



Non-Banks in the Payment System: Innovation – Commentary and Questions



May 3, 2007

Presented to:





Selected Themes

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- Payments System innovation resulted directly from the introduction of personal computing and the internet.
- Network effects influence payments innovations: introductory subsidies; switching costs, required interoperability, learning costs.
- Established firms are better at incremental innovations; radical innovations are more likely from new entrants.
- Consumer demand depends on sunk costs, perceived benefit, and reliability/security concerns.
- Innovations in payments have been made by firms of all types and sizes.



Discussion Points

- Payments System innovations have exploded since the 1960's, driven mainly by networked computing.
- Many innovations address specific niches, but may struggle to achieve mass adoption.
- Few "radical" payments innovations are new; most are derivative of existing forms
- Payments innovations are generally supply driven; in many, the value proposition is suspect for one or more stakeholders.
- Mobile banking/payments adoption will likely depend on bank/non-bank partnerships.



Payment Innovations Framework

Nature of Innovation Category	Sustaining Innovation (Continues Existing Model)	Disruptive/Radical Innovation (New Model)
Product	<ul style="list-style-type: none">• Signature debit• Keep the Change	<ul style="list-style-type: none">• Credit card• ATM• EZ Pass (automated toll collection)
Process	<ul style="list-style-type: none">• Risk Management (credit, fraud, collections)• IVR, VRU• Check Imaging	<ul style="list-style-type: none">• Electronic bill payment• Remote banking
Utility	<ul style="list-style-type: none">• PIN POS debit	<ul style="list-style-type: none">• Google• PayPal



Evaluating Payment Innovations

Payments Innovations Can Be Evaluated Along the Following Framework

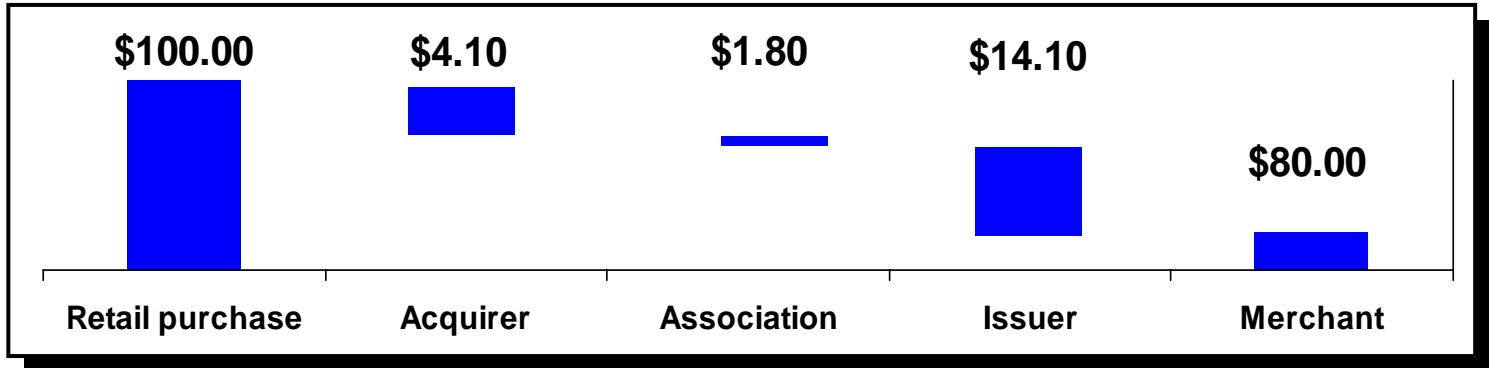
Category	Sample Questions
CONSUMER / USER EXPERIENCE	<ul style="list-style-type: none">• To whom is the product marketed? How is this done?• Is the product easy to understand and use?• Is it a new application or is it derivative of existing systems?• What incentives are offered to adopt and use?
VALUE PROPOSITION	<ul style="list-style-type: none">• Does the product solve a consumer problem?• Is it faster, cheaper, easier, or safer than incumbent?• Does it improve system efficiency, reallocate economics, or increase systemic costs?• Which participants will "lose", and how will they respond?
SOURCE OF COMPETITIVE ADVANTAGE	<ul style="list-style-type: none">• Price• Technology• Process• Delivery• Service level / performance (e.g. reduces fraud)
SUSTAINABILITY	<ul style="list-style-type: none">• Resources• Partners• Intellectual Property



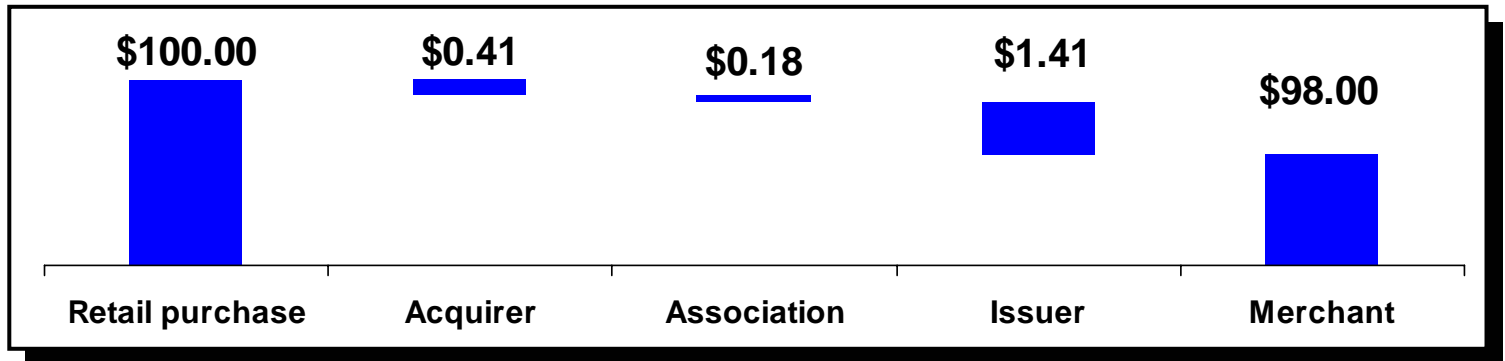
Evaluating Payment Innovations



Traditional Transaction



Innovation Transaction



Qualitative Assessment

<ul style="list-style-type: none"> Facilitates credit card use, but cumbersome to enroll. 	<ul style="list-style-type: none"> Fairly easy to accept. Difficult dispute and adjustment process 	<ul style="list-style-type: none"> Servicing issues challenged 	<ul style="list-style-type: none"> Modest Incremental revenue likely Difficult process for disputes, etc. 	<ul style="list-style-type: none"> Strong product for those in the micropayments industries. Good flexibility and versatility.
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Mobile payments fall into two main categories:

	<u>SMS</u>	<u>NFC</u>
Primary Use	Remote	Proximity
Leader	PayPal	Various
Value Proposition	Security	Convenience
Uses	P2P, Bill Payments	POS Purchase
Challenges	Convenience Learning curve	Security Acceptance
Substitute for...	Cash, Money Transfer, Internet Payments, ACH-based solutions	Access Devices: Card, RFID, Etc.

Mobile Payments Will Likely Require Cooperation Between Mobile Network Operators And Payments Networks

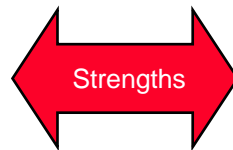


PAYMENT NETWORKS

- Increase transaction volume

- Financial institution/funding account connectivity
- Robust risk management and rule sets
- Widespread acceptance

- Short message format; limited content
- Relatively few endpoints



MOBILE NETWORK OPERATORS

- Increase number of subscribers and users' loyalty

- Millions of endpoints
- Ability to transmit robust content

- Security for financial transactions
- Merchant acceptance
- Lack of funding source



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