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Payments Innovation 2011

The Global Jury Decides

January 2011

Introduction

Innovation is one of the most hotly debated topics in the financial services sector at present with the number of new product and service announcements running at record levels. Although 2010 was a testing year for banks, technology vendors and the growing number of organisations that have a stake in the payments industry, the tough economic climate has not stifled payments innovation. In fact, there were several notable developments in the industry in 2010, from the explosion in mobile applications to the growing focus on open payment platforms.

Fuelling these advances are increasingly diverse organisations that are putting pressure on traditional financial services companies to evolve the payments market. From global telecom players to emerging online start-ups, the competition to take a share of payments revenue looks set to intensify in 2011.

This report is based on the input of 22 banking innovators and experts from around the world that share my passion for driving change in payments. It highlights challenges and opportunities in the global payments market and identifies the innovations that we may see in 2011.

A handwritten signature in blue ink, appearing to read 'John A. ...', with a horizontal line underneath.



Global Innovation Jury

To understand the challenges facing the payments industry and their impact on innovation, the Global Innovation Jury was convened. The Jury of payments industry leaders last produced its view on innovation in 2008. If you would like a copy of the 2008 report, please send an e-mail to marketing@ixaris.com.

The new Jury, sponsored by Ixaris, consisted of 22 payments industry leaders from around the world. Members of this select group have all held prominent roles at major global organisations, most have lived and worked in multiple countries and all are still directly involved with payments innovations. Members of the Jury and chair, John Chaplin, president of Ixaris, were drawn from 15 countries across 5 continents.

This report details the Jury's thoughts on the current state of the payments market and issues such as the environments that best foster innovation, global leaders in payments and missed revenue opportunities that may take off in 2011. The results provide an insight into the Jury's current views and also an interesting comparison to the findings of the 2008 Jury.

Innovation Defined

As the Jury made its considerations, the following definition was adopted to ensure the meaning of "innovation" remained consistent:

- *Innovation* is the turning of an invention or new concept into commercial success
- *Innovation* is more than evolution
- *Innovation* is not confined to technology

And for ideas to become successful innovations there has to be a viable commercial business model and the determination and means to implement it.



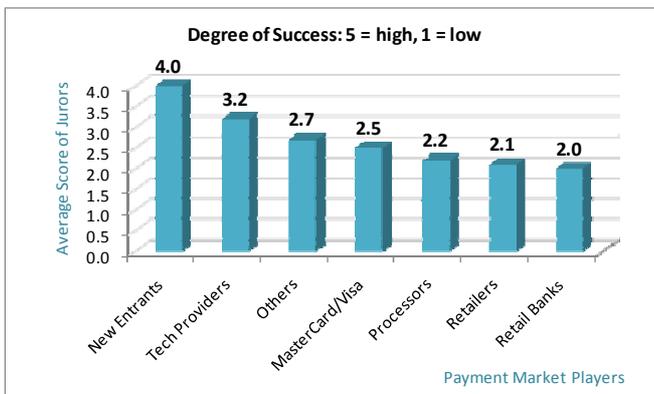
Questions and Responses

Q1. Who is best at driving innovation?

The Jury's decision mirrored that of two years ago – new entrants are still clearly the primary force behind innovation.

'New entrants' has often been a term to describe new banks such as Metro Bank in the UK and rural banks in India, as well as multiple payment institutions springing up as a result of the EU Payment Services Directive.

However, in 2011, the Jury is forecasting that new players and 'others' from more diverse sectors will impact the payments market, citing Facebook, Apple and telecoms as real threats to the status quo.



Facing challenges with legacy systems and antiquated processes, many jurors think that banks and payment schemes are heavily entrenched in existing systems and processes and therefore are generally followers, rather than leaders of innovation. This indicates the precarious position of

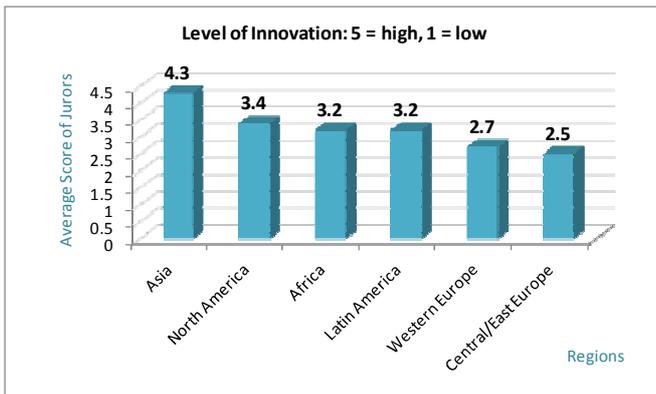
many organisations with a heritage in payments as they compete with non-traditional payments companies to take a share of the market.

Jury comments:

- “Retail banks and the schemes are prisoners of the status quo. So perversely are the major processors who need to innovate to stay relevant, but are short of investment money, and retailers who are focused on other things. Innovation is most likely to come from the technology providers and new entrants.”
- “I now think of banks, processors and the card associations as being more in the role of enablers and distributors of payment innovation, than actual creators.”
- “MasterCard and Visa have made interesting strides in innovating around payments and they have the potential clout to make it happen. Both retailers and retail banks seem to be mostly waiting or adopting what the technology providers and others are offering.”
- “Innovation in payments seems to occur quite slowly. Although there is a degree of invention, translating this creative process into significant economic success for mass markets usually takes a long time.”

Q2. Which regions will show the most innovation?

Asia is clearly the top choice by a large margin when the Jury considers which region is likely to create the most innovation, followed by North America, which echoes the findings of the 2008 survey. While the world will watch Asia and likely adopt many of their innovations, the Jury believes that innovation occurring in North America is often not exportable to other markets.



In third place, Africa's position is buoyed this year by an ongoing necessity to innovate in areas such as mobile payments. Latin America has moved from last position in 2008 to a joint third with Africa this year. The reasons given for this rise include the current fast pace of the market and the positive impact that fast growing economies such as Brazil have on innovation. Europe as a whole is not well regarded by

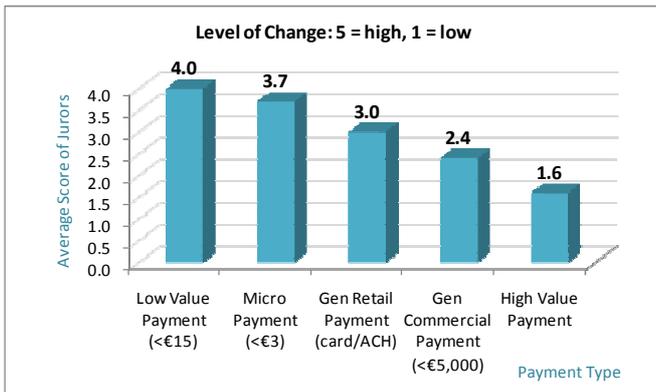
the Jury as source of innovation. Within that, Western Europe achieved a similar score to 2008; however, Central & Eastern Europe have dropped from third to last place, largely due to their shortage of investment capital.

Jury comments:

- “Europe has become sclerotic, burdened with regulation and short of cash. In Africa, necessity is the mother of invention and in Asia, there is a tech-push to innovation.”
- “Africa is making real progress in mobile payments. Latin America is often forgotten but the rate of change is very quick there these days. But Europe is still struggling to innovate... the consensus mentality makes it very hard.”
- “Despite the well established payments infrastructure in North America, the entrepreneurial spirit in the US means that innovation will continue apace there.”
- “Although there is lots of innovation effort in USA, it is rarely exportable to other markets. The burgeoning economies in Brazil, India and China will create more disposable income and greater penetration of commerce opportunities for emerging consumer societies in these countries. These will result in payment innovation.”

Q3. Which payment types will see the most innovation?

It remains clear that there is a direct correlation between payment size and innovation. Smaller payments are still operating with big inefficiencies, so this area maintains its hunger for innovation.



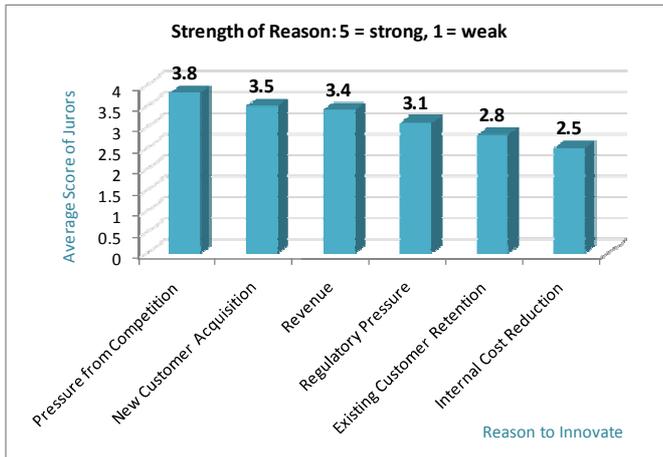
Even so, the Jury concedes that challenges remain; especially building a business case for micropayments. Jurors also highlight that cards remain an area of relatively slow innovation but the 'old order' is starting to break down and traditional partners will be compelled to compete in 2011. Cards are also being increasingly embedded in other innovative retail payment methods, such as PayPal or mobile wallets.

Jury comments:

- Evolution of payment technology always moves more slowly the higher the payment value. Youth and the affluent will continue to drive acceptance of non-cash payment methods in low-value payments.”
- “There is much greater opportunity now to change card payments because the old order is breaking down and traditional partners are starting to compete. That will lead to innovation.”
- “Removing bulk coin from economies has many benefits for merchants, consumers, banks and central banks and therefore initiatives that reduce bulk coin are likely to receive broad support.”
- “Card and ACH as such are not going to change that much but their usage will be embedded in other innovative payment methods (e.g. PayPal transaction funded by card, P2P solution over the ACH rails, card as a mobile wallet, etc).”
- “Dedicated B2B solutions, e-invoicing and non-bank international transfers will drive innovation in general commercial payments.”

Q4. What is driving innovation?

In a similar vein to the 2008 survey, the question of what is causing payment innovation sparked a mix of comments from the Jury.



Competitive pressure gains the highest vote overall, displacing revenue generation from first position, while cost reduction is declared the weakest driver of innovation, sliding from third place into sixth. Regulatory pressure is more of an important driver than before, shifting from the least important to fourth place this year.

The financial crisis over recent years had reportedly led to an increased focus on customer retention, but the Jury places customer acquisition back on the priority list.

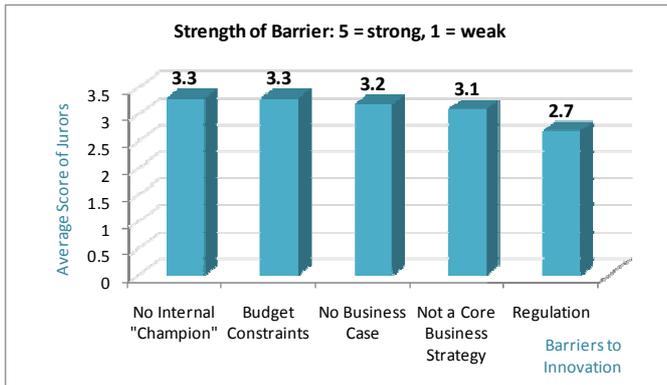
One juror comments that risk management is a worthy driver that should be on the list while another states the rise of smart devices and interactive TV are also key emerging trends that will bring developments in payments.

Jury comments:

- “It’s the opportunity to make a profit from the places where the banks and payment schemes have walked away.”
- “In some markets, it is becoming a case of innovate or get out of the market. But in others, there is still not real competition between the banks unless the regulator forces it.”
- “Risk management is not on this list but should be. Other than this, cost and regulatory issues will always take priority in a recessionary market.”
- “Smart, rich media devices (tablets, mobile, interactive TV) will require a new payment ecosystem to monetise them.”

Q5. What are the main barriers to innovation?

A new area of debate for the Jury this year is around the main barrier to payment innovation. This fresh topic resulted in the Jury's most even spread of opinions with no single obstacle having the most impact.



After deliberation, there are two factors at play, one cultural and one financial. Budget constraints and a lack of an internal 'champion' are jointly declared as the principal barriers to innovation.

As traditional payments organisations struggle to compete with new entrants in 2011, they are sometimes the creators of their own problems; internal staff not only fail to champion innovation, but often actively stifle it in favour of legacy business models and operating in their comfort zone.

Regulation is deemed to have the lowest impact on innovation overall; however, the research indicates that it remains a challenge in the US.

Jury comments:

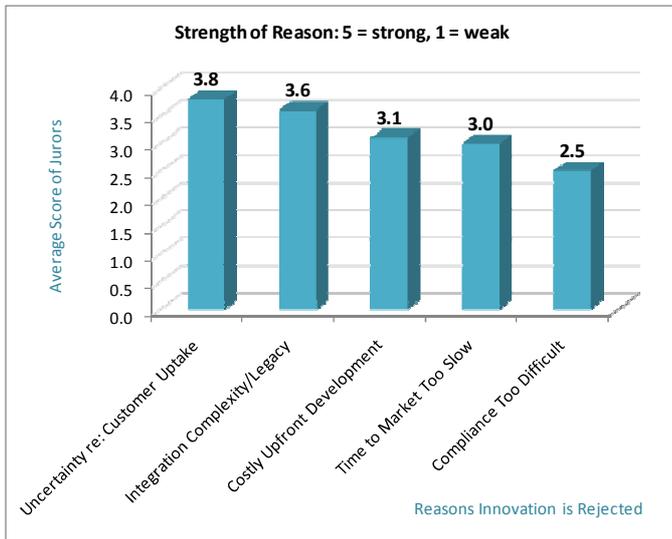
- "Conventional schemes and banks are not an environment that rewards risk takers and they do not allocate resources to activities with a significant risk of failure."
- "Increasingly there is not enough money devoted to product innovation in banks because it is all absorbed in compliance for the 'business as usual' function."
- "The highest barrier is resistance from internal and external legacy groups."
- "No vision and no ownership are the big inhibitors. Budget constraints are just an excuse."
- "Regulation is not a barrier in Europe and some other places, but is definitely a barrier in the US."

Q6. Why are ideas for innovation rejected?

The Jury considered the issue of why individual innovative ideas are not implemented. Interestingly, it is not a case of impatience, with compliance and time

to market both ranked as relatively low inhibitors. Instead, the inability to guarantee customer uptake was the chief reason for innovative ideas to be rejected by organisations. The unwillingness to invest without a cast-iron business case shows why innovation is being driven by new market entrants and technology providers that feel more comfortable about taking on entrepreneurial endeavors.

Legacy systems are cited throughout the research as a challenge that is undermining long-established payments providers. Complexity of integration with the legacy environment often halts innovation before it gets off the ground leaving the market open for new entrants.

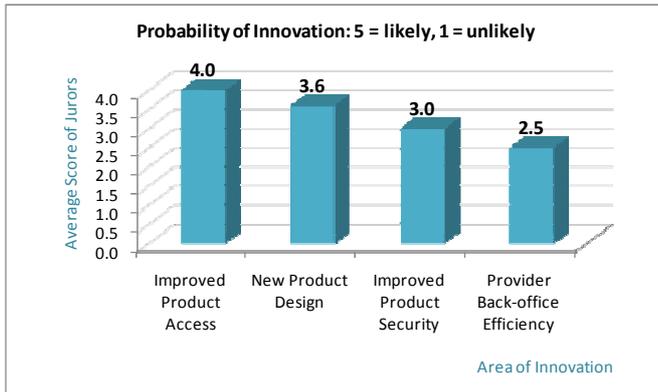


Jury comments:

- “The barriers that are set by many banks are impossible to surmount... but not even their existing business lines would pass these tests. That is why they are in danger of losing significant market share.”
- “This comes back to availability of investment funds within payments businesses and banks in the recession.”
- “Opportunities are often over-analysed. With many innovations you just cannot predict how customers will react, so you have to make the developments and then hope for the best; that just isn’t how banks work.”

Q7. Where will innovation be targeted in 2011?

When asked where most innovation will occur in the next year, it was clear to the Jury that improved access to products is going to be the key area of focus. This was in contrast to the 2008 survey in which new product development scored the highest.



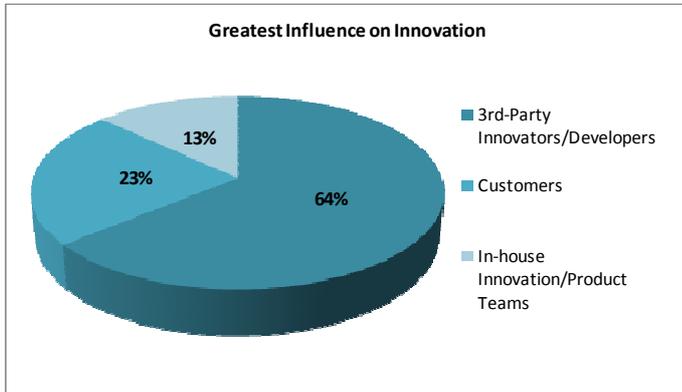
The explosion of the smart phone and tablet markets are two of the main reasons for this swing in opinion. Coupled with the rise of interactive TV and the increasing penetration of high speed internet, they present a revolution in access methods for banks. As new access channels emerge, traditional particular telecoms companies that are seeking revenue opportunities in the market.

Product security and back-office efficiency remain in third and fourth positions respectively, compared to 2008.

Jury comments:

- “The world is going mobile and somehow it’s more than a channel. It is a revolution and it can easily disconnect banks from payments.”
- “In a multi-channel world we are likely to see the most change in the way services are brought to the consumer. And the channels themselves bring new service possibilities.”
- “The emergence of new Internet devices – mobile, TV, tablets – and widespread take-up will offer channels that no financial player can ignore.”

Q8. Which stakeholder has the greatest influence on payments innovation?



The Jury believed that third-party innovators or developers have the greatest influence over innovation. In-house teams are said generally to be a ‘tick box’ for senior management rather than bringing true innovation.

In contrast to their substantial influence, third-party innovators and developers are generally much smaller in size than the financial institutions they serve. The growth of hosted and cloud services means they can operate globally with minimal worldwide presence.

Jury comments:

- “My fundamental belief is that real innovation comes from watching what people actually do, from how they use our products in ways that we didn’t anticipate and reacting to their needs. That’s the way to create profitable new product opportunities.”
- “In general, in-house innovation units are an absolute waste of money... very few ever deliver anything significant. They just make the Board feel that they are doing something as a company.”
- “I would add another stakeholder: competitors. Realising that you have been left behind by your competitors usually focuses your attention”
- “Why innovate if it does nothing for the customer?”

Q9. Which organisations stand out as the most likely payments innovators in the coming years?

PayPal maintained its leading position from the previous survey as the most likely payment innovator of the future. 2011 will be an interesting year for the company as it attempts to move beyond its retail roots and dispel market doubts about its ability to service a broader online payments economy.

Mobile operators and social networking platforms made their first appearance on the list compared to 2008, while new entrants and existing card issuers were also thought to be a source of innovation in the next few years.

Cited organisations:

- Adyen
- Amazon
- Apple (3 mentions)
- Boku
- BPS
- Facebook (2 mentions)
- Google (5 mentions)
- Ixaris (3 mentions)
- Limonetik
- O2
- PayPal (9 mentions)
- Safaricom (Kenya)
- Visa
- Voice Commerce

Q10. What is the largest missed revenue opportunity in the payments industry that innovation could address in 2011?

To conclude, Jury members were asked their opinion on how innovation can help address missed revenue opportunities, which revealed some valuable insights:

Jury suggestions:

- “Payment for virtual goods – it’s a new economy and being systematically ignored by conventional players in the same way that P2P was before PayPal.”
- “There is a tremendous opportunity to make cross-border B2B and B2C payments lower cost and faster. Customers would love it.”
- “Transform physical money into e-money.”
- “A way to make cross border remittances more flexible.”
- “Leveraging ‘smart’ payments (i.e. rich, context specific meta data).”
- “A universally-accepted, global and convenient mobile payment solution.”
- “Payment card issuing through ‘Over The Air’.”
- “Better linking and embedding of payments into the consumer purchase process (e.g. location-based, search-driven, impulse buying, etc.)”
- “Micropayments over the internet.”



More about the Jury and Judge

Payments Innovation Jury

The jury consisted of 22 payments experts currently living in Australia, Belgium, Brazil, Canada, China, France, Korea, Malta, Netherlands, Nigeria, Spain, Pakistan, Switzerland, UK and USA.

Members of this select group have all held prominent roles at major global organisations, including MasterCard, Visa, SWIFT, PayPal, Amazon, First Data, American Express and IBM. Most have lived and worked in multiple countries and all are still directly involved with payments innovations.

Payments Innovation Judge, John Chaplin

John Chaplin has been highly influential in the development of the payment card business for more than 20 years. He has previously worked in senior positions at First Data Corporation and Visa and has been credited as one of the driving forces of the phenomenal growth of card payments across Europe.

Since 2008, John has been a member of the Payments Market Expert Group that advises the European Commission. In July 2010, he was appointed as President of Ixaris, a developer and provider of streamlined payment applications, where he is working to expand the organization and its partnerships in the payment industry in order to capitalise on the surge in demand for innovative solutions.

About the Sponsor

Ixaris specializes in developing innovative global applications based on open-loop (Visa and MasterCard) prepaid card schemes.

Ixaris' consumer payment service, under the EntroPay brand, currently manages financial transactions exceeding US\$15 million per month. With more than 100 clients, Ixaris offers a range of co-branded payment applications that enable enterprises within the healthcare, travel, affiliate marketing and financial services industries to capitalize on the growing market for prepaid payment solutions through cost-effective, easy-to-access global payment networks including Visa, MasterCard and SWIFT.

Ixaris has offices in London, Seattle and Malta, which provide operational, customer service and fraud management. It is recognized by Visa and MasterCard as an independent sales organization. Ixaris is also certified by the U.K. Financial Services Authority to issue e-money, and is registered in the U.K. as a Money Services Business. Ixaris' financial service partners include Royal Bank of Scotland, Barclaycard, Transact Network and Bank of Valletta.

Ixaris is a privately-held company funded by leading UK institutional investors. Its corporate headquarters are in London.