JAG CAPITAL MANAGEMENT LLC

Change is Coming

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Imagine a world where tools for payments were not necessary. Paper checks are already on the way out, and within a decade they might not exist at all. Airlines and now some restaurants are no longer accepting cash. Credit cards are expensive, and they are cumbersome to use online, where consumers have to re-enter and re-enter names, addresses, and codes. Are fluid and secure transactions possible without checks, cash, and cards? The cashless future may be closer than you think.

>> **One-touch, One-Click applications are providing value to both consumers and businesses.**

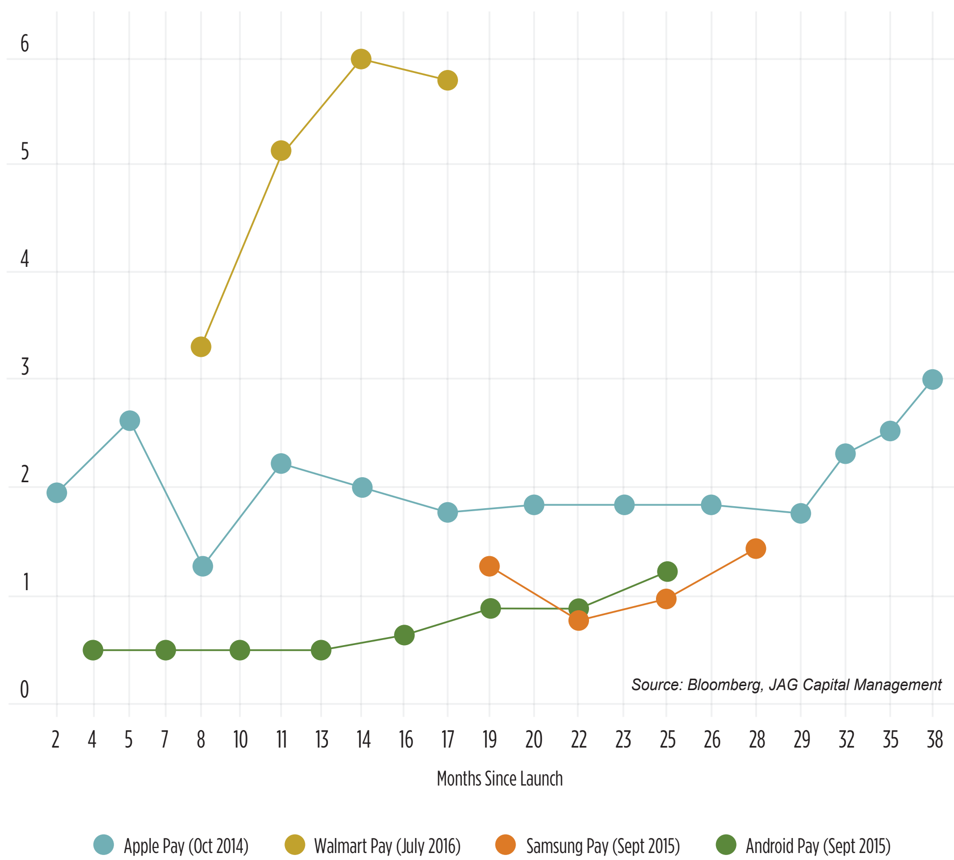
>> **Peer-to-peer payments are growing rapidly and becoming a material portion of total transactions.**

The trend away from physical payments has been underway for some time. The decline in checks hastened with the advent of both direct deposit and online bill pay. ATM utilization is on the down swing today due to remote deposit and a decline in cash transactions. Credit card companies have advertised to attract small dollar value transactions. While more transactions have been digitized, early efforts to create a singular cash replacement in the form of a digital wallet have not proven fruitful. Instead, one-touch payments and peer-to-peer methods are taking off. One caveat would be that a particular challenge for digital payments is moving from closed systems (Amazon One-Click or Walmart Pay exclusive to their sites) to applications that could be used anywhere.

Empty Wallets

Digital wallets, stores of financial information on a mobile device, have seen low utilization rates and scant use. Apple Pay is the most popular digital wallet, and only 13% of Apple users have even opened the application. Staying with Apple Pay, only recently have 3% of users embraced the platform. The blue line in the chart below shows a long, slow adoption rate defying Apple CEO Tim Cook who recently said that he hopes to be alive "to see the elimination of money." Samsung Pay and Android Pay show even lower rates of consumer acceptance. Walmart Pay has a better adoption rate, so perhaps a tie between wallet and where the wallet is used in a closed system creates utility for the consumer. By measures of adoption rate and utilization rate, digital wallets have been a disappointment. A few banks are trying to counter digital wallet avoidance with more fully featured digital bank accounts. JP Morgan just launched its "Finn" digital banking product on a national basis, giving incentives to pay bills, transfer money between accounts, and make peer-to-peer payments. Despite new initiatives, digital wallets have not resonated with customers yet. So, why do we think the move away from cash is hastening? See below.

Percentage of Respondents that Used the Wallet



Singular Clicks

One of the ideas behind the digital wallet is that consumers could pay for transactions with the swipe of a cell phone, no entering name, address, code data and no waiting endlessly for a chip card to process. Wallets do seem to have this "one-touch" utility, but there are concerns about ultimate security of storing financial data on one's mobile device. Getting away from the digital wallet format, one-touch payments are popular with both consumers and vendors. One-touch payments have a significantly higher conversion rate than other payment forms. For example, in a May 2017 study comScore found that PayPal Checkout converts a sale nearly 89% of the time, an 82% higher rate than other payment methods. Said another way, about 49% of cash, check, and credit card sales are completed once a consumer reaches the check-out; whereas, 89% of PayPal one-touch sales are completed at check-out. That's a material difference with customers showing a clear preference for not having to fill-out forms or to collect change.

Amazon was the first to develop "One-Click" technology, and it is believed to have increased their conversion rates by 5%. Amazon's technology was patented, and the patent expired in early 2018. As a result, several large internet companies, including Microsoft and Facebook, are launching one-touch/ one-click capabilities near term. This could be a big year for single click purchase growth. Consumers appear to be comfortable with digital payments within a retailer's environment (WMT, AMZN). Think of it like a store branded credit card. Outside of those store fronts, conversion rates are very high for one-touch digital payment systems that span websites. The degree of difference in those conversion rates may reveal how well liked, and how limited broad singular click technologies may be. One touch buying eliminates the need for cash or check, and the credit card connections, if present, are not readily visible to the consumer. Frictionless and cashless.

Peer 2 Peer

Peer-to-peer (P2P) payments are one of the fastest growing segments of the payments market, with growth near 75% in the past year. Typical P2P transfers would be a parent paying allowance to a child or two friends splitting a dinner check. Two companies dominate P2P payments, Zelle and Venmo. Reports suggest that Zelle has about 60% market share and that Venmo has about 30% market share, leaving a scant 10% for a half dozen competitors. Zelle is owned by a consortium of banks and most of their P2P transfers result from moves between accounts within the banks. Zelle benefits from being transaction cost free. Venmo leads in P2P payments between different banks. They charge a 3% fee for the service, and provide social media content in conjunction with the transaction.

Peer-to-peer transactions are thought to make up about 11% of the domestic payments market today. Although consumers appear to be adopting the money transfer technology in droves, the providers of the service do not yet have a sustainable business model. Zelle is a loss leader for the banks, and Venmo refused to commit to a date when it would expect to begin generating profits. As for moving away from cash, checks, and charges, both Zelle and Venmo require either a bank account or a credit card to be attached to the account. That split will likely result in fewer credit cards over time.

Conclusion

Although digital wallets have not caught on, digital payments seem to have a high utility implementation in one-touch and a rapid escalation in peer-to-peer. With these successful digital applications, a cashless future may be close at hand.

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