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THE NEW PAYMENT LANDSCAPE FOR RETAILERS: THINK MECHANICS AND MARKETING

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New technologies may be roiling the world of payment options, but they are giving retailers opportunities for deeper customer engagement.

The payment landscape hasn't changed that often, until recently. Money has been around for centuries. In-store accounts and credit cards have been around for decades. But it's changing now, and in fundamental and exponential ways. The culprit—or the champion, depending on your viewpoint—is technology. There has been more innovation in payments in the past five years than in the past five decades. In the next five years change may come even faster.

The retail industry finds itself smack dab in the middle of a revolution. What was once a discrete event—the moment of payment at the end of a transaction—is now just a data point in a spectrum that includes not only marketing, customer service, and customer engagement, but also all of a retailer's existing sales and fulfillment channels—stores, catalogs, websites, and mobile apps.

"When we first started talking to retailers about mobile payments, we were shuttled off to the payment processing guys," says Chris Gardner, who cofounded Paydiant several years ago as a platform for delivering mobile payments and loyalty rewards (it's now part of PayPal). "Now we meet with the marketing people. The payment step has become a sideline, part of what is really a marketing effort."

According to data released by the U.S. Federal Reserve in March 2015, payments via mobile phones have been steadily increasing. figure 1 And according to Forrester Research, mobile payments are only going to keep expanding, representing $142 billion by 2019, up from $52 billion in 2014. figure 2

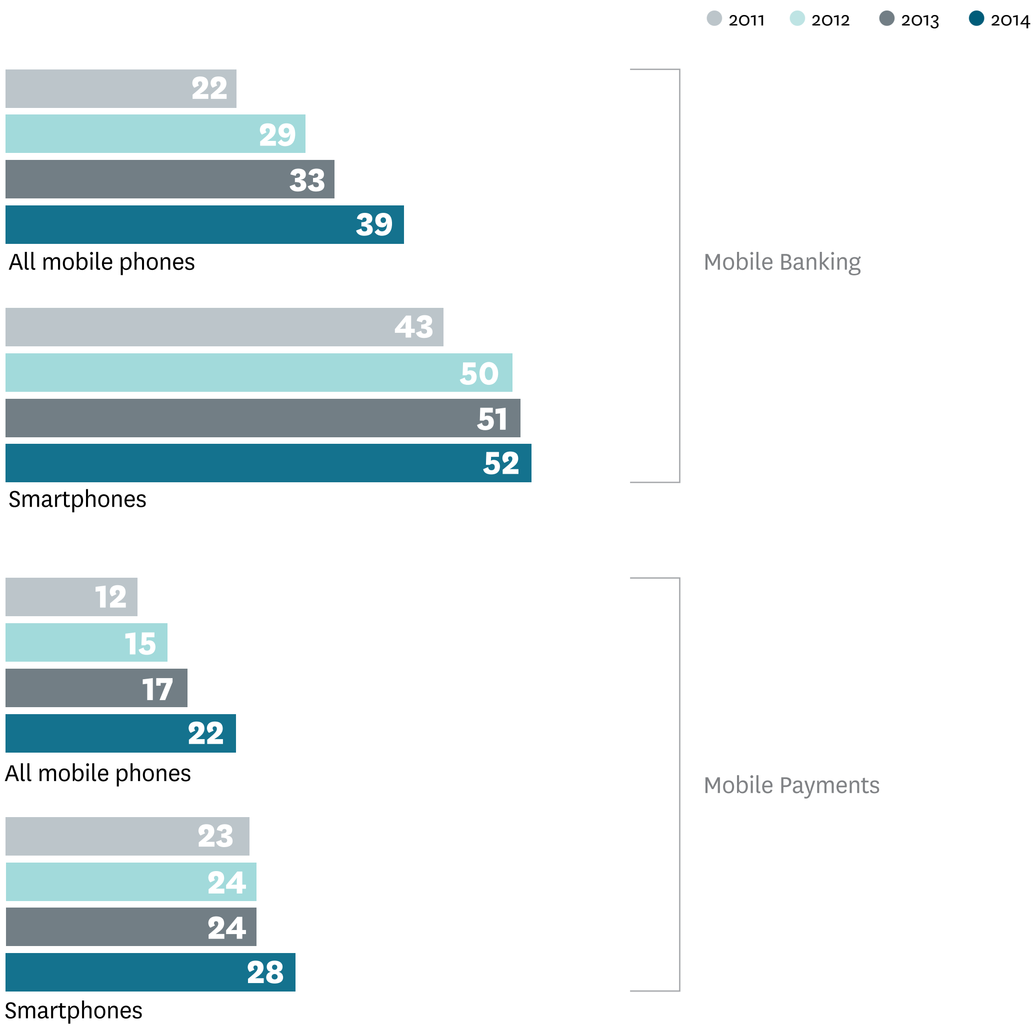
The worldwide trend looks similar, according to data from leading consultancy Capgemini. It estimates a compound annual growth rate for global mobile payments of 60.8 percent between 2011 and 2015. figure 3

So now, thanks to technology's ability to track what happens before and after a sale (indeed, even what may have triggered a sale), retailers stand at a crucial inflection point in their customer service strategy. They face the prospect of massive investment in a new payments infrastructure, one that not only encompasses advances in mobile technology, but also needs to encompass technologies relating to security, marketing, and customer loyalty. That said, they also face a great opportunity for new levels of customer engagement.

FIGURE 1

USAGE OF MOBILE BANKING AND MOBILE PAYMENTS BY MOBILE PHONE TYPE, 2011-2014

Percentage of respondents with a mobile device and a bank account



SOURCE CONSUMERS AND MOBILE FINANCIAL SERVICES 2015, U.S. FEDERAL RESERVE, MARCH 2015[1]

"This is the first time in history that the industry has had so many profound disruptions at the same time, relating to multiple technologies, including mobility and analytics," says Jean Lassignardie, corporate vice president for global financial services at Capgemini. But there's something even more fundamental going on, he maintains. "When you look at payments, you're looking at something that is part of everyone's life. The payment process is deeply embedded into any successful interaction between a customer and a retailer."

What's more, there's a high level of emotional attachment involved—relating to where people shop, where they bank, how they pay. Payments and their milieu are intensely personal, and those personal preferences are suddenly fair game for monitoring and insight. But it is precisely because those preferences are so personal that digital technology is enabling a deeper relationship between consumers and retailers, one that—as noted—goes beyond the mere payment event.

With the payment landscape shifting so radically, retailers need not only to understand it, but also to know how to take advantage of it. They need to think about how they can transform the transactional payment process to enhance an ongoing customer relationship; that is, how to learn more about customers and create a virtuous circle for serving them better. They need to think about integrating their omnichannel sales and fulfillment strategy with an integrated payment strategy. Perhaps most challenging, they need to think about how they can craft a multitiered system that not only serves loyal customers as they move from channel to channel, but also works to entice casual customers and prospects alike.

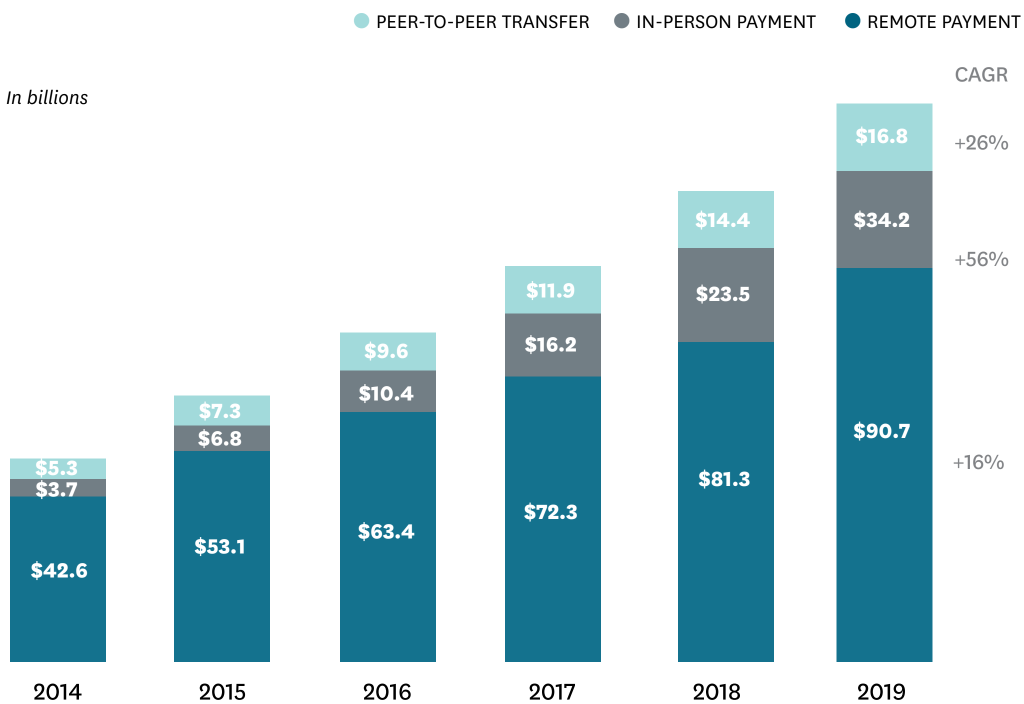
If it sounds like a lot to ponder, it is. Revolutions are never easy.

CHALLENGES RETAILERS CURRENTLY FACE

One of the biggest challenges retailers face in addressing the evolving payment infrastructure is to know where to invest their time and money. This is not a recent development, and the process is made all the more confusing because previous efforts have failed to gain traction.

FIGURE 2

U.S. MOBILE PAYMENTS WILL REACH $142 BILLION BY 2019

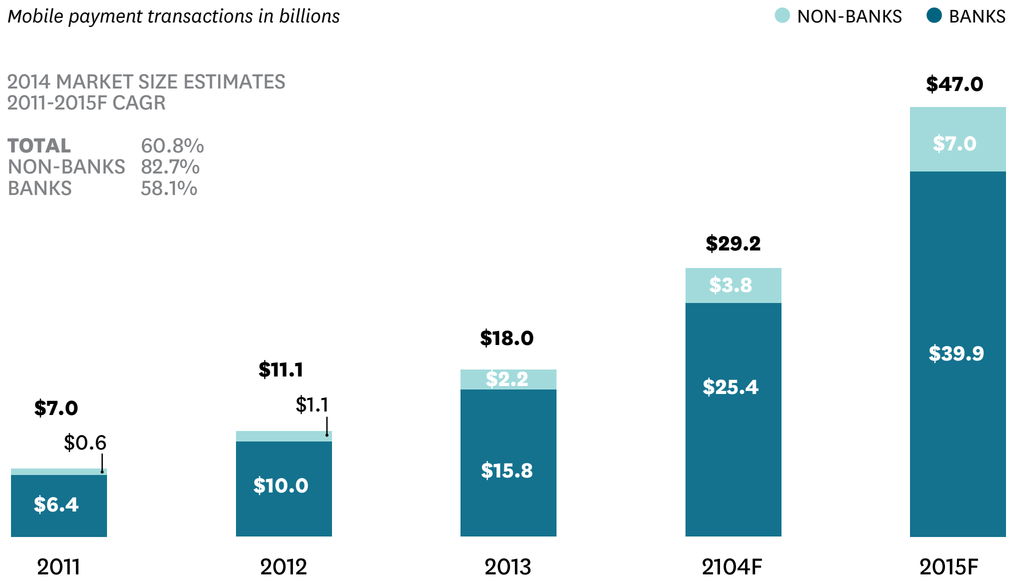


Note: Does not include purchases made on a tablet or card payments made at mobile point of sale (mPOS) or with a mobile card reader.

SOURCE FORRESTER RESEARCH MOBILE PAYMENTS FORECAST 2014-2019 (U.S.)

FIGURE 3

NUMBER OF GLOBAL M-PAYMENTS TRANSACTIONS IN 2011-2015F*



*Forecast

Note: Mobile payments, or m-payments, are defined as a form of payment where the mobile phone is used as a payment mode—not just as an alternative channel to send the payment instruction—and the payment information flow takes place in real time; chart numbers and quoted percentage may not add up due to rounding.

SOURCE CAPGEMINI FINANCIAL SERVICES ANALYSIS, 2014

As one executive who focuses on payments for a midsize Midwestern retailer says, "Three years ago, this conversation was about Isis Wallet and the first iteration of Google Wallet, and neither exist today." Even Google executives admitted their initial attempt at a mobile wallet was a failure,[2] and Isis Wallet was subsequently renamed Softcard to eliminate association with the terrorist group; then its founders (a consortium of telecommunications carriers) sold its technology to none other than Google for its next iteration of Google Wallet.

One problem: We're looking at the convergence of two trends. One is the digitization of the payment process itself; the other is the newfound ability to learn more about what happens before and after the payment takes place. As Capgemini's Lassignardie notes, "Everyone has been dreaming for years of the invisibility of payments. Everyone wants it to be as fluid as possible." In the meantime, he adds, "retailers have now realized that they can collect data to use to improve how they serve customers."

Retailers aren't the only ones focusing on the issue. As consultant Craig Conkling, who writes the *Mobile Trends Insight* newsletter, notes, there has to be concerted agreement among multiple parties. For any new payment system to take off, such as one that allows contactless payments, retailers need to install new point-of-sale terminals, banks need to upgrade their payment cards, and consumers need to believe that the system is as safe and secure as swiping, dipping, or scanning the card in the way to which they're accustomed.

THE LURE OF NEW SHOPPING AND BUSINESS MODELS

Retailers face other concerns. For instance, the way consumers shop is evolving. Most retailers have weathered well the shift to eCommerce, but even that's making the boundaries of brick-and-mortar options grow faint. Consumers can now order merchandise online and pick it up in the store. Retailers can now break down the cashier model, giving clerks mobile point-of-sale systems for in-aisle purchases. Mobile technology for clerks can be invaluable, because sometimes consumers have faster access to product information (and competitors' price information) than employees do.

And while the way consumers shop is changing, so too is the way they pay. Credit card processors Europay, MasterCard, and Visa have banded together to create the EMV system for better authentication of credit card users, using what's known as chip-and-pin technology. Although already introduced in most developed nations, it will come to fruition in the U.S. in October 2015. But it is still subject to wily card-not-present (CNP) fraudsters, whom retailers will have to watch for (since they're now on the hook for damages with EMV).

Consumers have access to numerous new payment options for mobile phones, including Apple Pay, Google Wallet, and others. The path to these systems may not be smooth. New payment systems aren't necessarily faster than current systems (is using near-field communication [NFC] technology faster or more accurate than swiping?), and consumers may be leery of any new systems because they might be newly subject to breaches. Retailers need to decide which mobile payments they want to accept, and think about how they can save money by avoiding multiple updates (for instance, moving to EMV and contactless payments at the same time). Most important, they need to think about how to best compile customer data to engage consumers more thoroughly. One option: support mobile payments in their own apps rather than deferring to third-party options.

The list of new models and methods of doing business goes on. Retailers are constantly looking for ways to reduce their payment processing costs. According to a recent survey by Ovum Research, titled "2015 Global Payments Insight: Retailers," 49 percent of retailers have seen their payment costs increase in the past 18 months, while 56 percent expect them to keep rising. Although credit card processors have recently reduced the percentage of sales that retailers pay to credit card processors (known as interchange costs), retailers—especially those with low-margin sales—still balk at paying them. Retailers are looking for ways to reduce these costs, either through consortia of retailers, such as MCX, or stored-payment systems, such as gift cards. According to the Ovum report, reducing operating costs relating to payments is one of the top two reasons (second only to improving customer experience) for payment infrastructure investment.

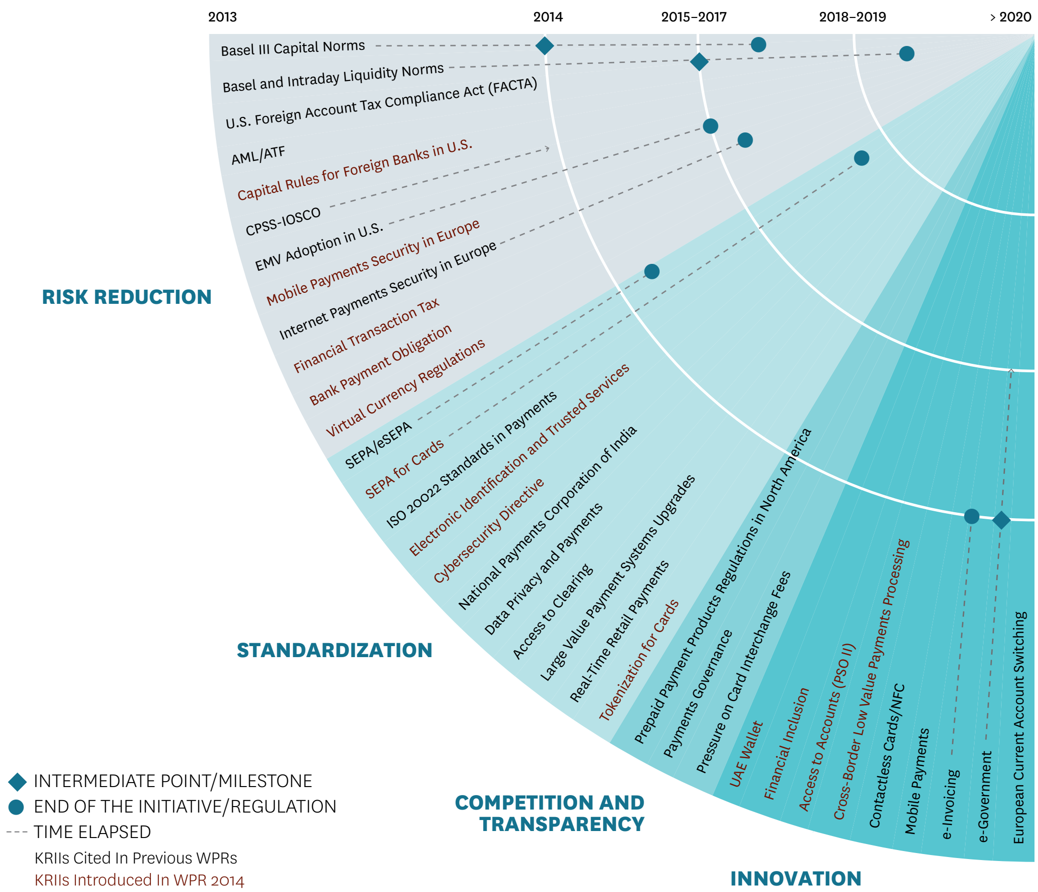
Retailers should look closely at new developments in their ability to reduce costs. The recently enacted Durbin amendment of the Dodd-Frank Act in Congress gives retailers an advantage because they are now able to find "least-cost" routing for processing of debit transactions.

In addition, their payment infrastructure should incorporate what's known as "direct-connect" capability between the retailer and its partner-issuer bank, which should not only reduce the lag time consumers resent regarding access to funds, but also reduce the retailers' cost per transaction.

Given these cost concerns, retailers tend to balk at any new payment system that requires them to upgrade hardware, software, or business processes, or to make other investments. At the same time, new payment strategies must withstand the spotlight of regulatory compliance, particularly when it comes to protecting transactional and customer data and reducing losses related to fraud. Compliance with the Payment Card Industry Data Security Standard (PCI DSS), which lays out standards for the secure transmission of payment data, is only one of the most famous

FIGURE 4

KEY REGULATORY AND INDUSTRY INITIATIVES (KRIIs) DRIVE FOUR KEY INDUSTRY TRANSFORMATION TRENDS, 2014



Note: Timelines have been provided for regulation where they are specified, no timelines are specified for industry-trend KRIIs. While some KRIIs may not be entirely new to the industry, they have been included this year as they become more evident.

SOURCE CAPGEMINI FINANCIAL SERVICES ANALYSIS 2014, WORLD PAYMENTS REPORT, 2011, 2012, AND 2013 mandates with which retailers must comply. Capgemini's Lassignardie notes, "Retail is still heavily impacted by local and geographical regulations. We've identified 35 global industry initiatives that affect the payment industry. They usually lack detailed implementation rules, and when you talk about global policies, they're usually applied without any consistency." (For a view of the initiatives Capgemini compiled, see figure 4.)

WHY RETAILERS SHOULD TAKE CONTROL OF PAYMENT SOLUTIONS

So what options do retailers have amid this roiling change? One option—highly touted by some experts—is to look for and follow the successes in the field. That means adopting a highly customer-centric attitude and striving to make payments as frictionless as possible. The method: through one's own payment application. "Payment is the operating system in this new mobile commerce landscape," says PayPal's Gardner. "The apps may be driving consumer adoption, but the retailer doesn't have anything if it doesn't have the operating system."

The success story most often cited is Starbucks. The app lets customers find nearby stores, order in advance, and skip the lines. The system automatically tracks purchases and tallies loyalty points. "That's the promise that digital technology holds," says Mark Flamme, vice president at consulting firm Strategy& (formerly Booz & Co.), a member of the PwC network of firms. "It's created something that crosses channels, integrating mobile technology to the physical store." (Subway shops offer a similar app, which allows line-jumping and custom sandwich building.)

Experts also cite the Uber transportation service as a success in eliminating friction in payments. It lets people call and pay for transportation without ever pulling out a payment card or money. Retailers should take inspiration from what Uber has done to make payments as close to invisible and as automatic as possible. The Uber app also provides information on where riders went, how long it took them to get there, and how much it cost. It lets them rate drivers (drivers can rate riders too).

Flamme also cites apps like the one Walmart has that fulfills the brand promise of "everyday low prices"; it enables consumers to scan a code on their receipt initiating an automated Internet search for lower prices and automatic credit of rebates for any price differences found. "Retailers are launching their own apps to curate the customer experience. They can combine those apps with GPS-based 'geo-fencing' that can draw customers into a store and in-store beacon technology, [that] can guide customers to and through the store," he says. "These apps can provide access to promotions and maps to help customers find merchandise—all ways to move customers from browsing to buying."

There are many reasons such a strategy has value. For one thing, it gives retailers the opportunity to take advantage of two converging demographic trends. First, the millennial generation is more likely and willing to embrace digital technology. Combine that with the fact that, as *Barron's*[3] noted not long ago, "this echo-boom generation," while representing less than the population percentage of baby boomers (27 percent versus 35 percent), could still "help lift GDP growth to 3 percent or more," almost as much as boomers did.

Need another reason to focus on one's own app? Look no further than the recent travails of highly vaunted Apple Pay, which triggered high levels of interest in the mobile payments space, but has been tarnished somewhat with security and uptake issues. Even after years of efforts, there's no ubiquitous and highly accepted alternative to credit or debit cards, and there's no alternative with a favorable cost basis for retailers.

> What's just as important as apps and new payment systems, however, is the back-end insight that they can provide retailers.

That's why PayPal's Gardner sees such apps as the future for retailers focusing on their best customers. Such apps help get rid of what he calls "the fat wallet," because instead of carrying around gift cards, credit cards, and debit cards, "it's just another app on your phone." Consumers who are casual rather than loyal customers will still have what he calls "meta-wallets" like Apple Pay, PayPal, and Google Wallet. Put another way, just as retailers offer multiple payment systems today—cash, credit cards, debit cards, and others—they will continue to do so. But the upper tier will consist of their most loyal customers, and there will be ongoing efforts to expand that tier by enticing casual consumers.

Other advances include the ability to reduce reliance on credit and debit card transactions, which brings cost savings through reduced fees. Though such apps may be reloaded through such transactions, the reloading would take place less frequently.

Furthermore, there is a big upside for retailers, according to consultant Conkling. With the insight gained from these applications, he says, "retailers can do more big data analytics and develop more-targeted marketing." Retailers can gain increasing insight into individual customer purchasing patterns, and thus benefit from greater insight into ways to increase sales and develop more enticing products and purchases.

What's just as important as apps and new payment systems, however, is the back-end insight that they can provide retailers. Retailers have to do better at integrating their channels into omnichannel systems for greater visibility into consumer behavior. They require visibility not only to reach across established customers, but also to identify prospects who become customers. To do that, they need better linkage among promotions, advertising, and sales. They also need better ways of engaging with customers who are focused on purchases or potential purchases. But they need to do so in a way that is extremely customer-centric. That is, it has to look helpful, not just creepy—so relevant that it feels like a service.

WHAT RETAILERS NEED TO THINK ABOUT

Contending with such an unsettled landscape, what's the best strategy for retailers? Challenges clearly remain, because, as Capgemini's Lassignardie laments, "there's a lack of a clear technology road map." He cites as a critical hurdle the lack of a standard or widely accepted payment technology, where players are "converging to common ground that gives retailers the confidence [that it's] sustainable and resilient, and can be built upon." He's confident that eventually there will be a sustainable business model for digital payments, but he's not sure "what will force players to converge."

He knows there are certain elements that will win out. One is efficiency—solutions that cost less while still being more secure and solutions that address the customer experience, "the ability to capture personal data and use it to deliver more relevant offerings."

There is a mismatch among technologies that still needs to be addressed. If consumers upgrade their smartphones every two years but retailers only upgrade point-of-sale technologies every 10 years, that's a problem. One possibility is that POS devices become less like dedicated devices and more like traditional computers, on which retailers can easily update applications and capabilities.

There may be a downside to that as well. "Online checkout pages [already] look like NASCAR cars, with multiple payment logos and more to come," Strategy&'s Flamme says. He believes the industry should create open POS checkout platforms and solution-agnostic wallet enablement solutions so retailers don't have to make big investments to upgrade terminals in stores or wrestle with a complex web of partners to accept new payments. "Then it doesn't matter how the market plays out," he says. "There will be multiple solutions, so retailers need to be flexible."

Retailers must also figure out the question of security. Any new technology—especially one as popular as mobile payments—creates new fraud opportunities, simply because in their newness, not all the vulnerabilities have been identified. Retailers need very strong fraud detection and prevention systems that span all their channels while still paying particular attention to mobile payment risks. This doesn't mean reinventing the wheel: retailers should think about using any security capabilities already built into mobile devices to their advantage, within their own apps and their payment systems.

No matter what payment infrastructure retailers decide to implement, they should strive to make it as effortless as possible for the consumer, using secure, tokenized payments as much as possible. Customers may not notice an invisible transaction, but they will remember a highly cumbersome one and think about shopping elsewhere.

IS A SEAMLESS END-TO-END SOLUTION POSSIBLE?

Because many payment solutions are still likely to fail from lack of traction, retailers do not have an evolved business model for creating a seamless end-to-end solution and are trying to figure out how not to reinvent the wheel; that is, to take advantage of the parts of the payment process that work while still accommodating future technologies. The executive at the Midwestern retailer says, "Somebody needs to climb up and say, we're building the right road but we're in the wrong forest. We need to pause—but not for too long—to develop an architecture and a strategy to figure out how we need to solve this problem so the next one becomes easier. When we get over the hill, the next hill should be easier to climb."

For instance, he says, payments should be separated from systems such as eCommerce and POS systems: "Let's separate the business data from the data the thieves want. If we keep the current system, retailers are locked in shackles. That separation will help us enhance security."

At the same time, retailers will need to stay cognizant of the need for multiple tiers of payment systems; an omni-channel strategy must include those beyond the most devoted customers. Otherwise, how will retailers transform prospects across tiers to loyal customers? And they must consider digital aliens—the grandparents of the digitally native millennials. "If I'm still non-digital but a loyal shopper, and you move all your offers to a digital realm, I'm likely to feel alienated," Flamme argues.

Another issue is employee training. "When the banking industry was creating more self-service tools for banking customers, tellers had to become more like teachers," Flamme recalls. "Faced with a complex array of digital payment mechanisms, customers are going to turn to clerks with similar questions, asking if they can use online offers in the store. Clerks with mobile point-of-sale

> Improved customer satisfaction and engagement will contribute to reduced marketing costs and maybe even reduced payment processing costs.

terminals are going to have to deal with that, and if they can't, the retailer may lose a customer. There's no doubt the transition period is going to be difficult."

THE PAYOFF FOR RETAILERS

Even so, while the transition to a digital world and the plethora of solutions and uncertainty in the market create challenges, retailers do have the opportunity to derive myriad other benefits by looking past the question of digital payments into the realm of customer service and engagement (the Midwestern retailer believes POS should stand for both "point of service" and "point of sale"). These include:

DEEPER CUSTOMER RELATIONSHIPS

The zenith of retail is the point where customers don't even think about visiting competitors. That's when they have the sense that retailers not only know them, but also anticipate their needs. "The more data you have about customer behavior," says Flamme, "the better you can shape it to drive more sales."

MORE CUSTOMER CONVENIENCE

Valuable time-saving line-jumping during lunch hour to get a sandwich you've customized yourself? VIP treatment, which is nirvana for a customer.

HIGHER LEVELS OF INSIGHT ABOUT CUSTOMER BEHAVIOR

Beyond understanding individual customers, there's also the attraction of understanding ever-smaller demographic subsegments of customers and prospects. Applying analytics to patterns based on other characteristics helps retailers craft strategies to attract other like-minded individuals. It may soon be possible to track the results of advertising from impression to purchase, which retailers have never been able to do.

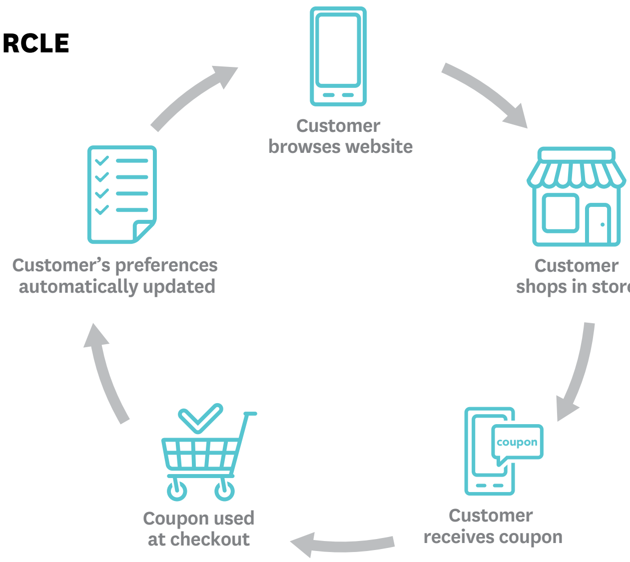
BETTER INSIGHT INTO SOCIAL MEDIA

Facebook "likes" may only be the beginning. At some point, retailers may be able to track what products or services loyal customers recommended, and which of their friends responded in kind.

All these issues feed that virtuous circle. figure 5 With a greater understanding of customer preferences, retailers can improve efficacy of promotional offers, coupons, and discounts, and can establish better customer engagement programs. They may also be able to increase security and

FIGURE 5

A VIRTUOUS CIRCLE



privacy because they'll have a better sense of their customers—who they are and who they aren't. The results are clear: improved customer satisfaction and engagement will in turn contribute to reduced marketing costs and maybe even reduced payment processing costs.

The underlying message about customer insight is even more important. Yes, payment systems feed data into this capability. But payment information should only feed the analytics and marketing—the two shouldn't be so inextricably linked that one couldn't be changed without affecting the other. Enterprises should be able to mix and match them, upgrading or improving one without impacting the other.

Ultimately, even though the urge to commit to digital payment strategies may be strong, the fact that the landscape is so unsettled means that any retailer should be, as Lassignardie recommends, "a prudent skeptic. Be ready to deploy quickly, but it's not necessary to be first." The Midwestern retailer concurs with this judgment: "You don't have to be the first, but you do have to be the best."

ENDNOTES

1 http://www.federalreserve.gov/econresdata/consumers-and-mobile-financial-services-report-201503.pdf

2 http://www.fastcompany.com/3021913/reverse-engineered/google-wallet-creators-reflect-on-its-failures-lessons

3 http://online.barrons.com/articles/SB50001424052748703889404578440972842742076

ACI PERSPECTIVE

The modern payments platform is about agility. It's about building an infrastructure that is fundamentally sound, but also nimble—capable of supporting experimentation and adaptation, and ultimately bringing the fruits of that labor to market quickly and effectively. It's an omni-channel platform simultaneously built on change and longevity. And the modern payments industry is the product of earlier disruption. If we are to avoid being superseded by a new wave of giants in the coming decades, we must embrace this opportunity for innovation and renewal. The same can be said for the retail industry.

Technological advances have brought about myriad disruptions for retailers, which face a daunting task yet an enormous opportunity to provide new levels of customer engagement. Payments play a vital role in this opportunity. The omni-channel payment process is deeply embedded into any successful interaction between the customer and the retailer.

Retailers strive to achieve a certain level of ubiquity in service offerings, and are now making room for multiple payments options while working to provide a low-hassle end-user interface that accommodates whatever the end user's preferred method. And as more retailers are putting a premium on building a rich understanding of the customer experience, they're letting the customer lead. As firms like Uber are demonstrating, new (and especially mobile) payments systems are far more likely to succeed when the focus is on integrating payments—an omni-channel payments experience—holistically into the customer experience.

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