CFA SINGAPORE INSIGHTS

By Alan Lok, Eunice Chu, and Guruprasad Jambunathan

Getting the most out of an increasingly cashless world

Get to grips with the investment fundamentals of the online payments sector

TAP, swipe, wave. Technology has made it so wonderfully easy to spend our invisible money.

Indeed, when was the last time you withdrew money from an ATM? It used to be the quintessential financial transaction, but it is gradually becoming less critical and thus less common. We'd be willing to bet that if you compared your bank account records from this year with that of even five years ago, the frequency of which you exchanged a PIN for cash would have been markedly higher back then.

It makes sense – why even bother with cash when you have smartphone-enabled e-wallets at your disposal? Not only do you save time from queueing for your turn at the ATM, but you also bypass the inconvenience of carrying notes and coins. Online transactions (which include mobile payments) have changed the way we pay for goods and services in our daily lives.

Of course, online payments are nothing new. Amazon has depended on them since 1995 when it was just a virtual bookstore. PayPal launched its money transfer services in 1999. But it is only with the advent of 4G mobile communication, coupled with the simultaneous proliferation of smartphones, that the online payments business model has come to the fore. Companies in this space need no longer rely on the legacy structure of credit card vendors, conventional retail banks, or even desktop computers.

Total worldwide digital payments by consumers alone (excluding business-to-business) reached US$4.1 trillion in 2019, and is estimated to hit US$6.7 trillion by 2023, equating to a CAGR of about 12.8%. BT FILE PHOTO

A non-uniform trend

While the general trend today is towards making cashless payments increasingly ubiquitous, the pace, format, and depth of coverage vary quite widely across jurisdictions. Consider Sweden, a developed nation on track to becoming an almost entirely cashless society by 2023. Only about 10-15 per cent of point-of-sale purchases by households are made using cash and many merchants no longer accept it at all. The same can be said of China – those who use notes and coins are mostly tourists.

That said, there are a few notable outliers among the developed nations that remain highly cash-centric, such as Germany and Japan. About 80 per cent of German household point-of-sale purchases are still made using cash. In Japan, the largest coin is worth 500 yen (about US$5), meaning residents have little choice but to lug around pieces of metal. It should be said, however, that the attachment to physical funds in these countries could possibly reflect their recent traumatic past rather than an inability to embrace new technology.

Common challenges

Still, despite these variations across jurisdictions, all online payment businesses across the globe face common challenges. One is disappearing geographical boundaries, which brings opportunities but also more convoluted tax issues. Another is the increasingly real-time nature of society. Satisfying the on-demand needs of consumers creates more intense pressure on hardware infrastructure, which also means much greater opportunity costs for any downtime.

Then there are switching fees. Even if moving to a newer and more efficient service provider may realise significant savings in the long run, stakeholders in the ecosystem may still be unwilling to bear the upfront charges. This is especially true for companies beholden to public shareholders, which often results in an incentive system skewed towards the short-term – always focused on the next quarterly earnings report.

> It is only with the advent of 4G mobile communication, coupled with the simultaneous proliferation of smartphones, that the online payments business model has come to the fore. Companies in this space need no longer rely on the legacy structure of credit card vendors, conventional retail banks, or even desktop computers.

Finally, there's the challenge of security. While encryption technology is improving by leaps and bounds, so is the hacking capability of criminals. And in a world where many proclaim that "data is the new oil", the issue of privacy and the potential theft of sensitive information are significant issues that the industry faces.

Cashless is worth trillions

Physical cash may be falling by the wayside, but the amount of money flowing through a myriad digital channels continues to increase. Total worldwide digital payments by consumers alone (excluding business-to-business) reached US$4.1 trillion in 2019, and is estimated to hit US$6.7 trillion by 2023, equating to a compound annual growth rate of about 12.8 per cent.

This impressive growth rate highlights the upside of the non-uniformity of the cashless trend – there are still many lucrative untapped markets remaining. Against this background, let's move on to a systematic framework for analysing both the high-level aspects and the nitty-gritty of the online payment business.

Niching down

Online payment is a term encompassing many different subcategories. As such, step one is to determine what specific products and services a company provides. See if the business is a payment gateway, digital wallet, mobile app, or a combination. Then, ask yourself what this service enables – is it for firms to accept online payments, for domestic and international funds transfer, or something else entirely?

Answering this question will help you ascertain the company's revenue model. In other words, who exactly is paying the company and for what are the fees for?

Fees are the most common revenue model in the industry, whether it is for transferring monies or enabling digital payments (such as e-wallets). Discover if the company is offering its services directly to end-users, or if it plays a more intermediate function. It may also be licensing its products as white-label offerings to third parties.

Understanding demand drivers

Next, probe the market structure. There are certain areas which can serve as demand proxies for a company's services, so it's worth taking stock of their numbers. For instance, if the firm is a digital wallet, then the size of the retail space is something you would need to study – make sure you also research the size and share of its e-commerce activities. If the company is dealing with transfers, then the proxy would be the remittance and fund transfers markets – review the proportion of online and electronic transfers and break it down by both transaction volume and value.

Sometimes, demand drivers aren't so evident. You'll have to dig a little deeper to uncover something a little less obvious. One example is the prevalence of online bill payments. It's a seemingly minor thing that doesn't jump immediately to mind but could have huge effects on a country's online payments ecosystem.

The competitive landscape

Now, it's time to scope out the competition. The online payments ecosystem, being so related to the technology sphere, can be brutally Darwinian – weak companies don't last long, and oligopolistic "winner takes all" scenarios are common.

So, the first question is, are there any entrenched incumbents and is that company one of them? Examine the market share of the various players by the number of merchants and consumers using their services, and also look at whether consumers tend to use multiple competing services.

Then, scrutinise barriers to entry. Often regulations will prove to be the highest hurdle against new entrants – investigate the licences and approvals required. Capital requirements (which may also be tied to regulations) are another.

Finally, in an industry where offerings tend to be almost homogeneous, you should identify any competitive advantages or points of differentiation a company might have. This could range from fee structure and ease of signing-up to merchant partnerships and interoperability with the primary payment networks and intermediaries such as SWIFT and Visa. Analyse how this aligns with the firm's customer acquisition strategy. Essentially, the question you want to answer is: What makes a merchant or consumer choose the company's services over the competition?

Analysing finances and operations

Start with the usual suspects of financial analysis, such as revenue, Ebitda, and margins. Break this down by types of services, markets, and end-users, and contrast them against the firm's user numbers and transaction volume. How do the company's margins shift in accordance with its user and transaction volume? Single out the main margin drivers – are they the number of merchants, transaction frequency or size?

Move on to its cost structure. What are its capital expenditures and infrastructure outlays? If the company does not own the payment infrastructure, how is it being charged for riding on third-party infrastructure? Pay attention to the ratio between its fixed and variable costs. Next is customer acquisition - which is paramount, but can also be expensive. Delve into the marketing and promotional strategies and uncover what kind of return it is generating especially in relation to its peers.

On the operational front, go beyond a scrutiny of top-line transactions and customer volume and explore the growth rates of its gross transaction volume (GTV) and gross merchandise value (GMV). Probe usage frequency and per transaction value trends – what picture does this paint of the company's customer stickiness? Compare the percentage of its active and inactive user base to gain insights into the firm's retention strategy, and how it is using data analytics to improve it. Lastly, evaluate how the business designs the fee structure for its different types of customers and how it stacks up against the competition?

Gauging long-term prospects

The trend is clear, and the future of online payments is bright. But this broader outlook doesn't necessarily translate to that for the individual companies, especially given the competitive nature of the industry.

To better assess the long-term growth prospects of a firm, look at which markets it is planning to expand in. Is it a saturated space where cashless payments are already the norm? Study the larger factors that affect a market's potential, such as per-capita consumption, working-age population, and the penetration levels of smartphones, Internet, and financial products.

Invest in what you already use

Online payments aren't going anywhere – they're only going to become more prevalent. Use this framework as a starting point for further analysis of this growing industry. You already use these services, so why not move from being a mere customer to an investor as well?

Alan Lok, CFA, is the director, Society Advocacy Engagement, of CFA Institute. Mr Lok researches and writes on investor-protection issues and capital-market structure.
Eunice Chu is an ACCA-qualified finance professional. She was a regional finance director of a Fortune 500 multinational corporation and presently heads the policy function of ACCA Hong Kong.
Guruprasad Jambunathan, FRM, is a director for Financial Research at CRISIL, a global analytical company. He has over 12 years of experience in equity research and works closely with a broad clientele of buy-side and sell-side firms, as well as with academic think tanks across various continents.

This column is an excerpt from the joint research by CFA Institute, Association of Chartered Certified Accountants (ACCA) and CRISIL, entitled "Sector Analysis: An Investors Framework". The excerpt is printed here with permission from the three organisations. A full version of the research will be published on CFA Institute Asia-Pacific Research Exchange at www.ARX.cfa

GOLD REPORT

By Benjamin Lu

Gold supported over lacklustre economic data

A weekly market summary for gold, Oct 14-18

SOFTER geopolitical overtones from a preliminary US-China trade deal and signs of progress in the EU-UK divorce deal has limited upside gains for safe haven assets. Lacklustre global economic data has kept global risk appetites measured however, as investors deliberate looming downside risks. The world's second largest economy has indicated growing signs of weakness as Chinese GDP results (3Q) declined to the lowest in 27 years (6 per cent). Gold prices, though softening from six-year highs, will stay vigorous over mounting economic challenges and geopolitical uncertainties in the current term.

What should investors look out for in the longer term?

Weaker-than-expected economic releases have capped bullish gains for riskier assets as investors contemplate mounting economic challenges (4Q). A lack of clarity in the US-China partial trade deal along with political friction between both countries will keep bullion appeal strong over looming market uncertainties. The US Federal Reserve is widely expected to cut interest rates by 25 bps to support economic expansionary activities amid growing market risks. Gold prices, though cooling off from a strong bullish momentum in 3Q, will retain strength over subdued global growth and monetary policy-easing programmes by global central banks.

Technical Analysis for Spot Gold (XAUUSD)

The precious metal continues to illustrate range-trading activities as market forces remain irresolute on its price trajectory. Gold prices, though easing up on bullish gains from 2019 highs (US$1,557.00), remain supported at key technical levels (50.0 per cent Fibonacci Retracement). Gold bulls must break above US$1,500.00 and US$1,515.00 by extension for a resumption of the positive trend scenario. Failure to consolidate gains above the key psychological level of US$1,500.00 will afflict gold prices with negative bias for the near term.

Weekly Market Assessment:
Range-Bound
Key Resistance Level (1): US$1,515.00
Key Resistance Level (2): US$1,500.00
Key Support Level (1): US$1,480.00
Key Support Level (2): US$1,472.00

The writer is an investment analyst at Phillip Futures.