2015 Global Payments Insight: Retailers

The status quo is not an option

Catalyst

Payments are at a crossroads

The payments market is changing and the voice of the retailer is not being heard. From cash to checks, to charge and credit cards, through to store and then debit cards, payments have traditionally been an aspect of the retail experience to which little attention has been given. Innovations were measured in years if not decades, and there was little element of surprise to what to expect. This is no longer the case. Instead payments are evolving at a pace of weeks and months with new providers, new platforms, and new payment tools launching on a near daily basis.

The seismic shifts now happening in the payments markets mark an unprecedented period of potential disintermediation for some, and long term advantages for others, and it is unclear exactly how the dust will settle in the coming years ahead.

Since there is so much at stake, it's perhaps surprising that the voice of the retailer remains little heard and even less well understood. Much of the media hype around the revolution in payments remains fixed on either consumers or payment providers with little real consideration to how these technologies will play out in the retail environment.

As payments become smarter, this evolution has the power to transform the consumer retailer relationship, and as such the customer experience and expectations of retailers are more critical than ever.

Late last year, technology analyst house Ovum, in conjunction with ACI conducted the Ovum Global Payments Insight Survey. This global survey of retailers, retail banks, and payment taking organizations, asked respondents about their experiences, perceptions and expectations of payments and how this is shaping their behavior. As payments go from an evolutionary to a revolutionary market, retailers in particular will retain a critical leadership position as the gatekeepers of the consumer experience and it is essential that their views are understood.

The insights presented here highlight key findings for retailers and provides an explanation of what this means for their payment strategies and investment priorities. This document is one part of a four part series based on ACI and OVUM's 2015 Global Payments Insight Survey and those interested should visit www.aciworldwide.com/paymentsinsight for further information.

Methodology

For the 2015 Ovum Global Payments Insight Survey, ACI and Ovum created a nineteen point questionnaire, looking at key aspects of the existing payment infrastructure of retailers, their forecasts for future IT spending, areas for investment, and their perceptions on where payments fit within their broader strategic objectives.

A version of this survey was then sent to key payment decision makers globally in October - November 2014, providing a snapshot of payment perceptions amongst financial institutions, billers, payment accepting organizations such as government bodies and utilities.

Overall, this included a total 1,119 executive respondents across 15 industry sub verticals in 25 key global markets, resulting in over 144,000 separate data points on perceptions and expectations of payments amongst critical payment enablers globally.

This industry perspective piece focuses on retailers and those interested in finding out more are advised to visit www.aciworldwide.com/paymentsinsight for further information.

Respondent Breakdown	
Total Retail Respondents	**691**
Retail Respondents by Region	
Americas	**35.4%**
EMEA	**35.7%**
Asia Pacific	**28.9%**
Respondents by Annual Revenue (US$)	
<$50 Million	**33%**
$51 - 250 Million	**22%**
$250 Million - $1 Billion	**23%**
$1 - 2 Billion	**10%**
$2 - 10 Billion	**10%**
$10 Billion +	**2%**
Retail Respondent Sub-verticals	
General merchandise (include, fashion, electronics, health & beauty, FMCG, etc.)	**20%**
Travel & lodging	**38%**
Fuel/Convenience store	**10%**
Grocery/supermarket	**15%**
Food service/cafes/restaurants	**17%**
Example Respondent Titles	
Chief Operations Officer, Finance Director, Revenue Manager, Owner, etc.	

Summary

The status quo is not an option as retailers need to invest in their payment infrastructure

Retailers face a growing amount of pressure on their payment capabilities and maintaining the same course of action is not an option. Retailers report that they are fully aware of growing consumer expectation in payments, and payments are in turn becoming a more critical component of their broader business strategies. These trends show little sign of reversing and are likely to gather pace in the near term.

At the same time, retailers also face growing costs in maintaining and accepting payments, despite the global downward pressure on interchange rates, and remain nervous about the security implications of further developing their existing payments infrastructure.

Key highlights provided by the 2015 Ovum Global Payments Survey show that:

- Up to 93% of retailers believe consumers want a broader choice of payment tools.
- 75% of retailers see payments as a clear part of their business strategy.
- 49% of retailers have seen their payment costs increase in the past 18 months while 56% expect them to keep rising.
- The customer experience is king, with 50% of retailers citing it as their key expected driver of ROI on any increase to their payments investment.
- 54% of retailers are holding back their payments investment due to security concerns.

The combination of these factors suggests that for retailers, maintaining the status quo in payments is no longer an option. Older legacy payment infrastructure will become more expensive over time and become increasingly less capable of introducing new payment options and capabilities to consumers, while leaving them more exposed to fraud and other security risks.

With the rapid pace of payments development, now is the moment that retailers should be focused on enhancing their payments infrastructure, and future proof their payment capabilities for longer term brand survival. No one knows exactly how payments will continue to evolve in the mid to long term, but continual change is now inevitable. Not being able to adapt to this will soon begin to have more concrete repercussions for retailers.

Consumer demands are changing and retailers have little choice but to invest in payments

Retailers are facing the pressure of shifting consumer demands

Regardless of their size, be it small scale owner operated convenience stores through to large chain supermarkets, retailers are feeling the pressure of shifting consumer demands when it comes to payments. From small scale operators to multi-billion dollar big box giants, retailers are near universally in agreement with the statement that consumers demand a broader choice of payment tools, as outlined in Figure 1.

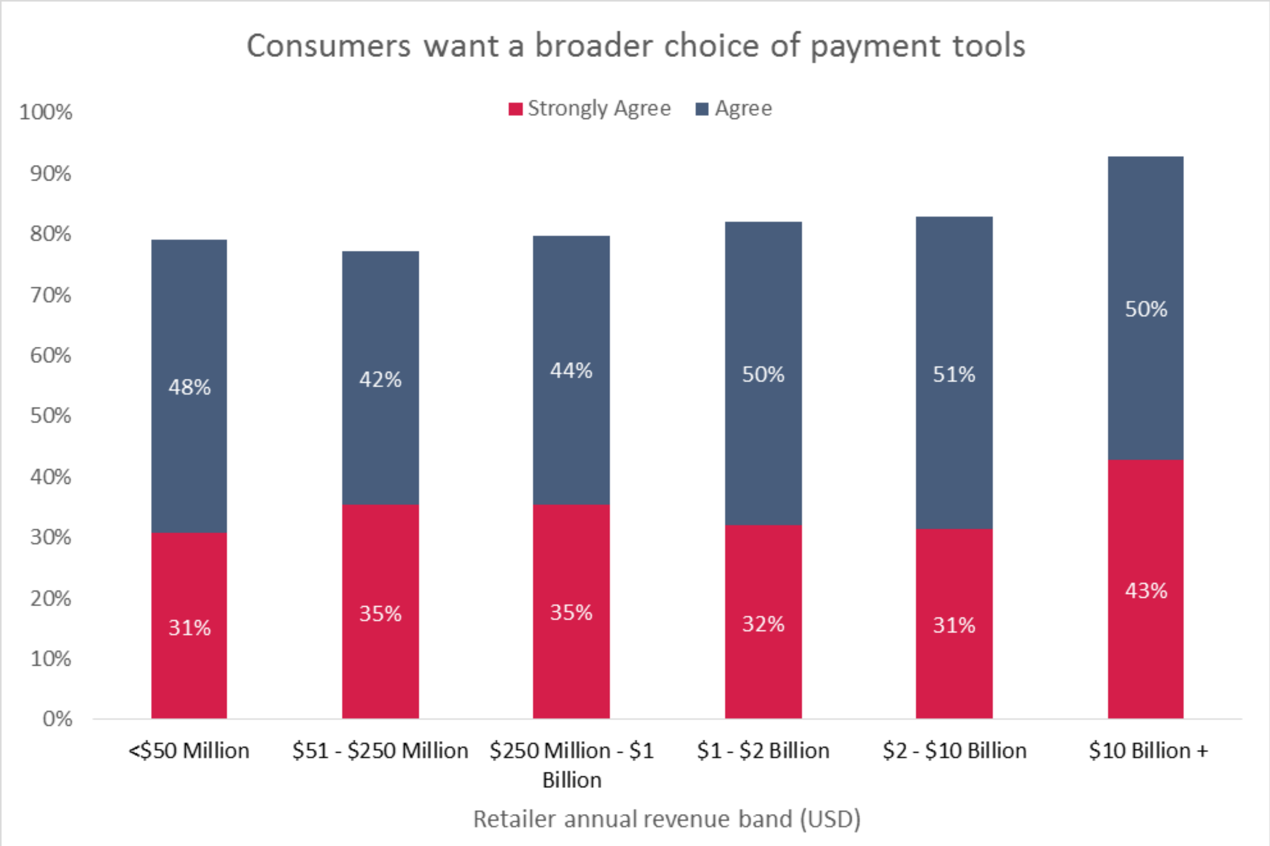
Nearly four out of five retailers at the smaller end of the scale, with revenue below $50m per year feel that consumers want to use a wider range of payment tools and this figure rises to over nine out of ten retailers (93%) amongst the biggest retailers with sales above $10bn per year.

Retailers are in many instances seeing this have a direct impact on their operations and go-to-market strategies, particularly through the growing prevalence of multichannel and omni-channel retail strategies across online and mobile channels. With even small scale retailers, such as coffee shops, and general merchandise fashion boutiques now active in the online and mobile space, the race is on to introduce a seamless, user friendly experience, and payments remains a critical part of this strategy. In the online space alone, shopping cart abandonment rates remain stubbornly high for many, and payment friction can have significant impacts on incoming revenue.

Across mobile channels as well, the race is now on to introduce new services which can help reduce friction and drive sales for both the digital and in-store experience. Payments are now becoming a more critical component of these broader mobile strategies including through saving payment credentials, and developing new in-store experiences, such as hands free payments achieved by confirming a name, or one button ordering and payment through apps such as Uber.

For retailers this demand for more payment tools, such as PayPal, mobile, contactless, direct bank payments and so on, is driving the need for more payment investment. This includes spending on key payments infrastructure and services, and partnering with new providers through to development of new services and training of in-store staff. A ‘do –nothing’ approach, however, in favor of the current status quo will remain increasingly untenable as these new tools become more ubiquitous and consumers become more demanding.

Figure 1: 77% to 93% of retailers feel consumers want more payment options



Source: 2015 Ovum Global Payments Insight Survey

Payments are a clear part of a retailer's business strategies

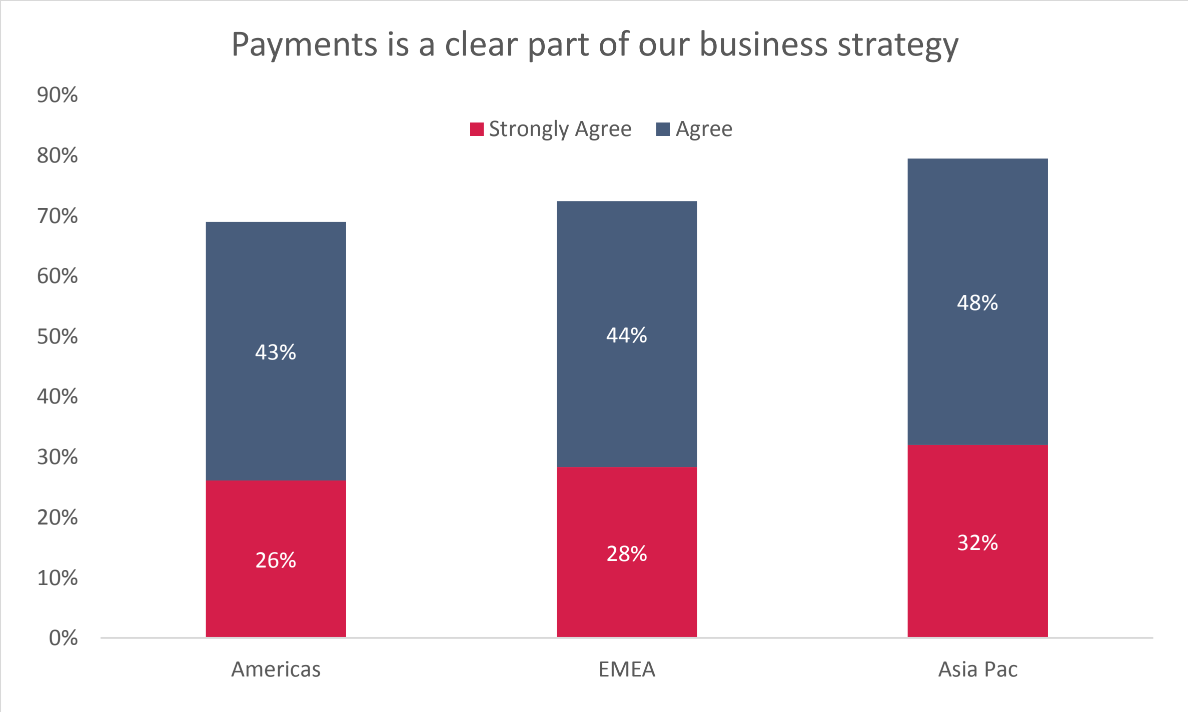
A seamless, easy to use, and effective payment system is a growing focus for retailers and will continue to increase in importance.

With the growing momentum behind the shift towards omni-channel retail strategies and the need for a broader choice of payment tools, payments are increasingly seen as a clear part of a retailer's business strategies. This underlines the focus of developing new customer engagement points in online and mobile channels, while providing a consistent consumer friendly experience.

Interestingly these trends are broadly consistent globally, including across industry sub-verticals and by revenue. Payments are widely seen, by 69% to 75% of all retailers, as a clear part of their business strategy. This is perhaps surprising given the fact that historically, payments have been a means to an end for many, and are now seemingly moving up as a priority.

However as omni-channel retail strategies and new means of engaging with consumers continue to evolve, payments are likely to become an increasingly critical aspect of retailers' broader strategies. From speeding up transactions at the POS, through to deepening customer loyalty and creating new engagement mechanisms, new payment technologies potentially provide not only benefits to consumers in terms of convenience and cost, but also to retailers as well in terms of engagement and operational efficiencies.

Figure 2: Up to 80% of retailers see payments as a clear part of their strategy



Source: 2015 Ovum Global Payments Insight Survey

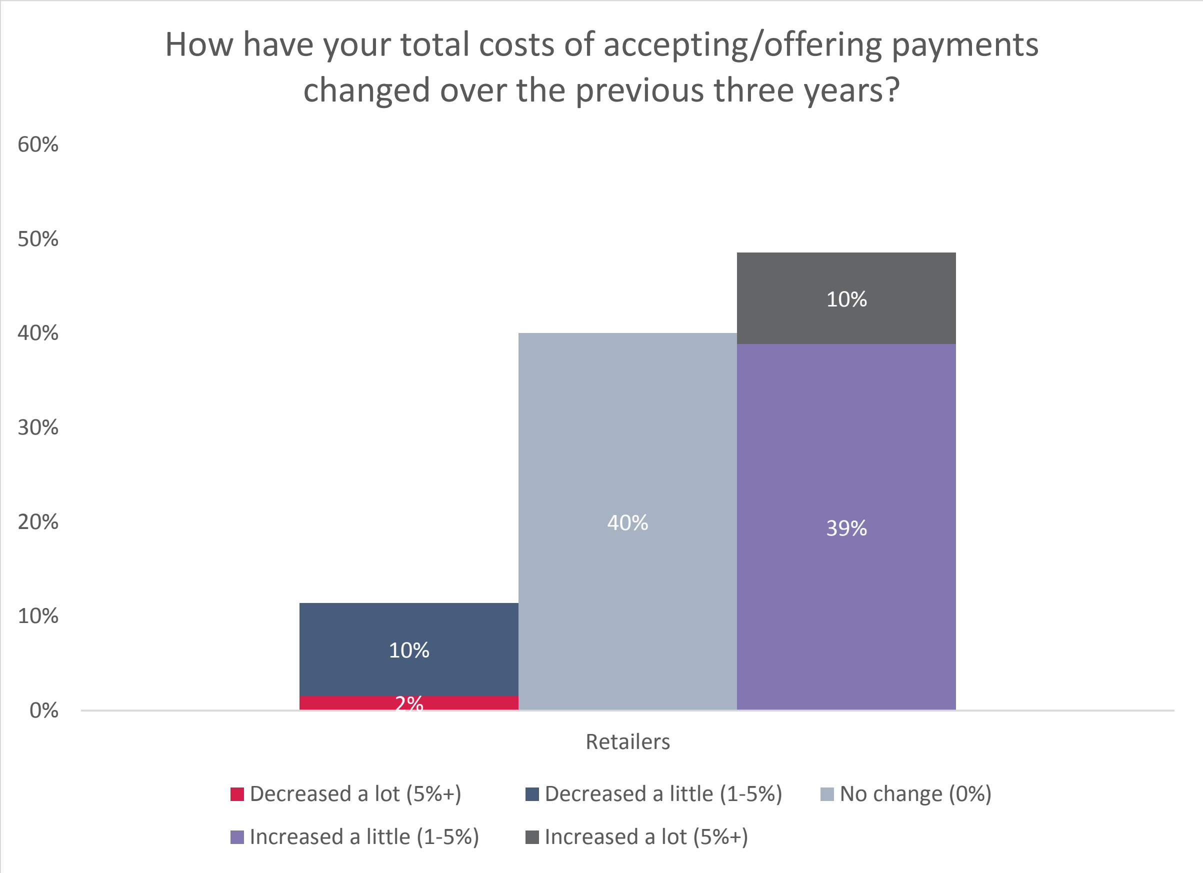
Payment costs remain stubbornly high for retailers and their spending is only increasing

With retailers renewing their focus on payments as a means to enable their strategic goals, both the costs and level of investment in payments are increasing. Retailers globally reported a strong increase in their payment costs over the previous 18 months, with nearly half (49%) saying their costs had increased, of which 39% say it had increased by 1-5%, and 10% that their costs had increased by a staggering 6% or more.

Despite the fact that interchange rates in many markets are coming down due to regulatory pressure, and consumers in many markets shift away from credit to debit card based spending, only 12% of global retailers reported they had seen a decline in their costs of accepting payments. Other segments within the payments space such as financial institutions, and bill taking organizations such as utilities, report that their costs of accepting or offering payments had seen a more substantial decline.

In stark contrast to this, although 40% of banks report a rise in their costs, nearly 30% of banks and merchant acquirers report they have seen a drop in the cost of offering payments. Much of this drop is likely due to some banks who have invested in their payments infrastructure, lowering the cost of maintaining legacy platforms. These declines in cost for some have seemingly not trickled down to retailers at any great level.

Figure 3: 49% of Retailers report an increase in payment costs



Source: 2015 Ovum Global Payments Insight Survey

Despite historic rising costs, spending is still increasing

While most retailers report their costs of payments have gone up over the past three years they also expect their investment in payments to rise, as shown in figure 4 below. Retailers from all industry segments forecast that their spending will increase in the next 18-24 months. Gas stations and fuel retailers hold the biggest expectations of payments IT investment growth, with 61% overall expecting an increase.

Even the segment with the lowest expectations of investment growth, grocery stores and supermarkets, still show 50% of respondents forecasting their spending on payments to continue to rise.

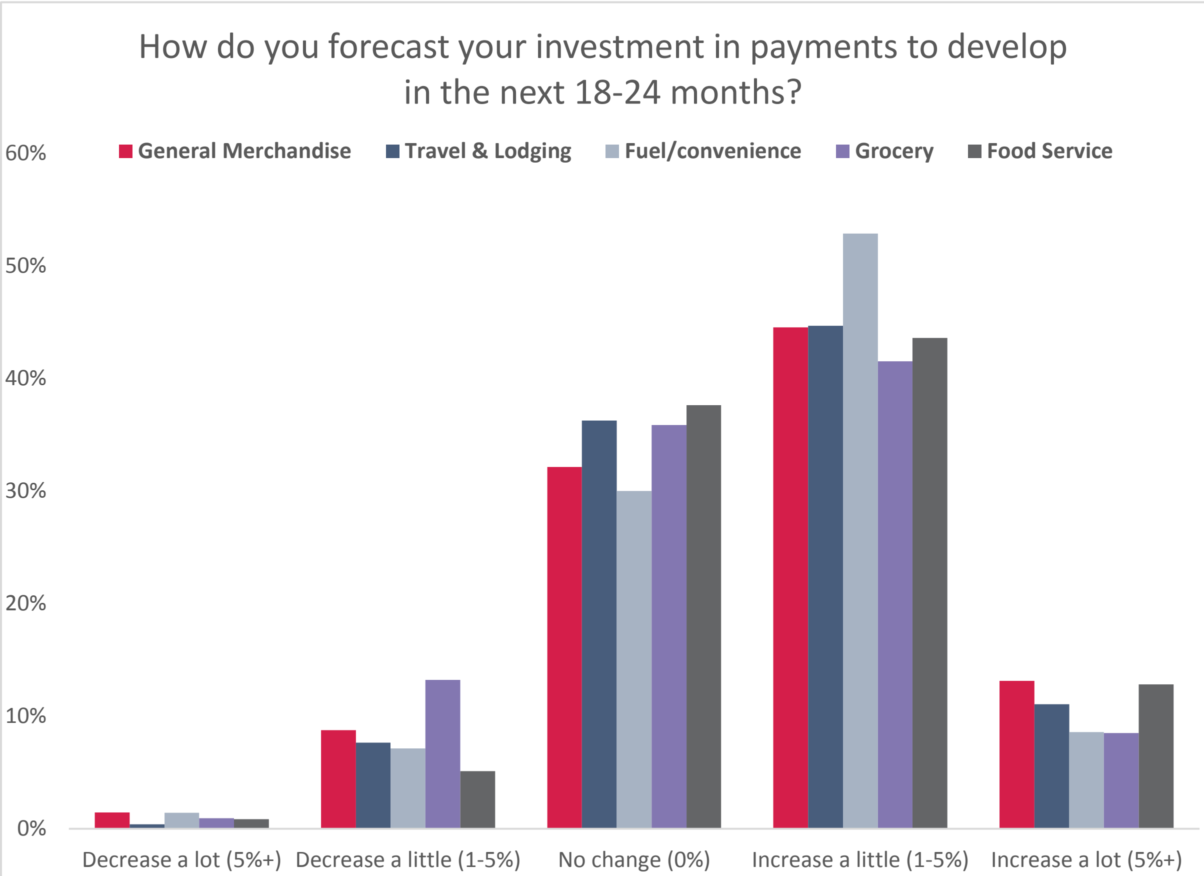
Only a small portion of retailers (9%) expect their cost of accepting payments will see any decline within the next two years.

For an industry facing its own disruptive and emergent challenges, these spending forecasts on payments technology paint a potentially precarious picture for organizations dependent on aging legacy payments infrastructure.

As payments become more critical from a customer engagement, omni-channel and cross selling perspective, this legacy infrastructure will continue to be a potential drag on operating costs.

Likewise, as legacy payments infrastructure ages, and struggles to keep pace with emergent payment technologies, this risks becoming even more of a drag on costs. As a result, this may increase the costs of accepting payments for these merchants, as maintaining existing platforms becomes more expensive over time. All this maintenance spending increase is without the potential benefit of enabling new forms of payment and commerce.

Figure 4: 54% of retailers report payments spending will increase in the next 18-24 months



Source: 2015 Ovum Global Payments Insight Survey

Real-time clearing and settlement is a top priority for payments investment

Although mobile technologies remain a critical focus area for many retailers, real-time clearing and settlement capabilities are in fact perceived as the primary gap in the current payment capabilities of many retailers.

Overall, 32% of all retailers cited real-time capabilities as a gap in their services. This compares to 28% of retailers which cited a smart card based loyalty program as the largest gap in their payment services, followed by mobile QR code capabilities on 26%. These levels of interest remain broadly consistent to all retailers regardless of their size, with the largest organizations expressing the highest level of interest. Interestingly, retailers with revenue over $1billion, broadly categorized as tier one and tier two players, have the strongest view on the benefits of real-time but have a lower expectation of considering investing in these capabilities. In contrast to this, smaller players show a greater propensity for actively considering real time payments.

This may be due to the payments infrastructure of these smaller players being likely easier to enhance compared to tier one and two players. However the high perception of real-time as a gap among top tier players highlights the potential benefits real-time has to all retailers.

With the growth of faster payment systems in many markets the visibility of real-time clearing and settlement is beginning to grow. For retailers in particular, real-time capabilities likely prove particularly enticing as they can help to improve the liquidity of their operations, reduce risk, and provide a better consumer experience. As real-time clearing and settlement becomes more widespread, it is likely that retailer interest and investment will only increase.

Enhancing the customer experience while also reducing their costs is a tricky balance for retailers

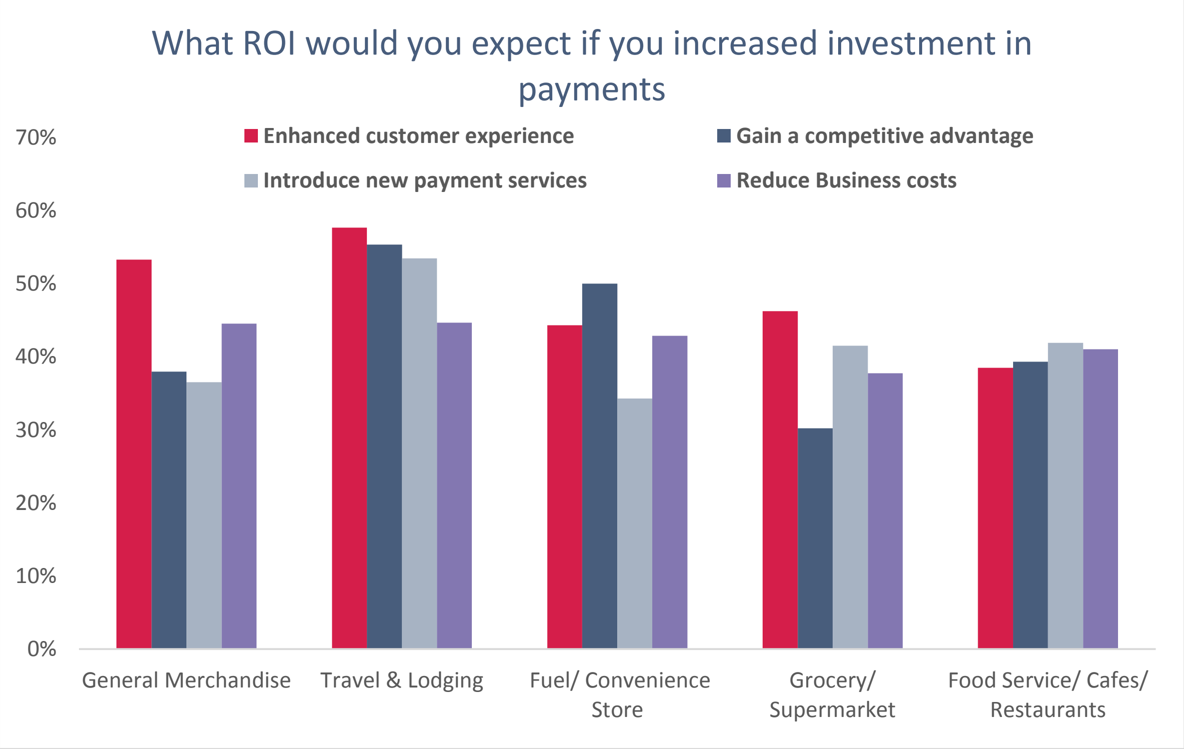
With a perceived customer demand for more payment tool choices, retailers face a challenging balancing act in maintaining the payment systems they currently operate, introducing new (and potentially more data rich and complex) payment options, and lowering their costs simultaneously as part of their broader retail strategies.

Unsurprisingly, the twin demands of enhancing the customer experience and reducing operating costs are by far the key benefits that retailers seek from any payments infrastructure investment. When asked what returns they would expect from increasing their investment in payments, an enhanced customer experience emerges as the top priority for most retailer segments, and often by a considerable margin.

This ranges from as high as 58% of travel and lodging providers, down to 38% amongst food service retailers. Ovum notes that although the overall rating for customer experience is lower in the food sector, this is in large part due to the nature of many food businesses where a high speed payment experience may be of less immediate benefit such as in many restaurants and cafes.

Other priority ROI areas are gaining a competitive advantage, introducing new payment services, and reducing business costs for 45%, 44% and 43% of all retailers respectively. Introducing new payment services in particular stands out, as not only do consumers demand a broader choice of payment tools, but these new services can also help drive overall retail transaction growth and enhance the customer experience. In an ideal environment these new payment tools and services will also lower the overall cost of accepting payments.

Figure 6: The customer experience is of paramount importance to most retailers



Source: 2015 Ovum Global Payments Insight Survey

Payment security fears are needlessly holding retailers back

Security is critical but it shouldn't hold back innovation

As a result of a series of high profile data breaches in the U.S. in late 2013 through 2014, security has become a growing concern to retailers. This is rightly so given the growing complexity and sensitivity of customer data that retailers now frequently handle. However, these security concerns are now impeding retailers' investment in their own payments infrastructure, ironically exposing them to heightened levels of risk further down the line.

Retailer fears of exposing themselves to new and unknown security challenges, may in fact be lowering their overall security by limiting the deployment of newer and more secure payment technologies. These security fears also limit the potential for retailers to introduce new payment services, enhance the customer experience, reduce operating costs, and ultimately gain a stronger competitive advantage.

Overall, 54% of all retailers cite security considerations as the biggest stumbling block to increasing their payments infrastructure investment. Other obstacles include the high costs of maintaining existing legacy infrastructure (43%) and customer protection requirements (40%).

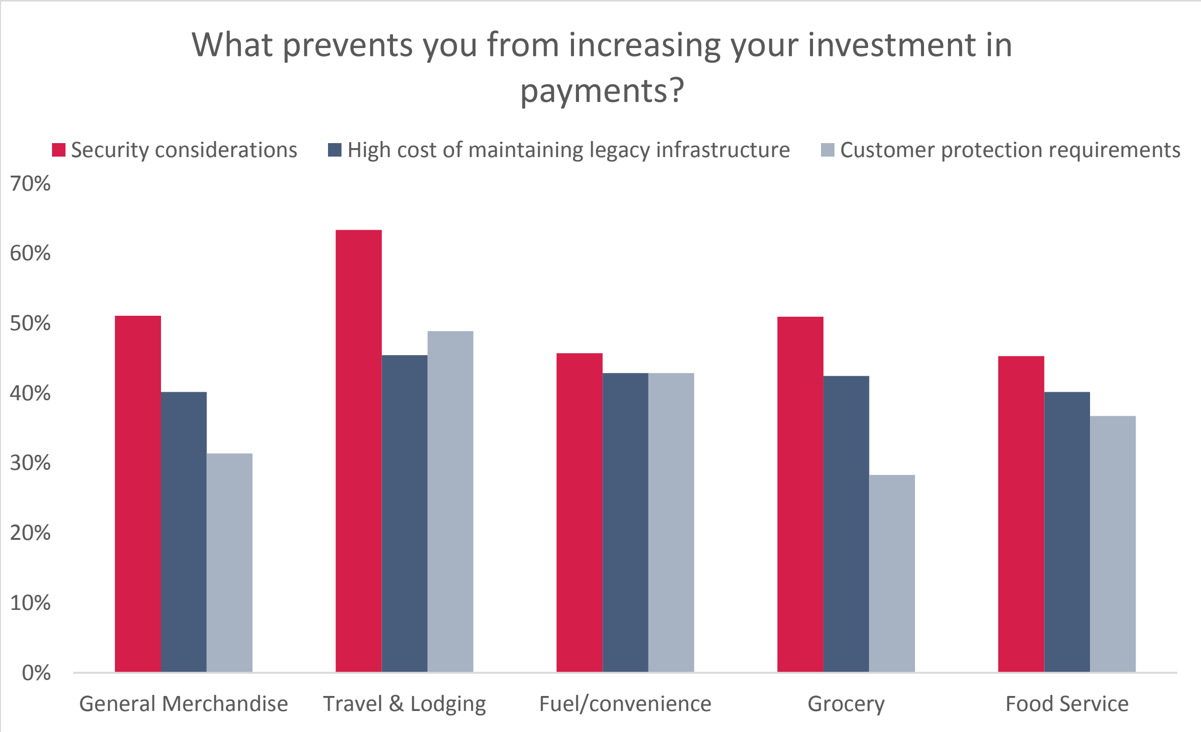
These concerns are not limited to driving investment in security focused technologies, and instead suggest that security as a whole, across all aspects of payments infrastructure is increasingly critical. This should come as no surprise given the reputational challenges many retailers have faced following a high profile data breach.

In many instances retailers appear to be instead maintaining the status quo and relying on older, often less secure platforms, as these are systems they feel more comfortable with and assume are more secure. However these concerns over security are precisely the reasons that retailers should be investing in their infrastructure.

Newer payments infrastructure platforms are characterized by the fact they can simplify much of the complex 'spaghetti' architecture found in many retailers' payment stack, while introducing newer payment security features better capable of handling the latest generation of fraud and risk to payments.

Retailers should not wait for the possible security breach, but rather make security a key component of their innovation payments strategy.

Figure 7: 54% of all retailers feel security concerns are holding back payments



Source: 2015 Ovum Global Payments Insight Survey

Security is an ongoing battle for retailers

As the fraud and security environment becomes more complex, with threats emerging in new and unexpected ways, retailers now face an array of security standards, protocols and technologies that can help them reduce their overall risk profile and help secure their customer relationships.

As outlined in Table 1 below, these security technologies and standards are either already in place or are newly emergent technologies with the potential to become industry standards either by best practice or through more formal regulatory mandate.

In some instances, such as with EMV the costs of these roll outs can be substantial, with the US market only now gaining momentum after much of the rest of the world has already made the leap. The changes brought on from EMV however also highlight the fact that as the security technology changes, so do the sources and strategies followed by fraudsters. As the rest of the world moved to EMV, much of the world's counterfeit card fraud moved to the US, which has ultimately resulted in the card networks to introducing liability shifts to drive EMV migration.

P2PE and Tokenization are unlikely to be as expensive a proposition as EMV for retailers, however they will likely lead to a reassessment of existing payment infrastructure. As a result, fraudsters are likely to target these weaker older systems with much greater veracity.

For retailers it hence remains critical that not only do they focus on security throughout their payments infrastructure, but also that they adapt to the latest risks and adopt the latest fraud prevention technologies.

Table 1: Key payment security standards

Key Technologies	Description	Development
PCI-DSS	Global payment information security standards managed by the Payment Card Information Security Standards Council. Standards incorporate broad aspects of payments, from telephone call centers, through to technical device specifications	Global and widespread, standards are frequently updated and broad ranging
Network Segmentation	Confining data to a private protected network can provide an added layer of protection. By isolating payment processing on a segregated network this can enable the removal of POS hardware and software from PCI compliance liabilities.	Relatively early stage of developments driven by individual retail organization's payments and broader IT strategy
Point-to-Point Encryption (P2PE)	P2PE allows for secure card data to be encrypted on a POS device, and is then decrypted by payment gateway processors, limiting the risk exposure of merchants. P2PE in theory can help reduce broader PCI-DSS liabilities for retailers	Early stage of development, with standards now emerging from industry bodies but relatively few live deployments
EMV	EMV is a global standard for chip enabled payment or ATM cards that are intended to prevent card cloning and provide a more secure payment card than a standard magnetic stripe. Often closely tied in with PIN payment authentication, but can also be used with signatures.	Most major markets already have or are in the process of standardizing EMV across the payments landscape, often at significant costs. The US has been a laggard on EMV and is due to see a heightened roll out in 2015 and beyond due to shifts in fraud liabilities mandated by the major payment schemes.
Tokenization	Tokenization is the replacement of sensitive card information with token replacement data that is typically dynamic, based on the transaction criteria and encrypted. Interception of tokenized is hence useless as the secure payment credentials cannot be reused.	Although in development for several years, tokenization is due to receive a major boost in the near term as it forms a critical element of many mobile payment solutions including Google Wallet, Apple Pay, and Samsung Pay. Tokenization standards are now slowly emerging

Source: Ovum

Appendix

Methodology

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Ovum Consulting

We hope that this analysis will help you make informed and imaginative business decisions. If you have further requirements, Ovum's consulting team may be able to help you. For more information about Ovum's consulting capabilities, please contact us directly at consulting@ovum.com.

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