

Cannabis In Canada

How Payments Are Shaping
The Future Of Cannabis



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Executive Summary

The payments ecosystem in Canada is becoming disrupted by an unlikely new player: cannabis.

For almost a century, what was once a prohibited substance is now legal for Canadians to use recreationally, with sales expected to skyrocket into the billions within the first year of legalization. Although production is federally regulated, provincial governments have had to decide for themselves on how cannabis will be distributed and to whom it will be distributed.

Different sets of rules and regulations have posed unique challenges and opportunities for the Canadian FinTech industry. On the one hand, there is an opportunity for Canadian FinTech to create compliant, flexible payment models that will work across provinces. On the other hand, finding a banking partner that will support cannabis payments may continue to be a challenge, especially for companies headquartered outside Canada.

Along with opportunities and challenges, a collaboration between the cannabis and financial industries will create new and improved ways to process payments. As many sectors work towards frictionless, real-time payments, the cannabis industry will be no exception. Business and consumer alike will want fast, secure payments across any of their mobile or digital devices. Companies will rely on the data and analytics to better understand this emerging new market.

With the legalization of recreational cannabis comes an excellent opportunity for the Canadian economy as cannabis purchases are now sold through legal channels. This new industry will push innovation in the payment space as providers work towards creating the most seamless payment experience possible.

Ending The Prohibition Of The 21st Century

Setting The Framework For A New Industry

On October 17th, 2018, Canada braced itself for a groundbreaking change. Never before has the world seen a G7 country legalize what was once a classified as an illegal, Schedule 2 drug. The drug goes by many names: cannabis, marijuana, weed, pot; whatever it is called, cannabis and its derivatives will soon be legal for recreational use throughout Canada.

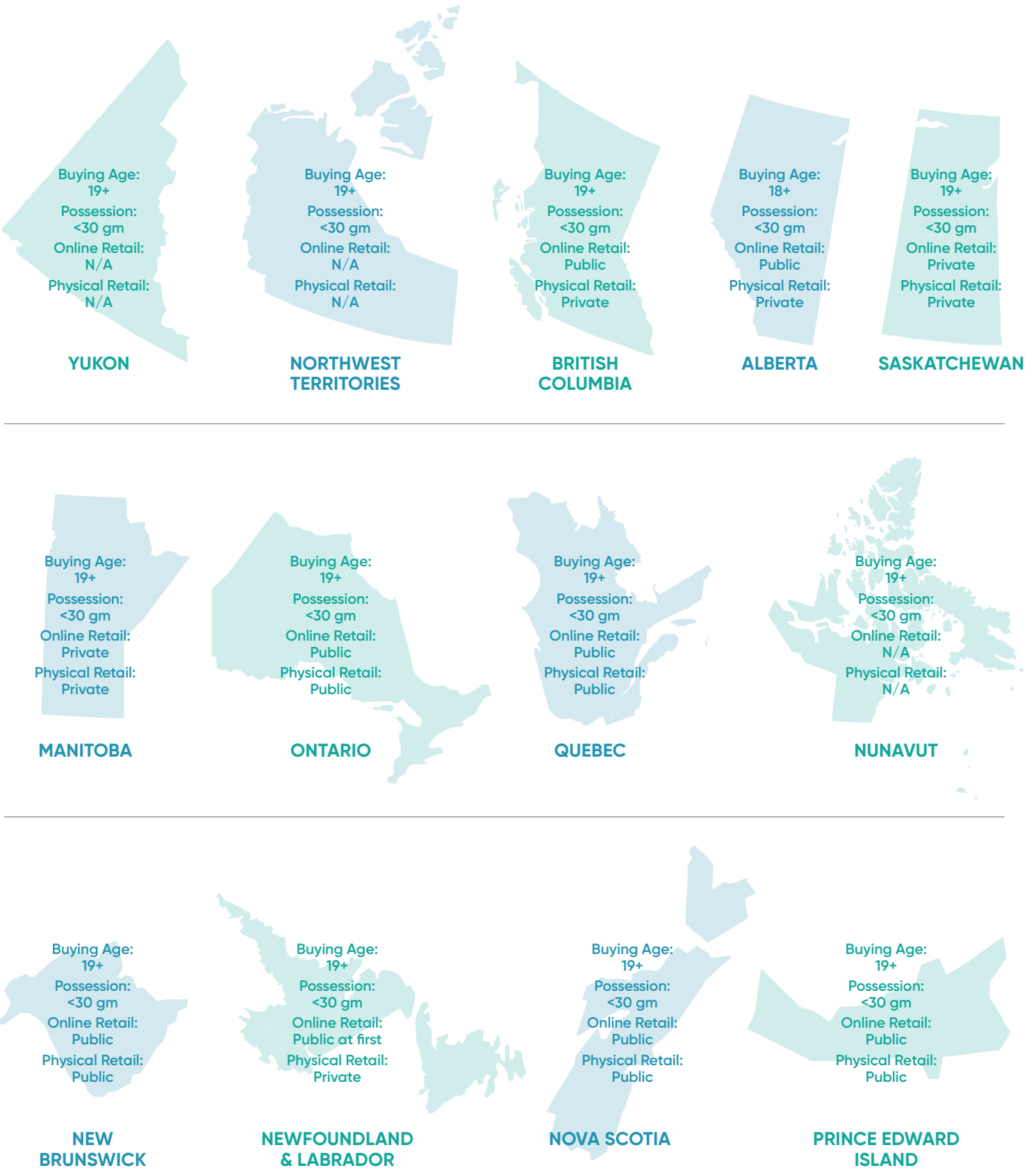
While the passing of Bill C-45, The Cannabis Act, is monumental for many reasons such as increasing revenue for Canada's economy and cutting down on the black market, the implications it has for the financial industry are perhaps the most formidable. The considerations and complexities of bringing an industry such as this out of the shadows and into the forefront is no simple task.

With the Cannabis Act, regulations for this new industry have been put in place to control the production and distribution of recreational cannabis. The federal government has taken on the role of managing the licensing and production of cannabis on a national level, leaving it up to each province to determine how cannabis will be sold and how stores will be operated. The provinces can set restrictions around possession limits, minimum buying age, cannabis use in public, and personal cultivation.

The rules for the production and sale of cannabis are set up federally and provincially, with strict guidelines and enforcement in place to ensure caution and responsibility for cannabis retailers. It is vital that cannabis retailers ensure age and purchase limits are being met, especially when it comes to online sales.



The current [regulatory framework by province](#) looks like this:



Where Payment Processors Fit In

Canadian cannabis sales are expected to exceed **\$7.17B** in 2019 the first year following legalization.

To put that number to context, tobacco products, which have been sold legally in Canada for well over one hundred years, are expected to bring in [\\$19.1b in 2019](#). Because each province has different rules and regulations around cannabis, there is a need for a payment process that can apply across use cases and provinces. Tools such as shopping carts and commerce platforms will need to connect to the payments ecosystem to ensure a smooth transaction flow, and allow for consumers to shop both online and in-store. While most consumers will likely purchase cannabis through a brick and mortar store, roughly one-third of them are expected to purchase [cannabis online](#). For an industry that was traditionally very cash heavy, as there was no regulation for banks to process cannabis transactions, there will be an influx of new payment types to support transactions in a secure manner.

There is plenty of financial opportunity with this new industry, but certainly some barriers. Banks may not want to provide accounts to companies associated with cannabis. Even though it will be legal, recreational cannabis is still seen as a high-risk industry, and there will be a spectrum of financial industry players who will choose to participate or remain on the sidelines.

Challenges For FinTech

While FinTech is innovating new ways for the cannabis industry to make it to the bank, one of the most significant challenges FinTech companies face is finding a banking partner that can support them. This challenge is particularly difficult for multinational banks. Under United States federal law, cannabis is still illegal, and as a result, the country is facing problems processing payments in the few states that have legalized cannabis. Of the states that have legalized it, those operating in the industry are still using cash as the primary payment method, exposing companies to the risk of fraud, error, and theft. Some international processors headquartered outside of Canada could struggle to be able to offer payment services to the Canadian cannabis industry, as this will be listed as a prohibited business.

Most major card brands will allow for consumers to purchase cannabis products in Canada, but they will not provide businesses with direct merchant accounts. This means that businesses will need to work with a payment processor that complies with government regulations through the value chain.

Opportunity For Canadian FinTech

Canada already has a well established medicinal marijuana distribution model in place between the government, licensed producers, and clinics. The payment industry has the chance to build upon this existing distribution framework, developing a compliant and flexible payment solution that allows provinces to build their compliance controls right into the model. This will ensure that the proper amount of cannabis can be purchased safely and securely, and be regulated for possession control in abidance with each of the provinces compliance controls.

Canadian FinTech companies have a unique opportunity to position themselves in this new market as a niche piece to the financial backbone for virtually every transaction that takes place within this realm. Banks will be cautious, leaving a gap that ambitious FinTech players will be quick to fill, granted they can provide the right solution.

Formation Of New Partnerships

Cannabis And The Financial Industry

To create a responsive, automated payments and compliance program that can be applied to any scenario, collaboration will be critical for all players in the cannabis industry, from producers and distributors to retailers and ultimately the consumer. Additionally, this ecosystem will provide cannabis companies with the tools to comply with provincial and federal regulations, helping them avoid potential fines that could arise from a sale that falls outside the federal or provincial law.

In the United States, new types of payment platforms are emerging that allow for legal cannabis B2B companies, such as a supplier and vendor, to pay each other in digital, seamless ways. These platforms offer everything from merchant services to invoicing and deposits via Automated Clearing House (ACH). In Canada, we will likely see this trend continuing, with Electronic Fund Transfers (EFT) between cannabis companies becoming the standard way of transferring funds between accounts. Payment processors that are already proficient in the EFT space in Canada will be an easy choice for emerging cannabis companies looking to make real-time payments. The adoption of real-time payments and ISO 20022 in Canada will save time and resources for companies with its clear and consistent procedures for real-time payments and powerful data payload.

ISO 20022: The standard for electronic data interchange between financial institutions, covering payment transactions, settlement information, and credit/debit transactions.

Collaboration between the cannabis industry and FinTech will stimulate competition and innovation for new and improved ways to process payments. Establishing regulations and framework for processing payments associated with cannabis-related businesses will break down entry barriers for emerging players.

Consolidation Within The Cannabis Industry

In anticipation of legalization, a frenzy of mergers and acquisitions began among Canadian cannabis producers to attain the lion's share of the market pre-legalization. According to a study by consultancy firm [Ernst and Young](#), two of the biggest barriers to entry for cannabis companies are access to capital and the speed at which the government can issue licenses to cultivate and distribute cannabis. With an estimated 87% of the cannabis market to be consolidated in three years, mergers with the big cannabis producers for smaller producers may be the most viable option to ensure their involvement in the legal sale of cannabis.

It may seem like the cannabis industry could be destined for the same fate as the beer industry initially was, with a handful of powerful brewery conglomerates controlling the market share with consistent products at a competitive price. However, with the craft beer boom, we saw local, independent breweries compete with global companies. What these craft companies lack in pricing power and marketing capabilities they make up for in innovation and appealing to the consumer experience. The number of craft breweries in Canada increased from [310 in 2010 to 775 in 2016](#), despite the reach and low retail prices of international breweries. There will always be a market for independent, local experiences that larger producers cannot fill, and this type of niche market will no doubt transfer over to cannabis.

Small to midsize cannabis companies will have different payment expectations than larger organizations. The SMB market will be looking for IT and payment requirements that fit into their budget. To capture this market, Independent Software Vendors (ISVs) will want to offer Enterprise Resource Planning (ERP) type systems that can support the payment needs of SMBs. Greater visibility and control over payment delivery and settlement times, as well as the ability to monitor business resources such as cash balance and production capacity in real-time will give smaller businesses the systems they need to ensure a smooth operational flow. Within an ISVs software offering, batch processing with EFT will help SMBs keep track of their payroll and expenses, and it works for both accounts receivable and accounts payable.

Players In The Market

Licensed producers (LPs) of cannabis will likely have to compete with heavyweights from the tobacco and alcohol industries, both of which are expected to enter the recreational cannabis market in some capacity, to make up for the potential market loss as consumers move towards cannabis or hybrids. Alcohol and tobacco companies are well versed in operating in highly regulated fields and have strong ties to capital. LPs will be challenged with their ability to scale production, raise capital, and enhance operations without compromising margins. Alcohol and tobacco industries already have an environment that is ready to go; cannabis companies will need to work closely with regulatory bodies and the financial industry to raise enough capital and scale their production to meet demand while still complying with the regulatory standards.

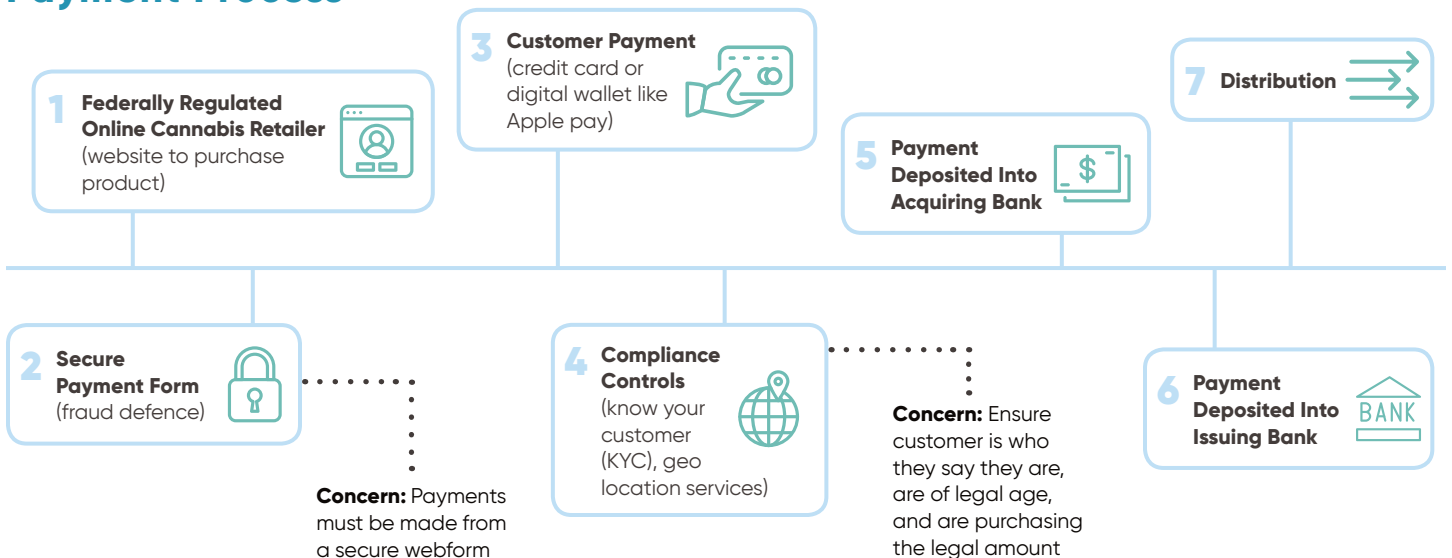
Cannabis and FinTech share a lot of similarities in that both fields are highly entrepreneurial, with start-ups propelling the industry forward. Technology and innovation are the driving force for capturing and maintaining the market share. FinTechs generally know their niche market very well, and the same can be said about the cannabis industry. The ability to read their respective industries will come as a substantial benefit as the two industries work together to develop a framework for processing payments for B2B and B2C scenarios.

The Payment Stack

To provide a seamless payment experience, payment processors will need to be able to work with front end tools like commerce platforms, as well as the backend payments infrastructure and acquirers. Payments processors who look at partnerships as a growth driver today will be the clear winners here, with flexible, secure application programming interfaces (APIs) and software development kits (SDKs) as core to their business model. All of this will be critical in enabling cannabis companies to quickly integrate their operations into a payment processor and balance user experience with due diligence.

The proper payment types for each demographic will need to be well thought out. For example, the preferred payment type for someone in their early twenties could be different than the preferred payment type for someone in their fifties. Payments must be seamless and secure across all channels for peace of mind, and ambitious payment providers will leverage new and emerging technologies to balance the user experience with security.

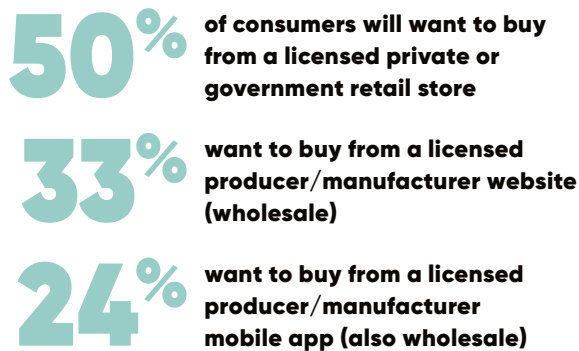
Payment Process



Strengthening The Canadian Economy

Consumers Want Online And In-App Options

According to a study by Deloitte, [55% of current Canadian cannabis consumers](#), expect and are willing to pay more for cannabis sold through legal channels. Nationwide, Canadians are eager to spend 9% more for a product they know is legal and safe. Also high on the priority list for Canadians is where they will buy their products and how easy it is to buy, as well as data protection and security.



When it comes to the e-commerce sale of cannabis a robust data management system, privacy protection, and cybersecurity are the most significant things consumers will be looking for, and rightly so. The increase in cyber breaches in recent years has increased the desire to keep personal and financial information secure. Cannabis e-commerce retailers will want to use an e-commerce platform and payment processor that can ensure the security of a customer's personal and financial information. Payment fraud prevention products such as 3D Secure 2.0 and tokenization will be integral to keeping sensitive payment data safe, and payment processors offering this security will have a clear advantage over those that cannot.

The number of consumers buying online are likely to increase, both for ease of use but also due to the expected stigma of going to a physical location to purchase cannabis. Ordering cannabis online from the safety of your own home will appeal to those that do not want to be publicly associated with the product.

3D Secure 2.0: a tool designed to create frictionless experiences for cardholders while maintaining a high level of security for your customers. 3D Secure 2.0 delivers 10 times more data than previous versions, including information on device channels and payment history.

Tokenization: encrypts sensitive payment data, such as a credit card number, into a non-sensitive "token", that has no extrinsic or exploitable meaning or value.

Possible Shortage And Meeting Transaction Demand

The estimated 800,000kg of cannabis that is needed to keep up with recreational demand could pose a potential problem for Canadian LPs; in the first three years of legalization, demand for cannabis will likely grow higher than the supply. However, there is some speculation that the shortage could be overstated. Health Canada is currently working on speeding up the review process for license applications, and now that the rules of the industry are in place, more producers will have the opportunity to enter the field, leading to an increase in production as long as the licenses can be obtained.

The financial industry needs to offer solutions to LPs to meet this surge in demand as it applies to transaction load. Producers entering the industry will want to sell their products wholesale in a way that maximizes profits. The ability to scale and grow their business simultaneously with the increase of production will be top of mind for these LPs. They will no doubt be looking for payment processors who can offer products and pricing that scales with them, such as the ability to move from simple to sophisticated products and pricing, as their payments skyrocket.

Moving From Cash To Cards

Payment Types

A traditionally cash-heavy industry will soon be flooded with multiple payment options, from cards to digital wallets and even voice payments. With innovations such as Amazon's Echo Alexa speaker, the thought that Canadians could soon be paying for cannabis just by telling their device seems outlandish, but perhaps is not too far off. Cannabis companies, both physical and online, will need to work with a payments processor who truly understands the Canadian payment landscape, as well as the preferred payment types for Canadian consumers.

Traditional card payments such as Visa, MasterCard, and AMEX will be tablestakes, while new digital solutions such as Apple Pay and Google Pay will need to be considered for cannabis companies. In-store debit is most common, and online debit is also making strides in Canadian payments/ Cannabis businesses should ensure they work with the right payments provider that supports this payment option. Localization of payment options across all channels will be critical to ensure the proper payment type is met for the appropriate demographic.

The API Driven Experience and Fraud

Integrating with a payment provider that offers flexible and secure APIs ensures a business is always up-to-date on the latest payment features. As the business grows, they will be able to seamlessly add new payment types, pull more data and reporting into their systems, and stay on top of fraud trends without ever needing to re-integrate. Like any other business, cannabis companies want to make sure they offer the latest authentication methods, such as biometrics and wallets. However, more so than other legal industry, cannabis will need to take extra measures to ensure that the sale of their product is made following strict protocols and regulations. Any slip-ups, such as the sale to minors, will result in hefty fines from the government, as well as the tarnished brand image that ensues.

Cannabis companies will need to integrate into APIs that can offer them authentication and Know Your Customer (KYC) methods that are viable across provinces and use cases to ensure that their business is compliant. The user not only needs to be authenticated through their payment methods, for example, the Card Verification Value (CVV) on the back of the card, but for their age and location as well. Address Verification Services (AVS) are instrumental in this process as the card user needs to verify their address prior to payment, which will notify the payment processor where they are making the purchase, to abide by provincial laws. By implementing AVS and other geo-location services with a KYC program that verifies age and identity, processors can make sure that only customers of legal age in their province can make purchases for the specified amount legal in their province.

Real-time Payments, Payroll, And Expenses

With businesses all over the globe adopting real-time payments, it is no surprise that cannabis companies will expect the same, both for B2B and B2C payments. With an explosive new industry comes new peripheral volume and market problems to solve. Specifically for the new cannabis industry in Canada, EFT will be a valuable payment type as an established B2B payment method. Canada is about to catch up to the US and other regions in supporting a real time EFT direct payments scheme by 2020. Cannabis companies will expect a faster settlement and consolidated reporting, especially as they scale as a legal industry with the anticipated growth rates. Taking the headache out of the accounting and finance departments who will no doubt have heightened reporting requirements is a fantastic advantage and growth catalyst for cannabis companies. For a potential multi-billion dollar industry, processing payments with cash is not an option. A digital ledger, for example, would ease the burden on payroll immensely.

Conclusion

Emerging Cannabis Payment Solutions

The world is watching to see how a G7 country such as Canada handles the legalization of a once illegal substance. The top concerns will be the sale and distribution of cannabis, ensuring the proper compliance models are in place so that the products are sold to those who are of legal age and for the authorized amount.

Payments providers will use trusted, secure payment processing to make sure provincial compliance standards are met across the board. From this process, a new ecosystem will arise where cannabis and FinTech industries work together to innovate new and improved ways for the cannabis industry to process payments. Flexible, secure APIs and partner integrations are at the forefront of driving this movement, and payment processors that can offer these will be positioned to capitalize as cannabis companies need to be up-to-date in the latest authentication and payment methods.

The payment types for cannabis sales will need to be relevant to Canadian consumer demographics, including the shift toward alternative payments and even digital wallets. For an industry once held back by only operating in cash, cannabis will want to receive the same flexibility and payments opportunity as any other legal industry as it comes to light.

The cannabis industry and the government of Canada will be working very carefully to make sure the sale of cannabis is safe and secure, and that the products are ending up in the right hands from seed to sale. To make this projected multi-billion dollar industry a success all the pieces between the cannabis industry and the government must be connected. Compliance and security must be enforced across all distribution channels, which becomes even more challenging in digital or online cannabis sales. With this in mind, the payments industry is positioned to play a key role in shaping the future of cannabis sales in Canada, laying the framework for prospective countries to follow in the years to come.



About Bambora

Founded in 2015, Bambora is a collection of companies with decades of experience in the payments industry. Now a global presence, with over 600 employees in 64 markets, Bambora processes over \$47 billion USD per year.

Bambora North America is responsible for processing 30% of all e-commerce in Canada and has equally ambitious goals for the US market. Bambora helps all businesses grow, with simple and secure payment tools.

Please note that cannabis is a restricted business for Bambora and we are unable to board any company who sells cannabis.



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bambora

