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Crypto Payments & Infrastructure: The Strategic Opportunity

PART I: WHY CRYPTO PAYMENTS?

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Why Crypto Payments?

As we prepare for Stablecon this week, crypto payments are high in mind. Stablecoins have captured mindshare, and will undoubtedly play an important role, however, the topic of crypto payments is far more nuanced than only stablecoins.

Architect Partners' formative experience around crypto payments and stablecoins was in late 2021 when we served as exclusive advisor to the Diem Project in its sale to Silvergate Bank. We return to the founding vision of crypto.

> **A purely peer-to-peer version of electronic cash would allow online payments to be sent directly from one party to another without going through a financial institution.**
>
> Satoshi Nakamoto,
> Bitcoin Whitepaper

Over the next few weeks, we will be sharing a step-by-step build of thoughts, observations, and data about the strategic opportunity for crypto payments. Stablecoins will certainly play a role, however, they are merely one piece of a complex ecosystem that must exist to allow crypto payments to scale.

Our first installment explores the problems inherent with existing payments and why crypto may be an elegant solution to these persistent issues.

The Symptoms of Payment Ills Are Widely Recognized

The symptoms of the problem are both visible while hidden at the time. Businesses tend to be acutely aware of the true cost of the simple act of payment while the average consumer is unaware. Several symptoms are present.

EXPENSIVE

Today making a payment imposes significant direct, yet often overlooked costs, on businesses and consumers across the globe.

McKinsey & Company estimate these direct costs at $2.4 trillion, the equivalent to 2.3% of global GDP, in 2023.

Certainly, some of these costs are necessary, however are there opportunities for meaningful cost reduction?

$2.4
TRILLION

COSTLY TRAPPED WORKING CAPITAL

An even less visible burden is the direct cost of maintaining cash balances for working capital purposes. Today's inherently slow invoice / pay / settle system necessitates substantial cash reserves to meet working capital needs. The cost to maintain cash reserves approaches, or may even exceed, the direct fees highlighted above.

On the low end, The Hackett Group estimates that businesses hold 12% of revenue in cash globally, totaling $12.6 trillion. The forgone interest earnings on that cash represents $500 billion, assuming a 4% yield.

McKinsey estimates the total value of transactions were $1.8 quadrillion in 2023. If the average cash collection cycle is 10 days, that represents $2 trillion in forgone interest earnings.

$500
BILLION
TO
$2
TRILLION

SLOW AND INCONVENIENT FOR MANY

Slow payment settlement is also a common theme, both for businesses as well as for consumers. Cross border payments are particularly problematic here.

However, these challenges, and others, are merely symptoms of more fundamental problems.

> **“Cross border payments can take multiple days to clear and settle, creating delays and uncertainty for businesses.”**
>
> McKinsey

Far More Fundamental Issues Are the Root Problem

The modern era of payments arguably began 30 years ago with the advent of online payment systems like First Virtual Holding, CyberCash, Authorize.net, and later PayPal.

Over time, a group of “shadow”, non-bank, payment businesses emerged, more recently designed with mobile-first use cases in mind. These include prominent innovators such as PayPal, Venmo, Square, Wise, Alipay, WeChat Pay, M-PESA, and many others. While certainly impressive, this innovation largely addressed the emergence of two new payment user interfaces, the computer and more recently, the mobile phone.

Relatively little innovation has addressed the core ills underlying the symptoms highlighted above. These foundational elements of payments have changed little in the past 30 years and underlie the longstanding, persistent issues.

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FRACTURED STANDARDS

The payment industry has struggled to adopt globally accepted open standards. Standards are a fundamental necessity to build upon and have proven time and again to be critical to unleash innovation and global capabilities. What are now common services, such as the Internet, email, streaming video, wireless communications, and even earlier systems like television and radio, all required and thrived on such standards.

Payments, however, remain a mosaic of standards, often country or region-specific and rarely interoperable. Fragmentation is the defining characteristic of today's payment landscape. A multitude of competing standards makes cross-platform payments unfeasible and cross-border transactions cumbersome.

STANDARD	COUNTRY
ACH	US
FedNow	US
SWIFT	Cross-Border
PIX	Brazil
SPEI	Mexico
Transferencia 3.0	Argentina
M-PESA	Africa
NIBS	Nigeria
SEPA	Europe
TARGET2	Europe
TIPS	Europe
UPI	India
NEFT	India
CHAPS	United Kingdom
BBPS	India
Alipay	China
WeChat	China
UnionPay	China
E-CNY	China
ISO 20022	Cross-Border

INNOVATORS DILEMMA

Traditional banks and payment service providers further complicate the issue by prioritizing the protection of their existing business models over fostering innovation. Even if motivated, innovation is far often led by the disruptive new entrant.

> **“The reason why it is so difficult for existing firms to capitalize on disruptive innovations is that their processes and their business model that make them good at the existing business actually make them bad at competing for the disruption.”**
>
> Clayton Christensen Author,
> *The Innovator’s Dilemma*

DUPLICATIVE AND OLD CORE BANKING TECHNOLOGY

Today over 100,000 institutions manage payments across the globe. Each one maintains its own proprietary infrastructure to manage the inflows, outflows and balances. In essence, 10,000 “sources of truth.”

In addition, the technology underpinning the global banking and payment systems is many decades old, patched together over time (often due to acquisitions), and very expensive to maintain. According to Gartner, banks typically allocate 67% of their IT budgets to maintaining legacy systems, sapping the funding for innovation.

> **“One large U.S. internationally active financial institution now operates in 400 separate payment systems around the world.”**
>
> Timothy Geithner, Former President of Federal Reserve
> Bank of New York

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Crypto Addresses These Fundamental Problems

Today Crypto delivers on the promise of value transfer, globally, anytime, virtually instantly. The open question is whether these capabilities will become globally accepted for everyday payments by businesses and consumers. These foundational elements include:

GLOBAL STANDARD POTENTIAL

Blockchain allows anyone, anytime, from anywhere, without permission to access and transact with the “source of truth” transaction ledger.

Blockchains such as Bitcoin, Ethereum, Solana and others are seeking to become the standard.

INNOVATORS LEAD

Blockchains such as Bitcoin, Ethereum, Solana and companies such as Circle, Tether, Lightspark, etc. are purpose-built, highly motivated, and incented to reshape global payments, with no existing business to protect and no legacy infrastructure to maintain.

FOCUSED ON INNOVATION OF THE CORE PLATFORM

Open source, public blockchains become the core payments platform. The potential for a single source of truth vs. tens of thousands of independent ledgers.

“The core concept and the fashionable phrase is ‘public blockchains.’ We need public blockchains that anyone can plug into and use. These global trust machines can be used to settle currency transactions, estate transfers, and lots of other use cases.”

“The marginal cost of storing and moving value will go to zero [and] it’s the exact same thing that happened with the internet.”

Jeremy Allaire, Circle

Our upcoming Part II will tackle where crypto payments are showing signals of acceptance and consider just how large an opportunity reshaping global payments may be.

About Architect Partners

Architect Partners is the leading M&A and strategic financing advisory firm serving companies on the front lines of crypto, blockchain, DeFi, fintech, and digital assets.

Architect Partners offers unparalleled senior judgment and expertise, delivering premium-value results for its clients. The Architect Partners team has completed over 350 transactions worth over $30B in value across the globe.

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