

The Impact of Digital P2P Payments on Community-Based Financial Institutions

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Introduction

Faced with downward pressure on revenue and inefficiencies in their payments infrastructure, many mid-size financial institutions are embarking on payments modernization efforts—with person-to-person (P2P) payments being a critical component of their strategies.

How will this payments modernization impact consumers and small businesses and what are their perspectives on this? To answer those questions, in Q1 2022 Cornerstone Advisors surveyed 3,112 U.S. consumers (a sample representative of the U.S. adult population in terms of age, gender, and race) to understand:

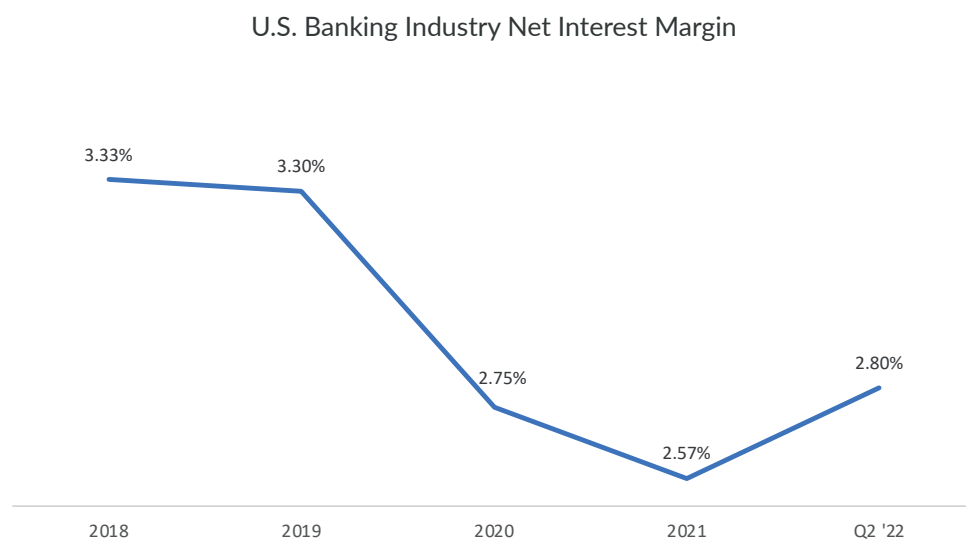
- ▶ **The impact of person-to-person (P2P) payments during and after the pandemic.** The study will explore whether consumers plan to continue to use P2P payments as frequently as they do now after the pandemic.
- ▶ **The drivers of P2P payments use.** What drives consumers' decisions to use one P2P payment app or tool over another? How important is security and speed versus social media in driving consumers' choice of P2P payment tools?
- ▶ **The benefits of faster payments.** Faster payments make it possible for consumers to send and receive payments more quickly and improve cash flow management.
- ▶ **Small business benefits from P2P payments.** To better compete with fintech and Big Tech firms that increasingly provide payments and lending services to small businesses, banks must embed their services into small businesses' value chains. The study will explore small business owners' perspectives on the potential benefits of this integration.

In addition, Cornerstone interviewed executives from community-based financial institutions to understand the extent to which they risk being disintermediated—from a payments, lending, and deposit perspective—because of digital payment trends.

The New Payment Realities in Banking

With 2022's rise in interest rates, the U.S. banking industry is seeing some positive results, as net interest margin (NIM) in Q2 2022 grew 26 basis points year-over-year to 2.80%. Nonetheless, NIM was still below the pre-pandemic average of 3.25% (Figure 1). Despite that positive news, Q2 2022 earnings were down 8.5% year-over-year.

Figure 1: U.S. Banking Industry Net Interest Margin



Source: S&P Global

The Proliferation in Payment Methods

Overall, revenue outlooks have been cautious and core profitability will likely remain pressured relative to pre-pandemic levels according to Fitch Ratings. This revenue recession is occurring on several fronts, with one of the most important areas being payments revenue, impacted by:

- **Mobile payments.** The growth of mobile apps providers like PayPal and Square's Cash App has created additional competition for traditional financial institutions. Since the start of the pandemic in 2020, PayPal has added 126 million new customers.¹ Cash App, meanwhile, has grown from 24 million users in 2019 to 44 million in 2022, as its revenue has increased from \$1.1 billion in 2019 to \$5.1 billion in just the first half of 2022.²
- **Merchant mobile apps.** According to Cornerstone's research, three-quarters of smartphone owners have at least one merchant's mobile app on their device. In total, roughly \$3.2 billion moves in and out of the 10 leading merchants' mobile apps every week.

- ▶ **Buy now, pay later.** Americans made \$100 billion worth of retail purchases using buy now, pay later (BNPL) services in 2021. Among BNPL users, 80% have at least one credit card—meaning that the choice to use a BNPL service creates additional competition for debit and credit card use, reducing interchange revenue for banks and credit card issuers.
- ▶ **Cryptocurrencies.** Despite the decline in cryptocurrency prices in the first quarter of 2021, PYMNTS.com reported that crypto's use for in-store purchases is growing. This was backed up by NCR, which said that although cryptocurrency adoption is still in its infancy, it is “growing rapidly as awareness and acceptance expands.”³

Payments Modernization is About Revenue, Not Just Technology

To the extent that community-based financial institutions are looking to modernize their payments stack, many aren't looking at it from the right perspective—the revenue perspective. According to McKinsey:⁴

“New revenue streams will be the primary source of return on investment in a modernized payments infrastructure.”

McKinsey identified five payments modernization-driven revenue streams for banks in both consumer and commercial payments:

- ▶ **Person-to-microbusiness payments.** Most innovation in the person-to-microbusiness arena has been on the front end, with products that make it easier for microbusinesses and small businesses to accept payments (e.g., Square and PayPal card readers). A faster back-end infrastructure would further improve the convenience of these apps. For example, in a used car sale today, a buyer usually gives the seller a check or sends a costly wire transfer. Faster-payments infrastructure will enable car buyers to send a real-time payment to the car seller on the spot and drive away in a car without the risk of a bounced check or a cash theft, and without the cost of a wire.
- ▶ **Consumer bill payments.** A real-time infrastructure combined with a ubiquitous merchant biller directory—integrated into mobile banking apps—could create a frictionless bill-payment experience involving push notifications and real-time confirmation of payment receipt. Consumers would have more control over their cash flow, a less costly and more convenient way to pay bills, and more certainty when making “consequence” payments (e.g., payments to restart a suspended utility service). The revenue opportunity here is significant, as bill payment touches every household. In the U.S., more than 15 billion bills are paid each year.⁵
- ▶ **Commercial just-in-time payments.** Real-time payments allow businesses to control when payments are made and to increase their certainty. Real-time payments are most salient for one-time, lower-value, business-to-business payments, which account for an estimated \$11 billion in payments volume in the U.S. For small businesses that need to tightly manage cash flow, faster clearing with real-time notification of payment offers a way to avoid late payments and adopt just-in-time business models. In addition, real-time payments create an opportunity for corporate customers to manage their intra-day liquidity more closely, enabling banks to generate additional revenue by offering liquidity management services such as intra-day loans or overdraft protection.

- ▶ **Direct deposit for temporary and hourly workers.** In the U.S., the current ACH Direct Deposit system requires a transaction to be initiated at least 24 hours in advance. Consequently, many businesses have drifted away from direct deposit toward prepaid cards. A faster payments system would allow more businesses to pay weekly workers through direct deposit. Given that 17% of workers in the U.S. are temporary employees, the potential savings in prepaid card processing expenses for employers is significant.
- ▶ **Automated e-invoicing solutions.** Enhancements to payments clearing systems could allow for new remittance data solutions that digitize the back office for businesses. While payments system modernization is not essential for e-invoicing, it can be a catalyst for improved business-to-business e-invoicing solutions. Converting invoices from paper to electronic yields a cost savings of up to about 70% per invoice; the value of automated invoicing, then, is indeed significant.⁶

The Coming Focus on Faster Payments

To meet these challenges, community-based financial institutions have launched digital transformation initiatives but have seen mixed results. Few, however, have produced gains in payments-related revenue.

Meanwhile, with the increased adoption of faster payments capabilities from a variety of vendors and the upcoming launch of FedNow from the Federal Reserve, financial institutions are scrambling to figure out the impact of faster payments on the industry—and their own organizations.

The topic of “faster payments” is hardly new. The Clearing House (TCH) launched the RTP® network in November 2017. According to TCH’s website:

“Today the RTP network’s real-time payment capabilities are accessible to financial institutions that hold 73% of U.S. demand deposit accounts (DDAs), and the network currently reaches 60% of U.S. DDAs.”

No doubt, that’s a true statement. But the percentage of payments in the U.S. that are “faster payment” transactions is probably in the single digits.

While many of the largest banks in the United States are in TCH’s RTP network, most small and mid-size banks and credit unions aren’t. According to Cornerstone Advisors’ What’s Going On In Banking 2022 study, 15% of mid-size financial institutions have already deployed real-time payments, with 28% expecting to launch in 2022, and another 26% planning to launch in 2023 (many of which are waiting for FedNow).

How will financial institutions go about deploying RTP? Many don’t know yet—37% of banks and 42% of credit unions said they haven’t determined their RTP strategy. About a quarter of banks and one in five credit unions say they’ll wait for FedNow to deploy before rolling out real-time payments (Table A).

Table A: Real-time Payments Approach

Which statement best describes your organization’s approach to providing RTP? (select all that apply)		
	Banks	Credit Unions
We haven’t determined our RTP strategy	37%	42%
We will wait for FedNow to deploy	27%	21%
We will deploy both The Clearing House and FedNow	18%	6%
We have deployed The Clearing House’s solution	7%	6%
We have already deployed another vendor’s solution	7%	10%
We plan to deploy The Clearing House’s solution	2%	4%
We plan to deploy another vendor’s solution	2%	11%

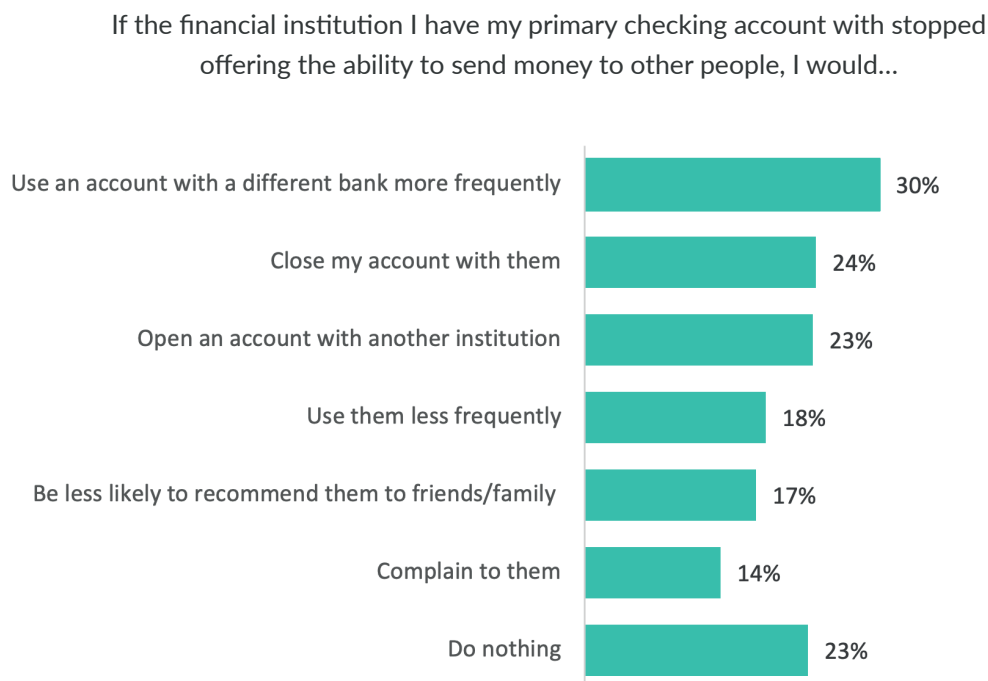
Source: Cornerstone Advisors survey of 300 community-based financial institutions, Q4 2021

Consumer Use of P2P Payments

Among consumers with a checking account, six in 10 send money to other people using a payment service like Zelle® or from their primary checking account provider's website.

This capability is critical to consumers. Roughly three quarters of them said that if their primary checking account provider stopped offering P2P payments capabilities, they would take action. What would they do? The most popular actions were using an account from a different bank more frequently, closing their existing account, and opening an account with a different institution (Figure 2).

Figure 2: Impact of Discontinuing P2P Payments

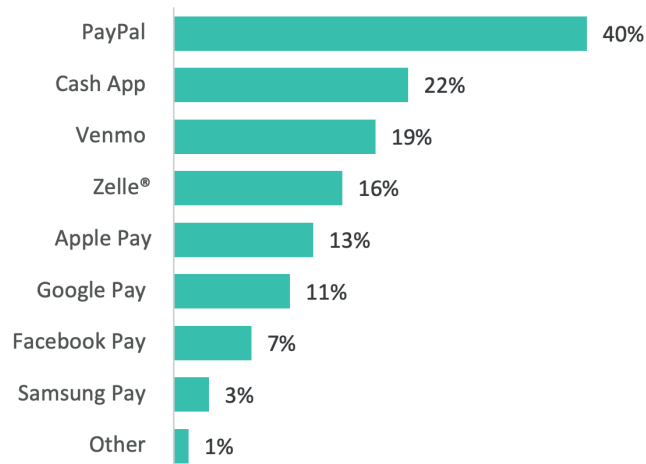


Source: Cornerstone Advisors survey of 3,112 U.S. consumers, Q1 2022

Consumers don't just rely on their checking account provider to make P2P payments. Four in 10 consumers use PayPal to make payments, while roughly one in five uses Square Cash App and/or Venmo (Figure 3).

Figure 3: Use of Non-Bank P2P Payments Tools

Which of the following digital payments tools do you use to send money to other people or businesses? (select all that apply)

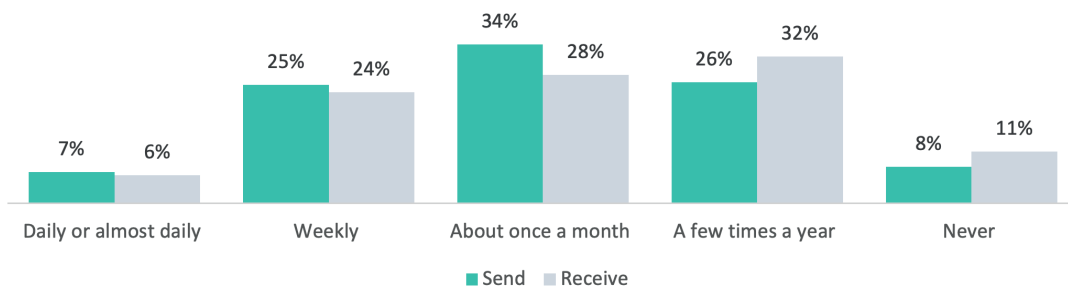


Source: Cornerstone Advisors survey of 3,112 U.S. consumers, Q1 2022

Among consumers who use P2P payments tools, a handful send and receive money on a nearly daily basis with a quarter of them on the sending or receiving side of the transaction every week. All told, two-thirds of P2P users send money through P2P tools at least once a month, and nearly six in 10 receive money (Figure 4).

Figure 4: Frequency of Use of P2P Payments Tools

How frequently do you use digital payments tools to send and receive money?



Source: Cornerstone Advisors survey of 3,112 U.S. consumers, Q1 2022

According to the consumer survey, 15% of P2P users send more than \$500 each month and 17% say they receive more than \$500 each month using digital payments tools (Table B). Data from the major P2P providers indicate that the average transaction size for Venmo transfers is about \$60, with Zelle® transactions averaging close to \$300.⁷

Table B: Monthly Amount Sent and Received Through P2P

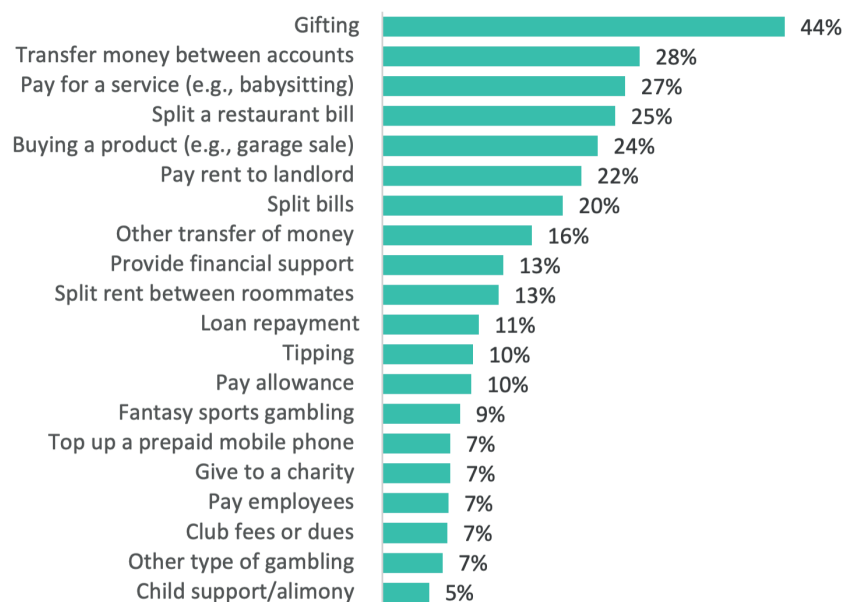
Approximately how much money do you send and receive using digital payments tools each month?		
	Send	Receive
Less than \$50	22%	21%
\$50 – \$100	28%	26%
\$100 – \$250	20%	22%
\$250 – \$500	16%	15%
\$500 – \$1,000	9%	9%
\$1,000 – \$2,500	4%	4%
\$2,500 – \$5,000	1%	2%
More than \$5,000	1%	2%

Source: Cornerstone Advisors survey of 3,112 U.S. consumers, Q1 2022

Why are they using P2P payments tools? Gifting is the most popular use case, with 44% of users sending funds electronically in the past year. Other popular uses include paying a babysitter, splitting a restaurant check, paying rent, and buying something from someone else (Figure 5).

Figure 5: P2P Payments Use Cases

In the past year, what did you use digital payments tools to send money for?
(select all that apply)



Source: Cornerstone Advisors survey of 3,112 U.S. consumers, Q1 2022

What new feature would P2P users most like to see? Transacting without the other having to create an account with the selected P2P payments tool was mentioned by 19% of respondents, followed by international payments, and the ability to make eCommerce purchases using digital P2P tools (Figure 6).

Figure 6: Interest in New P2P Payments Features

Which feature would be most useful to you if it was added to the mobile banking or digital payments apps that you already use?



Source: Cornerstone Advisors survey of 3,112 U.S. consumers, Q1 2022

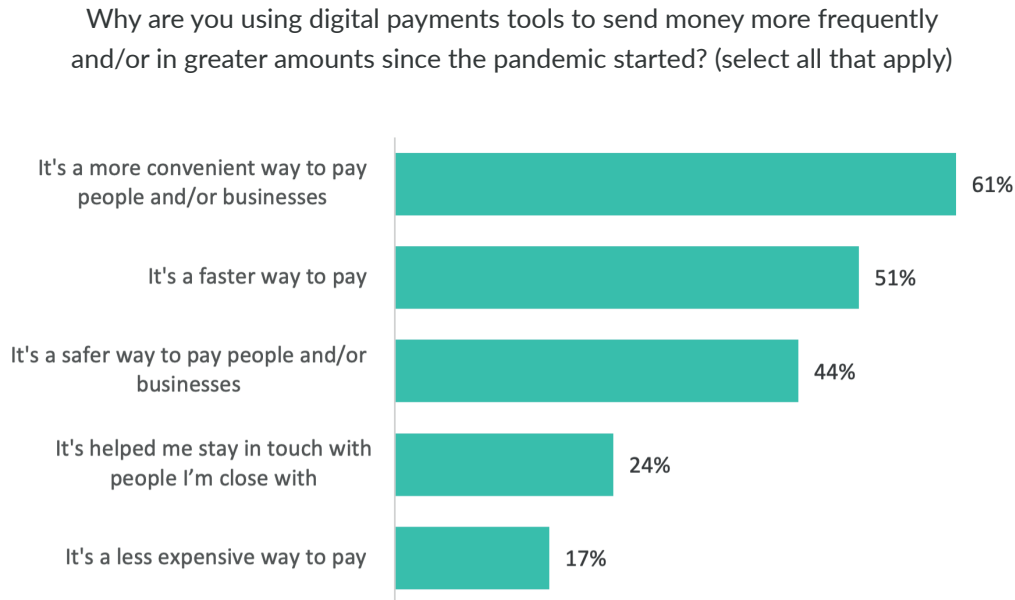
THE PANDEMIC'S IMPACT ON P2P USE

Many consumers reported that the pandemic impacted their use of P2P payments tools, specifically regarding:

- ▶ **Frequency of use.** A little more than half (56%) of P2P payments users said that, since March 2020, they send money using digital payments tools more frequently than they did before the pandemic. Just 16% said they send money less frequently than pre-pandemic.
- ▶ **Dollar volume.** One-third of P2P users report sending larger amounts of money using P2P payments tools since the start of the pandemic, in contrast to the 23% who said they're sending smaller amounts of money.

Why the change in use of P2P tools since the start of the pandemic? Convenience is the most frequently cited reason (by six in 10 P2P users), followed by payment speed, and security (Figure 7).

Figure 7: Reasons for Increased Use of P2P Payments Tools Since the Start of the Pandemic



Source: Cornerstone Advisors survey of 3,112 U.S. consumers, Q1 2022

P2P Payment Fraud

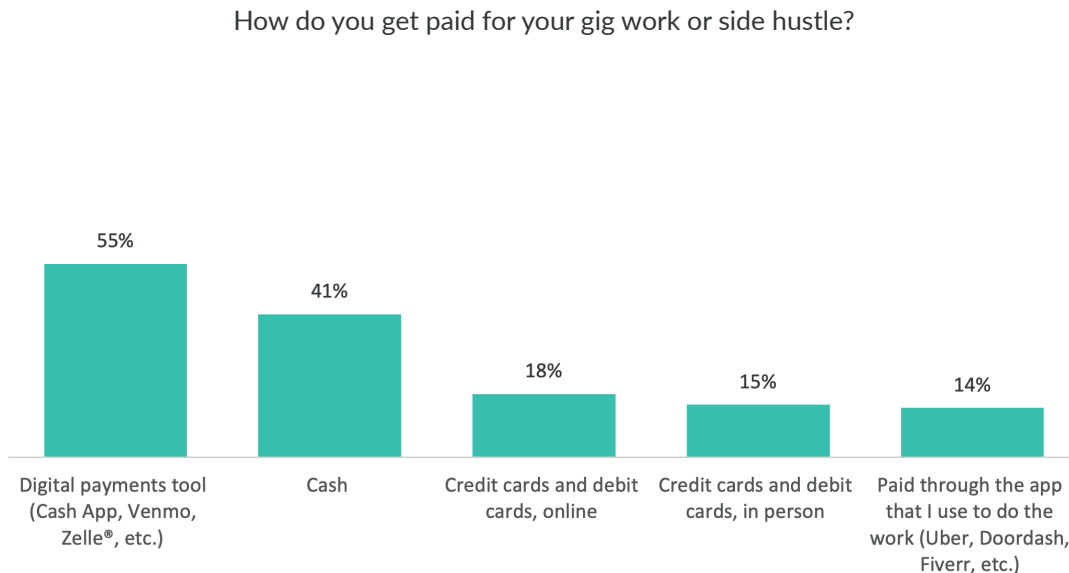
Payment-related fraud is a top-of-mind concern for many consumers. One in four P2P payments users said they have been a victim of fraud or scams involving digital payments. More than seven in 10 respondents impacted by digital payment fraud or scams said the incident (or incidents) was resolved to their satisfaction by their bank or the digital payments provider.

Gig Workers and Digital Payments

A growing number of consumers don't have traditional employment situations and work "gigs" or have "side hustles." Among the respondents to the Cornerstone study, 36% said that in addition to their full-time job, they earn extra income through freelance work, gigs, or a side hustle.

Digital payments are critical to gig workers and those with side businesses. More than half of them get paid with digital payments tools like Cash App, Venmo, and Zelle® (Figure 8).

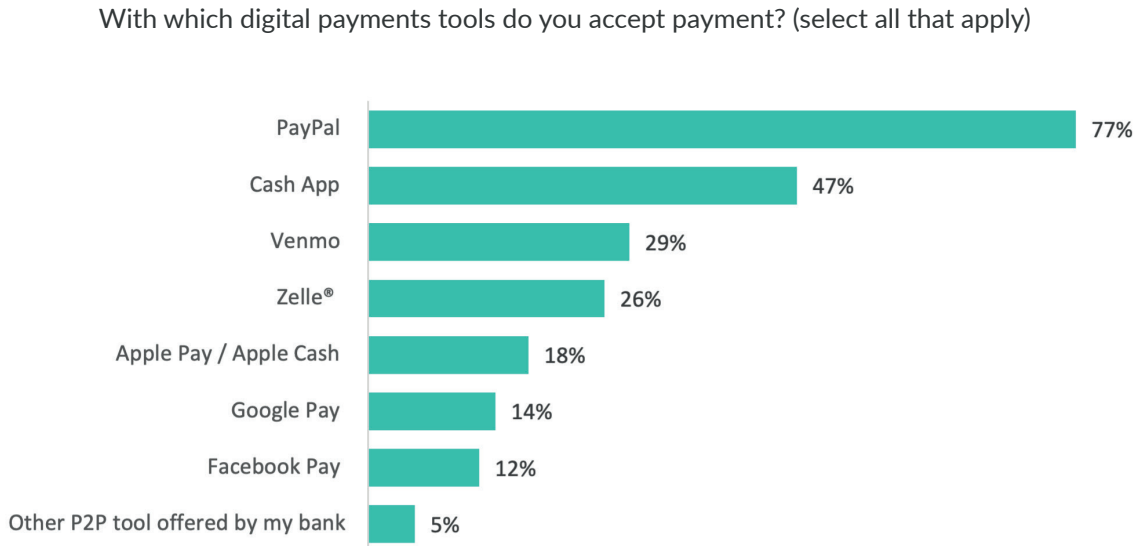
Figure 8: Types of Payments Accepted for Gig Work and Side Hustles



Source: Cornerstone Advisors survey of 3,112 U.S. consumers, Q1 2022

Among the gig workers and side hustlers who accept digital payments, PayPal is the most frequently accepted digital payment method, used by more than three-quarters of gig workers and side hustlers. Cash App is the second most popular digital payment method, followed by Venmo and Zelle® (Figure 9).

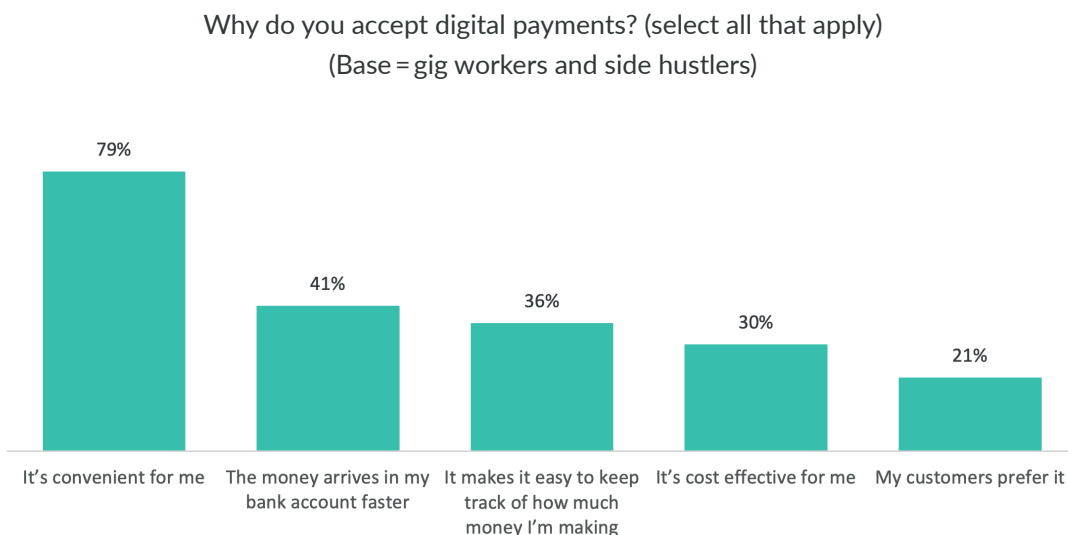
Figure 9: Digital Payments Tools Accepted by Gig Workers and Side Hustlers



Source: Cornerstone Advisors survey of 3,112 U.S. consumers, Q1 2022

Convenience—as always—is the number one reason why gig workers and side hustlers accept digital payments, but many cited faster payments and ease of tracking as important reasons as well (Figure 10).

Figure 10: Reasons Why Gig Workers and Side Hustlers Accept Digital Payments

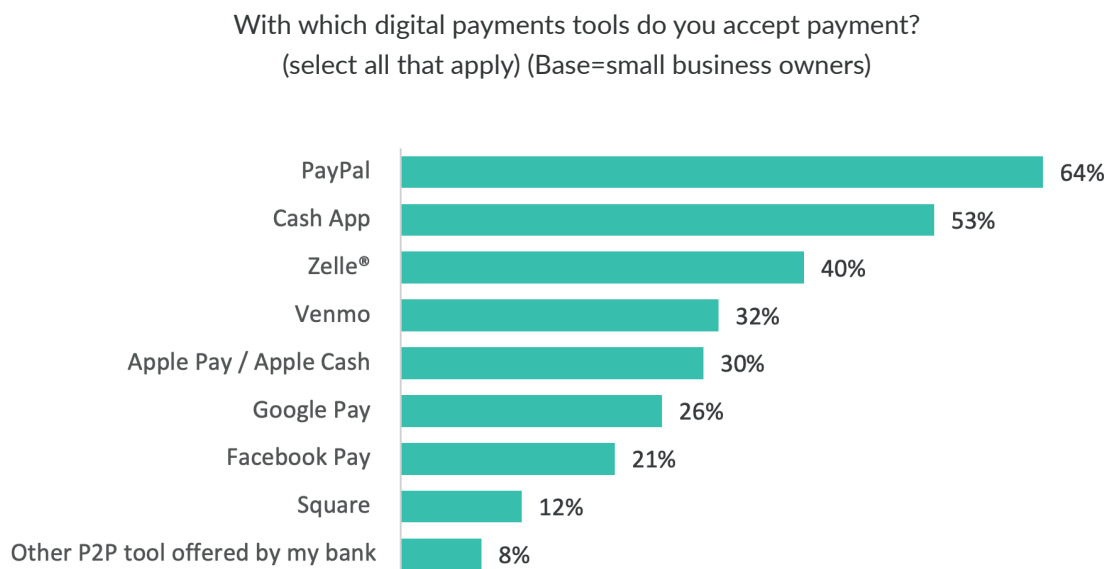


Source: Cornerstone Advisors survey of 3,112 U.S. consumers, Q1 2022

Small Businesses and Digital Payments

Among survey respondents, 16% identified themselves as small business owners. Nearly eight in 10 generate less than \$500,000 in annual revenue and three quarters employ 10 or fewer people. As with gig workers, digital payments are critical to small businesses with 80% accepting digital payments. More than half of them get paid with digital payments tools like Cash App, Venmo, and Zelle® (Figure 11).

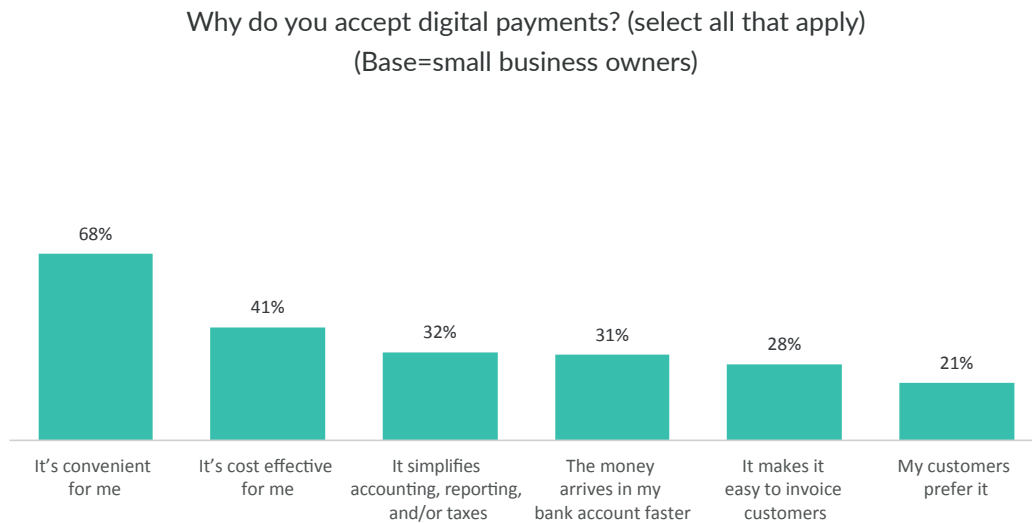
Figure 11: Digital Payments Tools Accepted by Small Businesses



Source: Cornerstone Advisors survey of 3,112 U.S. consumers, Q1 2022

Convenience—again—is the number one reason why small businesses accept digital payments, followed by cost effectiveness, simplified accounting, and faster payments (Figure 12).

Figure 12: Reasons Why Small Businesses Accept Digital Payments



Source: Cornerstone Advisors survey of 3,112 U.S. consumers, Q1 2022

Conclusions

Community-based financial institutions must rejuvenate (or revive) their payments strategies which will require the modernization of their payments infrastructure. Digital P2P payments will be a critical component of this modernization effort. According to Eric Sprink, CEO, Coastal Community Bank:

“When it comes to payments, one word is key for the customer—SIMPLICITY. To offer this at the point of consumption, banks have the immediate imperative to overhaul the payment engines that are the money moving wheels. Banks need a fresh strategic approach, rather than a reactive tactical response, to be a strong player in the new financial ecosystem.”

According to Cornerstone’s research, nearly 30% of community-based financial institutions have replaced or selected a new P2P payments application—often choosing Zelle®—in the past three years, and roughly one in five intended to replace their existing P2P payments system in 2022. P2P is becoming the heart of financial institutions’ payments strategies because:

- ▶ **P2P use encompasses all demographics.** According to Cornerstone’s consumer study, six in 10 Gen Xers (ages 42 to 57) and four in ten Baby Boomers (ages 58 to 76) are sending money electronically to their friends, family, and other parties who accept P2P payment transfers.
- ▶ **Consumer and small business lines are blurred.** According to Lou Anne Alexander, former group president of payments at Early Warning Services: “There are 28.8 million small businesses in the U.S., and only 20% of them have another employee. You might think of them as individual professional contractors, but they have some of the same needs, like to cut an invoice. The convenience offered by payment tools like Zelle® to send a request for money works.”⁸

Endnotes

¹ www.forbes.com/sites/jeffkaufman/2022/02/02/paypal-admits-45-million-accounts-were-illegitimate-as-fintechs-fraud-problem-grows/

² www.businessofapps.com/data/cash-app-statistics/

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⁸ independentbanker.org/2019/08/3-reasons-to-put-p2p-at-the-heart-of-your-payments-strategy

About the Author

As its chief research officer, Ron Shevlin heads up Cornerstone Advisors' fintech research efforts and authors many of the firm's studies. He has been a management consultant for more than 30 years, working with leading financial services, consumer products, retail, and manufacturing firms worldwide. Prior to joining Cornerstone, Shevlin was a researcher and consultant for Aite Group, Forrester Research, and KPMG. Author of the Fintech Snark Tank blog on Forbes, Shevlin is ranked among the top fintech influencers globally and is a frequent keynote speaker at banking and fintech industry events.



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About Cornerstone Advisors

After 20 years in this business, Cornerstone Advisors knows the financial services industry inside and out. We know that when banks and credit unions improve their strategies, technologies and operations, improved financial performance naturally follows. We live by the philosophy that you can't improve what you don't measure. With laser-focused measurement, financial institutions can develop more meaningful business strategies, make smarter technology decisions, and strategically reengineer critical processes.



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About Early Warning Services

Early Warning Services, LLC is a fintech company owned by seven of the country's largest banks. For almost three decades, our identity and payment solutions have been empowering financial institutions to make confident decisions, enable payments and mitigate fraud. Today, Early Warning is best known as the owner and operator of the Zelle Network®, a financial services network focused on transforming payment experiences. The combination of Early Warning's risk and payment solutions enables the financial services industry to move money fast, safe, and easy, so that people can live their best financial lives.

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