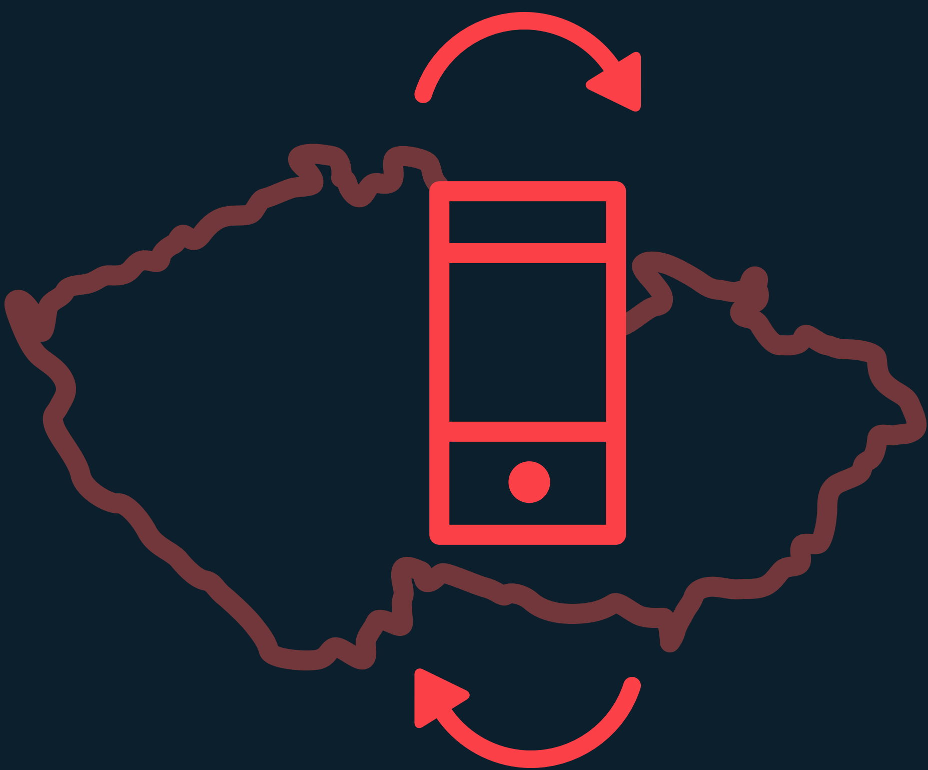
2018

Mobile payments in the Czech Republic



An overview for bankers

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Introduction

Despite lagging behind when it comes to general card acceptance, the Czech population have clearly demonstrated their readiness for mobile payments. Data from early 2018 puts the Czech population second in the world at using contactless payment.

"...cash to continue its reign as king."

Many small retailers in the region still trade in cash, however. There is a very clear opportunity for a company to provide a solution which leapfrogs cards and solves issues for these smaller merchants. New payment options in the form of contactless terminals don't add any value to underserved and cash-driven merchants and thus they've not adopted them - leaving cash to continue its reign as king.

When the customers of a smaller retailer already use a mobile payments app and the enrolment process for the merchants is really easy, it makes it much more attractive to offer cashless payment alternatives. The merchant doesn't need any third-party hardware (or even a phone) and can simply validate the payment on the customer's screen.

The value of being the provider of such a solution revolves around the customer data acquired along the way. The payments channel becomes a sales channel. The leading mobile payment providers in any given region have available to them millions of potential customers - individuals and businesses - which equal millions of potential up or cross-selling opportunities. For a bank, this could mean the ability to offer low-risk and real time lines of credit or other traditional bank products with very low customer acquisition costs.

The structure of the Czech banking sector has long been broadly unchanged, stable and conservative. Since 2010, the increase in low-cost banks has started challenging the traditional banks. Further disruptions have come by way of *interchange fee regulations initially introduced at the end of 2015, with amendments made in 2016 and 2017.*

When the regulation came into effect, caps on the interchange fees, together with the separation of card schemes and processing were the most impactful changes. It was these two changes which had the direct effect on banks' bottom lines. Issuers of cards were limited to charge 0.3% for credit cards and 0.2% for debit cards. On average, chopping 65% off the banks' card issuing revenue.

There has been much talk about how banks can *replace threatened interchange fees* but despite the stricter regulation, these fees have remained a steady source of revenue for banks.

However, *when PSD2 comes into full effect,* banks will see an even greater revenue reduction. A growing number of transactions previously conducted using cards will stop. Instead, there'll be more and more payments charged directly from a customer's bank account. Many of these payments will be enabled by and facilitated through the use of mobile payment solutions using PSD2 APIs at zero cost as opposed to running through a card rail.

In the past, banks (and their close partners such as card companies) would have had the monopoly on this due to regulations about who can and cannot facilitate financial transactions. *PSD2 changes this by cracking open access to bank accounts* to any third-party with a license. Consumers will make the final decision about which solution to use - be it from a bank, fintech or tech-giant. A survey (more results below) conducted by Auka of Czech bankers in September 2017 found that 41 per cent believed their card revenues were likely to decline post-PSD2.

26%*

feel worried that major tech companies will disrupt banking

** Of those surveyed in Czech Republic*

"...banks in the Czech Republic and across Europe have a time advantage, during which they're able to keep would-be new payments players at bay whilst creating and launching their own solutions to fend off disruption."

To date there's been no news about when the likes of Apple Pay will arrive in the Czech Republic. *Android Pay only went live late last year* and there hasn't been any great fanfare from Google about adoption rates. PSD2 means that banks are only able to keep the tech giants at bay for a limited time only. We know that *NFC-enabled solutions do not fundamentally solve problems for consumers or merchants.* The large tech companies know this too (see more on Google's Tez further within this report) and once access to the market is unlocked as a result of PSD2, a flood of new mobile payment entries will flow into the Czech Republic and across the rest of Europe and the globe.

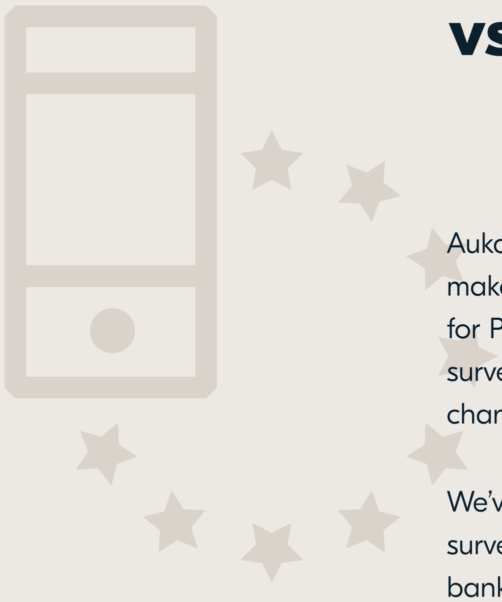
The same study mentioned above identified that more than a quarter (26%) of those surveyed in the Czech Republic feel worried that the likes of GAFA (major tech companies Google, Apple, Facebook and Amazon) will play a major role in banking disruption. As we will explore within this report, banks in the Czech Republic and across Europe have a time advantage, during which they're able to keep would-be new payments players at bay whilst creating and launching their own solutions to fend off disruption.

There is no clear mobile payments winner in the Czech Republic or its closest neighbouring regions yet. The addressable market is not that much larger than that of the Scandinavian countries where bank-issued mobile payment solutions have *meant the likes of Apple Pay haven't been able to gain a strong foothold.*

Topline analysis, combined with our research below, suggests that the Czech Republic is certainly poised for someone - bank or third-party - to create and launch a new mobile payment solution that can achieve rapid uptake by the population. Who will it be, though?

"Who will it be, though?"

Region overview



Banker perception in the Czech Republic vs. Europe

Auka ran surveys across Europe* which asked senior decision makers at banks a series of questions about their readiness for PSD2 and about mobile payments. Included in these surveys were also some questions focused on the upcoming changes to data access and storage in the form of GDPR.

We've compared some of the average responses of those surveyed in the Czech Republic against responses from bankers in the remainder of the addressed European regions.

On average, 42 per cent of surveyed European bankers said they felt worried about the impact PSD2 would have on their organisation. Bankers in the Czech Republic had slightly higher levels of concern, though, with almost half (49%) indicating they felt worried about the directive's impact.

Bankers from the Czech Republic were the second highest share of concerned respondents with regard to competition. More than two-thirds (36%) believe their bank's existing digital channels will not be able to withstand competition post-PSD2. The country feeling the most heat was Greece (where 38 per cent said they didn't think their bank might survive the post PSD2 competition).

**LM Research*

Despite this finding, Czech bankers were the most likely out of all regions surveyed to say that they don't think their organisation will have to change.

76%

More than three-quarters felt the organisation would remain the same, post-PSD2.

66%

On average, two-thirds of all bankers said they didn't think their bank needed to change.

27%

More than a quarter of Czech bankers, however, indicated that they believed their personal roles would be affected.

The average was 24 per cent. In general, the longer survey respondents had been working for their bank, the less they thought their roles would change. Overall, 33 per cent of those who had been working for their current bank for less than a year indicated that they felt it was likely their role would change as a result of PSD2.

When we originally (September 2017) asked Czech bankers whether their organisation had a plan in for GDPR, 67 per cent said yes. When we asked again in February this year, the figure had increased to 71 per cent. This is lower than the average which saw almost four in five (79%) confirming their bank had a GDPR plan in place already.

71%

↑

67%

Just over a quarter (26%) of all surveyed bankers said they thought external threats such as GAFA* would take the role of the bank in the next five years. Bankers from the Czech Republic didn't deviate from this average.

Two in five (40%) Czech bankers said they expected a fundamental shift in banking to occur within the next five years - higher than the average (35%) by five points. 19 per cent said they weren't sure.

PSD2

Just under half of all surveyed bankers in the region said that their bank had looked into opportunities for monetisation, post-PSD2.

This puts Czech bankers amongst the lowest numbers of bankers across other surveyed regions in Europe who would seek out new revenue opportunities to replace those lost by PSD2. Of those seeking new ways to make money, 31 per cent said they would look to both build a completely new digital channel and improve their existing payments channels.

The highest in the sample, almost two in five (37%) said they would look to acquire fintech companies to help them with their digitisation.

Two-thirds indicated they would maintain customer interaction by launching a new mobile wallet, however Czech bankers were also the most likely in the entire sample, (45%) to acknowledge that third-parties could take over their channels for payments.

Overall, surveyed bankers in the Czech Republic appear to be one of the most concerned regions in the whole sample. They also seem to have the clearest plan to introduce mobile payments and had the highest share of respondents indicating that they will look to acquire fintechs.

Why mobile payments?

Under the second payment services directive (PSD2), we're seeing open banking begin to challenge the status quo in Europe.

Third-parties (such as the GAFAs that 26% of the Czech bankers surveyed believe to be a threat to their businesses) recognise the value of dissatisfied banking customers and their data. They're clambering to launch mobile payment solutions and gain regional market share. But they can't achieve this yet. Read on.

Similar legislative changes are occurring all over the world. In 2017, India introduced a similar directive and within a few short months *Google had launched a mobile payments solution called TEZ.* Tez allows users to make payments and merchants to take payments in a multitude of situations never before available to them. Four months after its launch, it announced that it was about to surpass the *12 million user* mark.

This year, Google's rolled out their expanded Google Pay (initially in the UK and the US) solution.

The new mobile app will allow users to view and manage payments across all platforms using cards and other payment methods. The goal is that people (all people, not just those customers of affiliated partners) can use the solution to make secure payments to anyone, anywhere. *The model is the exact same* as that followed by Chinese mobile payments giants Alipay and WeChat Pay and the bank owned solutions in Scandinavia - Vipps, Swish and MobilePay.

#1

"To be number one in payments, you need to be number one in mobile payments."

Strong payment ties are fundamental to the primary bank/customer relationship. Payments are the banks' gatekeeper to its customers. The payments process is an increasingly important source of revenue, data, customer interaction and a driver of loyalty among customers.

Being (or remaining) number one in financial services requires being number one in payments. To be number one in payments, you need to be number one in **mobile payments.**

This means creating a mobile payments solution that puts the bank customer - merchants and the everyday public - at the centre of the experience.

Fundamentally, *mobile payments done the right way* will liberate people and businesses to pay, get paid and do business digitally in any situation. They are fast, cheap and secure. You don't need cards or card terminals, you only need a phone. The most common and fastest growing digital device in the Czech Republic and on earth.

Who will be the mobile payments winner in the Czech Republic?

Despite knowing that large tech companies and a host of fintechs would dearly love to launch mobile payment solutions which solve problems for many, they're unable to gain true traction - yet.

We have seen in *Norway, for example, that the likes of Apple Pay haven't launched there.* The bank-issued solutions are too sticky and well loved for the newcomer to see the market as a viable one. Once able to cut out the middleman and go straight to the customer account, we're likely to see all the payment solutions the tech companies have been trialling come out into the open in a blaze of glory in markets where there's no existing defence.

GAFA (*Google*, *Amazon*, *Facebook* and *Apple*) are working to create their own mobile payments solutions. Google has TEZ India, as mentioned above, and their new *Google Pay wallet* in the UK and the US. These companies are all following a model which saw Chinese mobile payment giants, Alipay and WeChat Pay, gain so much traction. The value of mobile payments in China had exceeded USD 5.5 tn - 50 times the size of the US's USD 112 bn mobile payments market, by the end of 2016.

Solutions launched by newcomers are a very real threat to banks, make no mistake. *The Financial Times recently reported how Alipay and Tencent are essentially starving banks in China of big transactional data* and are challenging the dominance of the biggest state-owned bank.

But banks in Europe are somewhat protected - for a limited time only. Let's look at this simply. No third-party (i.e. a company who isn't a bank) can gain a really strong foothold on the Czech mobile payments market until banks open their APIs, providing account access. No bank is compelled to open its API to any third-party until *the period in which the regulatory technical standards (RTS)* which govern the implementation of PSD2, and thus open banking, elapse.

13 January
2018

All EU states must incorporate PSD2 into national legislation

PSD2 applies

September
2019

Open APIs for all licensed TPPs must be available

RTS applies

"...the answer to who will be the mobile payments winner in Czech Republic is pretty simple: it can and should be a bank."

These RTS, which expire September 2019, give banks a distinct window of opportunity when it comes to creating and launching a region-wide mobile payments solution to help fend off third-party disruption.

So, the answer to who will be the mobile payments winner in the Czech Republic is pretty simple: it can and should be a bank. Overall, banks have the time advantage, we see *generally that they have more trust of customers when it comes to managing their money* (vs. tech and social media companies) and of course, the comprehensive and formidable payments know-how.

Which bank, right now, remains a mystery. We predict that the bank who succeeds will beat their competition to the punch by launching first. They will invest in marketing the channel across the entire region. They will create a solution that essentially follows the *same formula* of those mobile wallet owners who have managed to use their platforms to attract huge volumes of new customers and grow their revenues significantly.

Partnering with fintechs allows banks to quickly become agile and launch, for example, a real mobile payment solution that can withstand the competition from newcomers, or other banks.

During the next year, European banks will be forced to hand over the keys to third parties, they know what the state of play is. So they must answer the question: do I want to keep the customer relationship, build more customers and potentially come out on top, or do I want to become simply the pipe for payments facilitated through third-party mobile channels?

The only reason for a bank not to come out on top in the Czech Republic is a failure to act in the period of time they have to make significant change.

Contact us

We can show you how to take mobile payments to the market and beat the competition.

Get in touch to find out more.

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