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Mobile P2P Payments: Not a Priority for Most Banks

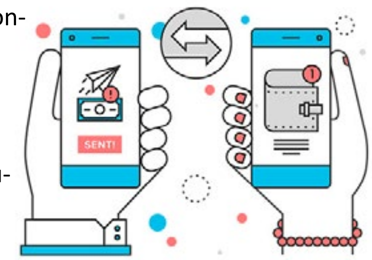
One of the challenges for bankers in the area of payments is determining the appropriate priorities for investment. For example, the recent launch of Zelle as a rival to Venmo, Square Cash, and others has brought peer-to-peer (P2P) consumer mobile payments to the fore. Is this a capability that most banks must offer in order to remain competitive? An examination of the basic facts regarding mobile consumer P2P may help to inform the deliberations on whether to invest in such capabilities.

Prospects for Growth

The rapid growth in mobile P2P usage is expected to persist as consumers become more comfortable with mobile payments and the number of younger, digital-savvy consumers continues to increase. The roll-out of Zelle, which is free of charge to customers of participating banks, will likely further spur growth in consumer P2P. However, it should be noted that consumer mobile P2P activity is dwarfed by that of credit cards. Admittedly, credit cards and mobile P2P payments are not perfect substitutes. But the transaction levels compared to credit cards indicate that consumer mobile P2P will remain a niche payments product for the foreseeable future. This raises the question as to whether a bank would be better served investing in credit cards rather than consumer mobile P2P.

Demographic Appeal

Surveys have consistently shown that, while mobile payment usage is low overall, younger people (18-34 years) are much more likely to use mobile payments than are older consumers. Consequently, many banks are offering, or are considering offering, mobile payment services to garner the loyalty and business of Millennials. Indeed, research shows that digital capabilities are the primary driver of consumers' perception of convenience, which is a primary factor in determining where consumers open their checking accounts.



This means that mobile functionality to perform core banking tasks such as balance alerts, account transfers, spending controls, budgeting tools, and digital account opening are crucial for customer acquisition. However, the level of importance that consumers assign to mobile P2P within the array of digital services is unknown. Customers can easily obtain P2P capabilities through Venmo today, yet they still look to their bank for other digital capabilities. Therefore, bank executives might assign a higher investment priority to digital account opening and offer mobile consumer P2P through a partnership with Venmo or another fintech provider.

Competitive Dynamics

Today, PayPal and its subsidiary, Venmo, are dominant in P2P payments. Venmo is particularly popular among Millennials in part because of its social media aspects, which Zelle currently lacks. Venmo is also more ubiquitous: it can be linked to any debit card, credit card, or deposit account at any financial institution.

Zelle's competitive advantage may lie in the fact that it is integrated into a customer's mobile banking app. Zelle may also benefit from the perception of being more secure because it is bank-sponsored. Also, with Zelle, money is transferred between users' bank accounts in minutes if both accounts are with participating banks (transactions may take one to three days to clear if the recipient's bank is not a Zelle partner).

Soon, Apple will offer consumer mobile P2P capabilities. The P2P payment aspect of Apple Pay will be integrated into Apple

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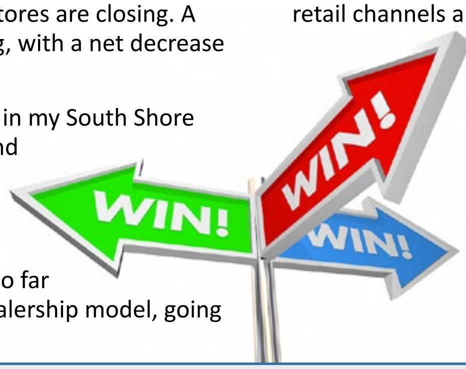
Winning at Retail

Much is being written today about the retailing industry in decline. Digital commerce is growing, often at the expense of traditional brick and mortar. As a result, thousands of stores are closing. A similar trend is being experienced in banking, with a net decrease of over 1,000 branches over the past year.

And yet, these three stores recently opened in my South Shore Boston neighborhood -- Tesla, Lululemon, and Capital One. What does this say about the state of retail?



First, all three of these are nontraditional retailers. Tesla is a car manufacturer that is so far successfully bypassing the traditional car dealership model, going directly to the wealthy consumer in exclusive retail shopping centers. Lululemon is an athletic apparel designer bypassing traditional retail channels and going directly to the consumer. Finally Capital One is a credit card issuer and retail bank that is using a "cafe" concept to attract prospects across its threshold, through a unique space sharing partnership with Peet's Coffee.

Second, all three of these "retailers" have robust digital channels to either lead or support their physical store channel. Even though an estimated 25-50% of their sales are digital, they understand that, from a distribution and branding perspective,

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Mobile P2P Payments (continued)

iMessage when iOS 11 is released in the coming months. Apple Pay has a competitive advantage owing to its strong brand-recognition and the integration of its P2P payment feature into the iMessage application. The service will also be convenient for consumers as no additional sign-on will be required to access it: consumers simply scan their fingerprint to approve the transaction.

Profit Dynamics

Today, consumer mobile P2P is not a source of revenue. To rectify this, Venmo's plan is to expand from merely a peer-to-peer payment mechanism into retail purchases. For this plan to succeed, the convenience of paying with Venmo, which is generally linked to bank accounts, will have to at least equal the value that consumers receive in the form of the rewards that they earn when they use their credit cards. Venmo will also have to gain much greater acceptance among merchants.

Like Zelle, Apple will provide its service free of charge. By doing so, it hopes to spur the use of Apple Pay and garner a share of the associated interchange fees. For Zelle, the competitive rationale is that the service is vital to retaining consumers, especially Millennials. It is not clear, however, that offering mobile P2P is a major factor in retaining clients for banks. Also, it is unclear whether the advantages of using Zelle will be compelling enough for consumers to opt to use it over Venmo, Apple Pay, or other providers.

Conclusion

Consumer mobile P2P is a niche product and its importance relative to other mobile functionality in attracting and retaining younger consumers is unclear. The field is already crowded with formidable competitors and the product will not generate revenue for the foreseeable future. In light of these considerations, many community and regional bankers may decide to place consumer mobile P2P lower on their lists of investment priorities.

Information on the payments investment priorities of banks can be found in the 2017 Payments Strategy Survey by the American Bankers Association and Capital Performance Group. Contact Claude Hanley for more information.

Winning at Retail (continued)

they need to have a visible physical presence where their customers shop.

What lessons should this provide to the rest of us?

We need to be creative and innovative about our business models, particularly how we attract new customers. Many of the old channels and media don't work anymore. New channels, partners, and techniques are needed. All three of these "manufacturers" would not have had stores ten years ago, and now they are building stores while traditional retailers are closing theirs. Why? It's all about the cost of acquiring a new customer, and these three manufacturers have clearly found that stores cost effectively expand their customer bases.

Finally, as Amazon's surprising purchase of Whole Foods makes clear (Bezos: "Alexa, buy Whole Foods!"), having a robust digital channel is not enough. Even though typical consumers spend five hours a day on their devices, they spend ten hours a day in the physical world, and a winning brand needs to have a presence there to be vibrant and relevant.

Contact Mark Gibson (508-322-8146) for more information on retail channel strategies.

Deposit Funding Drives Valuations

CPG analyzed the performance of publicly-traded banks with assets between $1B and $50B through the first half of the year. We compared institutions with higher valuations (i.e., those with a stock price to tangible book value (P/TBV) in the top quartile) to peers. Some key financial metrics pertaining to the financial institutions favored by investors:

- The High P/TBV Group had a median net interest margin that was 12 basis points higher than peers. The group had a median yield on interest-earning assets that was six basis points higher and a median cost of funds that was eight basis points lower than the overall universe of institutions.
- The High P/TBV Group had median growth rates in deposits and loans that were almost two percent higher than peers through the first half of the year.
- The High P/TBV Group had a lower median ratio of loans to deposits.

As interest rates rise, the loan to deposit ratio will receive increased attention by executives and investors. Obviously, institutions that are able to grow loans while keeping funding costs low by attracting and retaining core deposits have greater likelihood for higher earnings growth than institutions that can do neither. The battle for deposits is well underway and will become more heated with the passage of time.

Metrics	Public Banks $1B - $50B Median	High P/TBV Group* Median	Variance
Net Interest Margin	3.50	3.62	0.12
Yield on Interest-Earning Assets	4.01	4.07	0.06
Cost of Funds	0.51	0.43	(0.08)
Loan Growth	11.24	13.19	1.94
Deposit Growth	8.79	10.74	1.95
Loans to Deposits	92.82	90.20	(2.62)

Source: S&P Global Market Intelligence, LC, 2017. Data are for 2Q17 YTD.
*Publicly-traded banks with assets of between $1B and $50B that also rank in the top quartile in terms of price to tangible book value at August 2, 2017.

Announcements

Michael Flores joins CPG as a Senior Consulting Associate

Michael Flores brings over 30 years of financial services experience with focuses on loan and deposit operations, commercial deposit and cash management product strategies, alternative financial services, overdraft protection programs, payment systems and process improvement and reengineering through enabling technologies.

Liam Murphy joins CPG as a Business Analyst

CPG is happy to announce that Liam Murphy has joined our team. Liam graduated from Colby College in May of 2017 with B.A. in Economics, and Global Studies.

CPG and the American Banker ranked the performance of regional banks In the third and final part of this year's analysis of industry performance, CPG and the American Banker rank the top regional banks (banks with with assets between $10B and $50B). The rankings appear in August edition of American Banker Magazine and online. To obtain a spreadsheet that contains the complete rankings of banks, or for other information, please contact Kevin Halsey (202-337-7873).