolving and is not predictable. Payments regulation, although necessary, creates however another layer of unsteadiness and becomes a driver of change that could switch market dynamics. The uncertainty on a potential EU regulatory framework on cryptopayments and virtual assets' transactions is a perfect example.

Here are however highlighted two main directions that clarify the positive contribution of EU regulation to the industry's future growth and to fair competition in European territories.

The European regulatory framework is complex, but it has also been oriented towards innovation and transparency.

The PSD2 and Open API directives provide clear guidelines to speed up innovation and decompartmentalization of the payments market.

The Digital Single Market directive is also a unique opportunity for payment services providers to take advantage of the European strategy, which consists of enabling consumers to "*enjoy full access to all goods and services offered online by businesses in the EU*". The objective is to break down cross-border restrictions, as mentioned on the European Commission's website.

Technology

Rather obviously, new technologies support the growth of the payments market at various levels.

For the record, the technological density of the payments industry has been quite high: hardware (POS), infrastructure (payments platforms), SaaS and software (payment solutions). It's becoming even higher as crypto-currencies, blockchain-based apps, and APIs permeate the market as digital payments soar.

For example, various technologies co-exist to facilitate mobile payments validation by end-consumers: facial recognition, QR code approvals, voice recognition. Future AI-based developments may contribute to make consumers permission instantaneous and effortless. Technology will continue to play a key role in shaping market dynamics.

Business capillarity

In the first place, the payments industry is well positioned to absorb innovative proposals coming from adjacent markets and extend its scope of influence. 'Adjacent innovation' may spearhead major changes in the supply of payment services.

Then, the increasing porosity of the market boundaries with other fintech segments and financial services is both an opportunity and a threat for payment players. US and Chinese giants penetrated the global market with ambitions in Europe and the UK.

This business capillarity with tech players is a key driver of transformative change.The gradual expansion of payment services enter a new phase. The 2021-2030 decade shall by marked by the rise of bespoke digital payments and related services.

An overview of prospective payment services, resulting from the opportunities identified to unleash the value potential and taking into account the industry-specific drivers of change, is summarized on next page.

In such a dynamic environment, PSPs are likely to implement ecosystem strategies with various stakeholders, from corporate customers to tech partners, to continue to thrive.

Vertical specialization

The verticalization of payments' offerings is a key emerging trend in the B2B market, as payment options, modes and needs vary from one sector to another. This ongoing wave of specialization may increase strategic differentiation among PSPs. For example, Worldline recently launched WL Easy EV, a trailblazing line of payment services aimed at the fast-growing electrical vehicle charging market. More generally, payment services providers are instrumental to innovation in the retail sector through specialization.

Another absolute example comes from the food and catering industry. French startup Sunday lately raised $24 million Series A to accelerate the developments of their QR Code payments solution, betting on massive adoption in restaurants following Covid-related behavioral changes.

Vertical specializations are also a smart way to address underserved market segments across an industry chain, such as freelance workers, which are another pocket for future growth.

Partnering strategies

There a few other sectors like payments industry which can claim having pioneering the ecosystem strategies by building close relationships with first circles of partners. This is genuinely not a surprise at all, as the successful execution of one single payment transaction results from the coordination of a comprehensive ecosystem of partners. Partnership strategies may intensify as the sophistication of the industry grows.

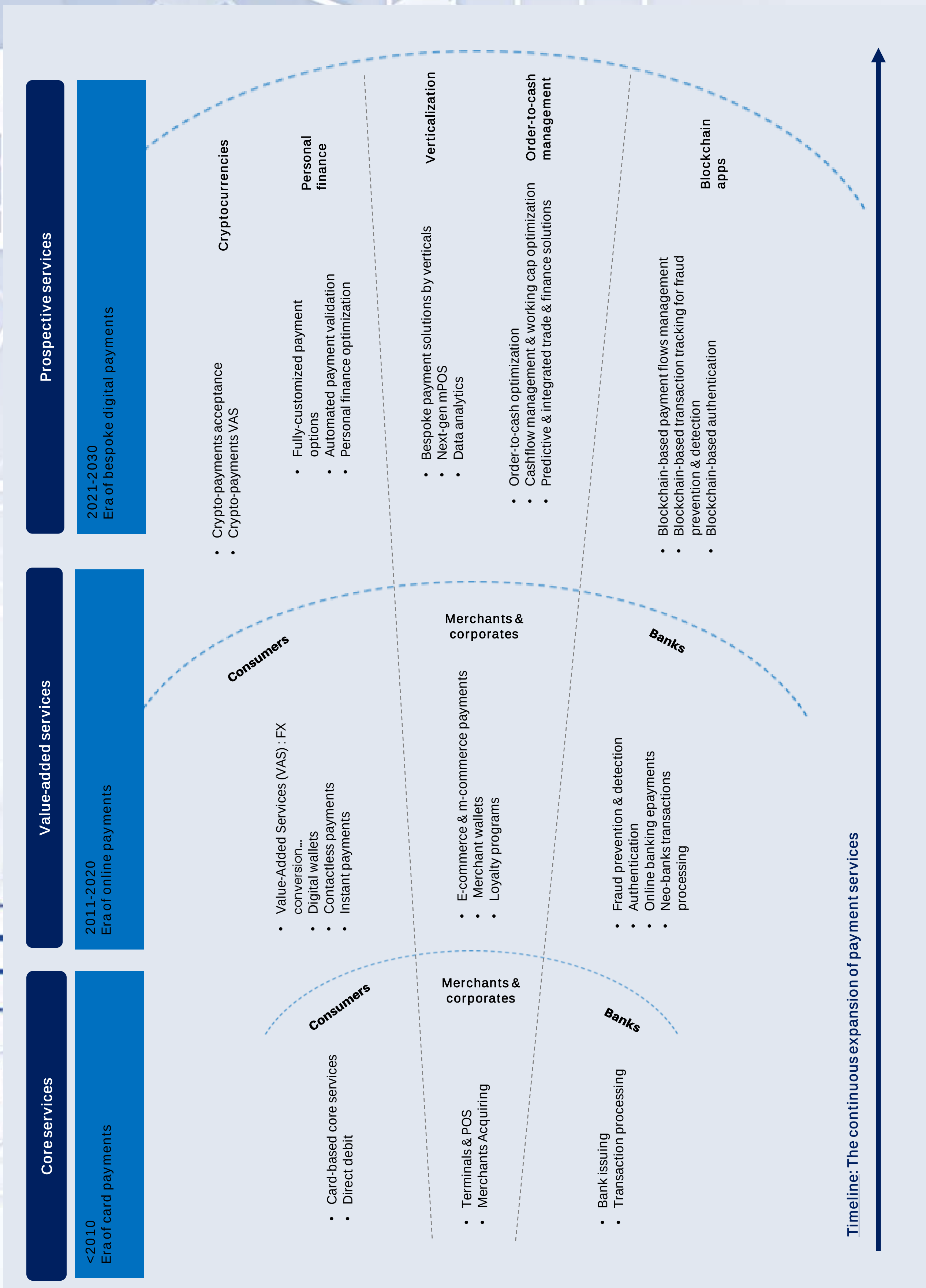
Partnerships with 4 major types of players could be contemplated as component of PSPs strategies: (1) schemes and banks, (2) Fintech startups, (3) tech partners, and (4) other industrial players.

Payment services providers have traditionnally partnered with incumbent banks and other institutions involved in the payments' processing circuit. What may alter PSPs' strategy is the surging disconnect between schemes (Visa, Mastercard…) which may be tempted to accelerate on crypto-payments and DeFi applications, and traditional banks. PSPs have been so far a valuable connecting point to reconcile two splitting universes.

PSPs could also closely collaborate with most advanced startups to shape the future of payments. Corporate venture capital is an alternative option, but the acquisition of startups is for various reasons not such a frequent strategic model in the payments industry. It may change as the market expands.

Technology partnerships with cloud infrastructure or services providers may accelerate with the rapid adoption of digital payments. Industrial partnerships offer certain leverage to access the abovementioned specialization in specific verticals.

Chart #7: Payments market expansion timeline, by Odyssey



Paving the way to a sustained double-digit growth

Despite the adverse impact of Covid-19 on payments revenue last year, the European market may enter a new stage of solid growth, at a higher pace than over the past decade. The main outcomes of our meta-research, which is based on aggregated existing surveys are the following:

1. **Uncertainty prevails** and is now a constant feature in most tech markets. The revenue growth volatility is expected to range from 'moderate' to 'high' over the 2021-2025 period. Payment services providers remain exposed to a series of exogenous factors such as the persistence of low interest rates or regulatory changes on corporate taxes, still in a VUCA+ environment.

2. In terms of development stage, the payments market is **rapidly maturing** while still offering attractive growth potential. The pandemic moved the needle from «emerging » to an accelerated « **expansion** » phase. Technological innovation, new usages, and the limited saturation on some specific segments such as SMEs indicate that actual maturity has not been achieved yet.

3. Annual market growth forecasts are expected to reach **5% to 6%** in 2021 on average, and could be slightly higher but not in a central case scenario, with a perceptible acceleration in Q4. The 2021 annual forecasts highly depend on the potential relief or tightening of governmental restrictions regarding the Covid-19 pandemic.

4. The market may fully bounce back to a double-digit growth annual rate no later than **H1 2022** in the central case. Some riveting signs are expected as soon as Q4 2021, which may be the landmark for coming back to a market-standard pre-Covid growth. Strong differences among European countries, and obviously between online and POS payments segments should nevertheless transpire.

5. The 2021-2025 CAGR for the European payments industry is estimated at **13.5%** on average. With APAC, Europe may be the **fastest-growing region** over the period, bolstered by global market growth and unified initiatives to facilitate cross-border payment transactions within the EU. This outstanding CAGR is impressive relative to other industries, but realistic given the sector's foundations.

**: including publicly available information from Gartner, Grand View Research, Mordor Intelligence, Markets & Markets*

INVESTOR HIGHLIGHTS

Are valuations of payment companies too high?

At first sight, market valuations of payments groups and startups seem ranging from reasonably high to stellar at the moment.

In fact, the payments industry has for long nourished private equity firms with top-notch success stories. Generating an average 2.7x exit multiple over the 2008-2020 period according to Bain & Company, the payments industry is more than appealing indeed.

For the record, enterprise valuations are (i) relative to the valuation of other assets, and (ii) depend on macro-economic conditions, among other parameters.

Payment services providers steadily deliver fast growth and recurring profitability, contrasting thus with some assets which are explicitly overvalued in a context of unprecedented monetary expansion. As long as the current global financial paradigm prevails, there is no sense in undervaluing an industry that relies on sound financial fundamentals and provides actually positive return on investment.

On the contrary, the question whether current valuation multiples capture or not the full incremental value potential and promise of future cash flows from payment companies remains unanswered, considering the emerging market growth dynamics.

Compelling M&A strategies

The long-lasting competition between deep-pocketed private equity firms and cash-rich strategic buyers to acquire targets in payments is intensifying.

Key converging factors indicate that M&A-driven consolidation is very likely to continue. Large players may both be interested in acquiring payments' subsidiaries of banks for sale, in consistency with their strategy of volume growth, and smaller companies offering strategic innovation capabilities. The first phase of the consolidation wave led to a scarcity of sizeable assets available on the European market. The opening second phase already translates into more disciplined buy & build and M&A strategies, with a focus on the acquisition of smaller value-adding targets.

Cherry-picking strategies seem adequate as differentiation through innovation and services may become the highest priority on the strategic agenda. The payments industry is growing into a land of plenty, with tons of extension possibilities that are new canisters for future growth, such as dramatic verticalization, or open innovation in the crypto-sphere. The industry is at the dawn of an upper-level differentiation among players as diverse paths to strategic singularity, to unique selling proposals start to emerge.

Industry players are at a strategic crossroads which may significantly influence the future allocation of funds in the European market. Either large or midsized, strategic acquirers may intend to move from scale-driven M&A deals to capability-driven transactions with the objective to effectively develop new bridges with adjacent and edge competencies. For this reason, a hike in cross-border transactions within the European Union is expected to occur in the coming years. Due diligence on the strategic rationale and tech value may rise in importance in the M&A process.

A fast track for European scale-ups

Both relentless consolidation and continuous innovation fueled the emergence of a binary ecosystem, which is now, to overemphasize the trend, mostly composed of rising giants and of ambitious startups.

Best-in-class payment startups have also been maturing at a fast pace. Comfortable with new market dynamics, nimble, centered on technology and end-customers, some of them also lead the race in terms of growth hacking, which is definitively a strategic cornerstone in that industry.

The Klarna case is an adequate example of what scaling up truly means. The Swedish PSP raised $93 million in April 2019 on the basis of a $ 3.5 billion valuation, and for the short story welcomed Snoop Dogg as an investor. Less than 24 months later, Klarna raised a $ 1 billion and is valued at $31 billion. Investors' hype relies mainly on rapid revenue growth in the US.

The soaring adoption of Sumup solutions also illustrates how the rather old-fashioned payments industry has become trendy, and therefore attractive to investors and customers. SumUp offers portable and user-friendly card readers to small merchants. Sumup now competes with well-established payment terminals poviders and expands at a pan-European level.

iZettle, a Swedish startup, which was acquired by Paypal for $ 2.2 billion in 2018, is another example of the potential of European startups to scale-up in volume and skyrocket in value.

Funding early-stage innovation

New market dynamics are finally in favor of specialized venture capital firms, ideally positioned to ferret out innovative companies that are too early-stage to appear on the radar of larger investment firms. Scouting capabilities are a key factor of investors' success in identifying the next blitzscaling Klarna among the considerable number of European Fintech and payments startups.

By the way, such skyrocketing trajectories helped most venture capitalists understand why the payments industry is not just another subsegment of the stupendously vast Fintech market.

From an investment strategy perspective, the reinforcement of early-stage funding of tech and usage innovation is vital in determining the future role of Europe in the global payments' exchequer. For now, venture funding resources serve primarily startups' fast-growth objectives. They are mainly allocated to (i) capacity investments in tech & platforms, (ii) geographical reach extension, and (iii) development of a partnering ecosystem to leverage growth.

Funding a race to scale, although complex, may prove an insufficient strategy as the whole industry is maturing. Such a limited vision on the role of funding would also expose European young innovators to direct competition versus US and Chinese startups, which collect investments of another magnitude. Moreover, today's European giants are certainly not grown-up startups but were for long deep-rooted in a large corporate and banking background.

A key message to venture capital firms is conveyed here. They are gently invited to consider their own strategic role in shaping the future of the payments industry, by (i) reflecting on building new investment models to massively feed very early-stage innovation, from inception to Seed, and (ii) directing their investments on the most differentiating segments, in close cooperation and full consistency with European strategy and industry players.

Low liquidity risk at exit, especially as European SPACs may emerge

Exiting shall be a no brainer for sponsors invested in payments, as the demand for such assets is invariably high due to solid financial foundations. In the payments industry, competitive auction processes are indeed more prone to buyers' remorse than to sellers' disillusionment.

In addition, the incoming transposition in Europe and the UK of special purpose acquisition vehicles (SPACs) may offer unprecedented exit scenarios to early-stage investors. Indeed, the prosperous growth of payment services providers could make them eligible to such an alternative IPO process.

Referring to the SPAC frenzy that shook the US equity capital market in 2020, a valuation uptick is even likely for this type of exits.

Anyway, few industries such as payments enable private equity firms to alleviate or counterbalance a denominator effect in these rather turbulent times. Selling a portfolio company specialized in payments should also help overcome liquidity squeeze obstacles.

The European payments scene has for long enticed non-European investors, especially coming from the US and more recently from Asia, a trend that compounds exit opportunities.

At exit also, financial sponsors might increase awareness on their active role in European sovereignty, as selling to non-European investors a stake in a portfolio company operating in a critical industry may be prejudicial to the whole region. Exiting is not any longer a matter of money only.

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