

Apple is late to its own mobile payments party

By: Cody Guluk, September 12, 2014

Apple's eagerly awaited payment strategy was unveiled this week, and anyone hoping for a disruptive, banking industry altering technological advancement was left disappointed. Instead, Apple chose to facilitate payments, allowing consumers to upload their existing credit cards to their iPhones. By choosing a role which fits within the traditional payments model, Apple has positioned themselves to gain a share of interchange fees while revealing a lack of **foresight**.

Apple Pay will generate revenue through the interchange fees charged to merchants who accept credit cards¹. The fees from the interchange are split based on the level of risk and responsibility that each party assumes. The issuing bank receives the largest portion of the interchange fees (61%), the acquiring bank receives the second largest share (35%) and finally the payment network (4%).

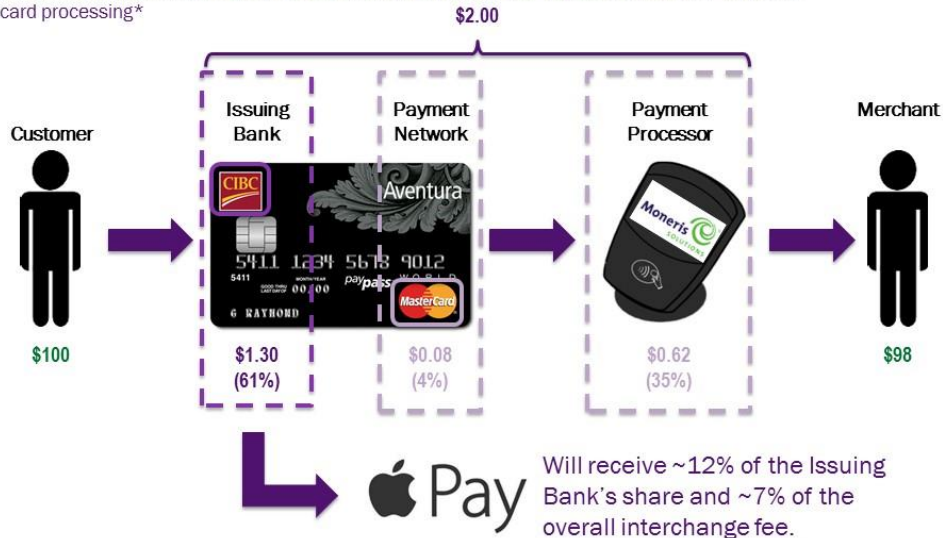
Apple Pay enables banks to satisfy their customers' desires for a "mobile wallet" without requiring them to develop any of their own products. On top of that, Apple will enter payments without challenging pre-existing industry paradigms and will provide a degree of stability and standardization that will doubtless have banking execs breathing a sigh of relief.

In return for enabling mobile payments, Apple is positioning itself within the interchange cycle, and will generate fees as illustrated in the figure below:

¹ In a typical credit card transaction, a merchant must pay a fee for the privilege of accepting a credit card payment. These fees are called "interchange fees" and are typically distributed to three parties: (i) the bank who issued the credit card to the consumer (called the issuing bank); (ii) the payment network (Visa, MasterCard, American Express); and (iii) the company who supplied the point-of-sale terminal enabling the merchant to accept credit cards (either the payment processor or the acquiring bank).

As an enabler of Mobile payments, Apple Pay will receive its share of the transaction at the expense of issuing banks

How fees are divided for a \$100 transaction if a merchant has negotiated a 2% fee for credit card processing*



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The net effect on Apple's bottom line from the above structure will depend on the deals that Apple has negotiated with the banks as well as the pace of industry adoption of NFC technology. Early estimates suggest that Apple will receive \$0.15 cents per \$100; which is equal to 7.5% of the overall interchange and 12.3% of issuing bank's share. With conservative assumptions for merchant adoption of NFC payments it is easy to see Apple Pay generating over **\$200 million** per year in revenues by 2016 from the United States alone.

Although the potential revenues generated by Apple Pay are substantial, the story here is really one of **lost opportunity**. NFC technology made its first appearance on the Nokia 6131 in 2006. It gained traction on Android devices with the launch of the Nexus S in 2010, and has been a feature of Android devices ever since. Apple surprised many people by not including NFC in either the iPhone 4 or iPhone 5. Apple never explained why NFC was not incorporated in those models and the release of the iPhone 6 highlights that Apple is very late to the game.

Apple's lack of foresight and leadership in adopting NFC technology has resulted in the loss of a multi-million dollar opportunity that will now take Apple years of iPhone sales to realize. Failing to include NFC in earlier iPhone versions means that there are over 450 million iPhones that had the potential to use Apple Pay but are instead a road block to further Apple Pay adoption.

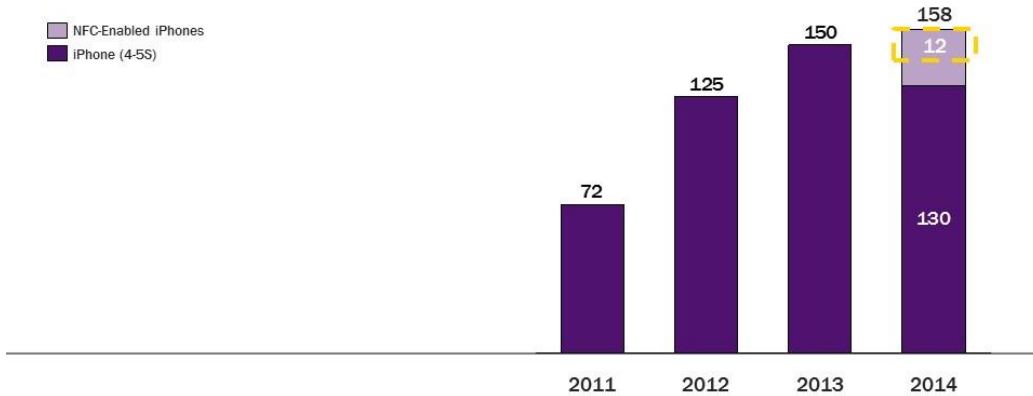
Apple's late adoption of NFC means that of the 500 million iPhones sold since 2011, only 12 million will be Apple Pay enabled

Global iPhone Sales

MILLIONS OF UNITS SOLD PER YEAR

Source: Statista, TBBI Analysis

■ NFC-Enabled iPhones
■ iPhone (4-5S)



Estimated iPhone 6 sales USA

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Google, on the other hand, is in an excellent position to capitalize on Apple's endorsement of NFC. If Google can alter its Google Wallet strategy and pivot away from "a business model that was centered around their own self-interest" (thank you, Mr. Cook) to an open system which embraces Apple's model, they can quickly find themselves with a market opportunity **60 times larger** than Apple Pay.

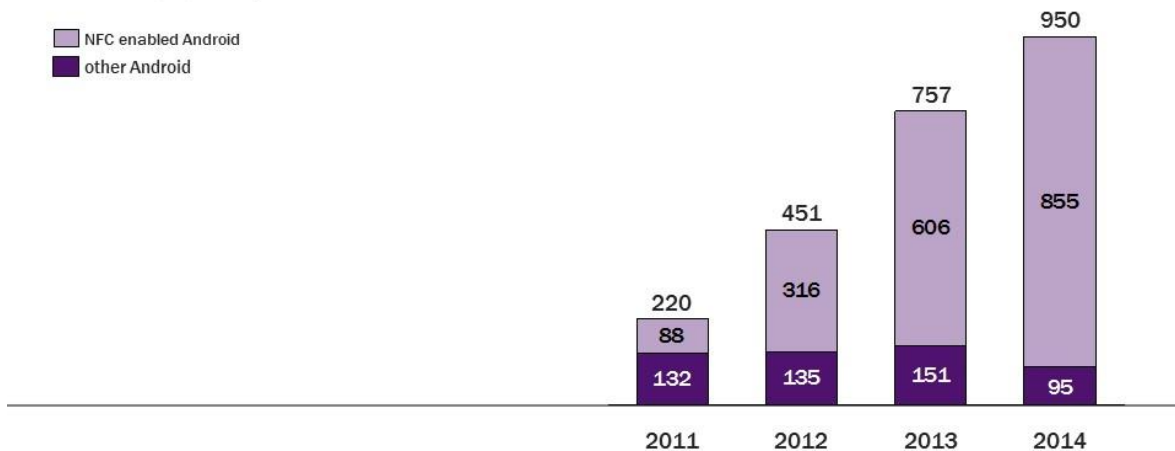
With over 1.8 billion NFC enabled devices shipped, Google Wallet is in an excellent position to benefit from the inroads Apple has created

Global Android Sales

MILLIONS OF UNITS SOLD PER YEAR

Source: Statista, IDC, TBBI Analysis

■ NFC enabled Android
■ other Android



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Although Apple's initial footprint in payments is smaller than it could have been, there is plenty to be optimistic about. Firstly, Apple proved once again that they are capable of effecting large scale change on the most entrenched of industries. Secondly, Apple's initial foray into replacing the wallet is just that – a first step. As Tim Cook said, "Our goal is to replace [the wallet], and we're going to *start* by focusing on payments".

Payments is the low-hanging fruit in the transaction process. The average wallet contains at least three ways to make a payment, but there is still only one convenient way to receive money. Now that the banks and payment networks have allowed the fox into the henhouse, it won't take long for Apple to find a way to fully disrupt the traditional payments process.

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