Why enhancing the in-store checkout and payment experience will help safeguard the merchant acquirer business model

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EXECUTIVE OVERVIEW

This white paper provides a summary of the views of payments industry experts (based on a series of interviews undertaken in December 2016 and January 2017) and an analysis of relevant research studies within the retail and financial technology sectors.

It calls for acquirers to increase their investment in smart point-of-sale technology to both support their merchant partners and safeguard their own business models from the risk of disintermediation. It highlights how payment handling is becoming a subset of a new merchant acquirer value proposition, that includes value-added services such as improving operational efficiencies and the smarter use of customer data.

Customer expectations of the in-store environment are being raised by their online experiences. Retailers are responding to this challenge by delivering a richer, frictionless face-to-face experience, that is part of an integrated omnichannel strategy. A seamless and customized payment process lies at the heart of this shift, leveraging the power of the next (third) generation systems to integrate all forms of payment and retail apps into a single, hand-held or fixed smart point-of-sale.

The primary role of this new technology is to empower rather than replace the human dimension within the in-store environment. Off-line retail has always been a face-to-face experience and the use of mobile technology to liberate retail staff from being stuck behind a central cash register opens-up new opportunities to engage customers and enhance the overall retail experience.

A business model under pressure

These are challenging times for merchant acquirers. Fees have been under pressure for many years, but now with regulated levels of interchange and a requirement to disaggregate the merchant service charge into its component parts, there is nowhere left to hide. New competitors are emerging into this space, encouraged by the actions of legislative bodies in Europe and the US seeking the creation of a more open banking environment.

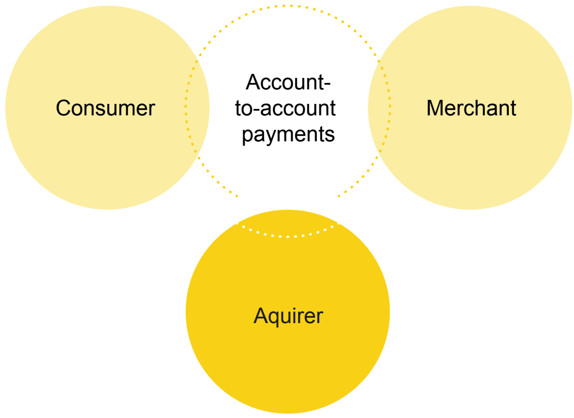
The implementation of the second payments services directive (PSD2), with its open data agenda, is expected to herald a revolution in the European payment industry, adding two new types of players into the payments ecosystem: Payment Initiation Service providers (PISPs) and Account Information Service providers (AISPs). It will also allow for new types of payment with merchants having direct access to bank accounts - a business model that does not feature acquirers. These changes, scheduled to come into force by January 2018, are likely to drive down fees for the handling of payments, and potentially erode the in-built advantage enjoyed by acquirers over new players coming into the market.

Payment Service Providers, which have provided online payment services for retailers, will continue to ride the ecommerce wave and especially its greater use within the in-store environment, in which the distinction between on and offline retail has become blurred. Existing players will either grow or merge, creating a new category of 'combined acquirers', combining classic POS and ecommerce products and thereby deliver a better, more integrated service for omnichannel merchants seeking a single vendor rather than multiple payments suppliers.

According to Mitch Armstrong, director of sales and marketing at digital engagement solutions provider Telrock and a former Vice President and Head of Transaction Banking for EMEA at ACI Worldwide: ***'The card payments model, that has been in existence since credit cards were introduced over 50 years ago, is coming under threat. Enabling transactions to go from account to account will effectively disintermediate the acquiring function. This is not simply a threat to their profitability but to their very existence.'***

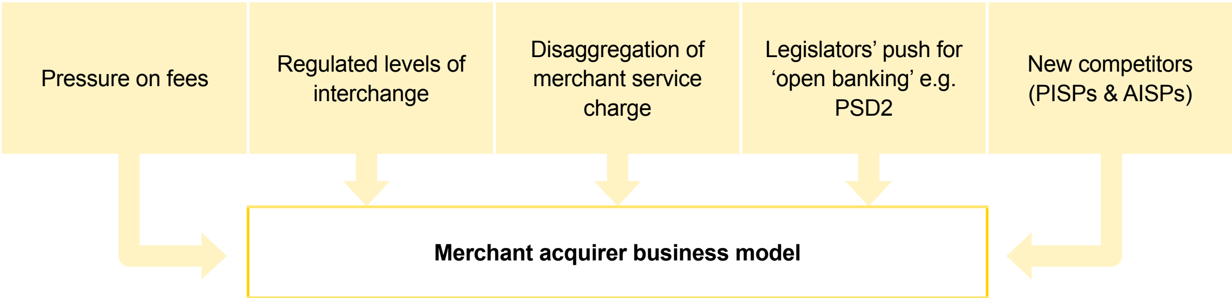
Disintermediation has been the logical consequence of digital disruption in many industries, from travel agents to advertising media buyers. Being caught in the middle of any commercial or transactional set of relationships, without appearing to add much value, is a dangerous place to be.

Disintermediating the aquirer role



Acquirers clearly need to offer merchants more tangible services and support if they are to protect the value of the merchant service charge (MSC) and ultimately justify their existence. Being able to answer the question, '*what is my acquirer doing for me?*' will become key to their survival.

A business model under pressure



Offering added value

Acquirers cannot rely simply on delivering the basic service functions that underpin the processing of payment card transactions. Payments handling - even though the proliferation of payments products and technologies will make it even more complex - will increasingly become a subset of a wider 'service package' that could include customer analytics, loyalty services and marketing support. ***'The payment act is starting to become an invisible component of a rich, frictionless customer experience',*** says Mario Cantero, co-founder of Deep Payments, entrepreneur and former group head of acquiring at Banco Santander. He points to the success of app-based payment models within the transport sector such as Uber and Cabify, as examples of how the payments process has become so subsumed within the overall experience that it has virtually disappeared as a separate act.

Acquirers will need to work with their merchant partners to increase operational efficiencies, open-up new revenue streams and unlock the value that can be derived from customer data. According to Cantero, **this requires: *'a different type of conversation with merchants that focuses on new value propositions… rather than simply talking about the cost of accepting payments, acquirers need to be talking about how to gain new customers, convert more sales and shorten servicing processes.'***

The new merchant acquirer value proposition

This is not a new challenge. In 2012, consultant Capgemini, in its report of the global merchant acquirer market, stated that: ***'acquirers cannot sustain their market share by reducing prices and promising to offer only best customer service. They require a new idea to compete, which may be new product offerings or use of technology to create an integrated solution for point-of-sale systems and electronic cash registers. They also need to provide excellent after sales support to their customers in order to develop long-term loyal relationships'*** [1].

In the five years since Capgemini's analysts made this claim, the position for acquirers has become even more challenging and the requirement for 'a new idea' even more pressing, especially with blockchain on the horizon and its promise of revolutionizing the peer-to-peer payments model.

Helping merchants enhance the in-store customer experience

The traditional (bricks-and-mortar) retail industry is clearly facing acute pressure from online retailers benefitting from a lower cost base and changing buyer preferences. That said, there is some evidence that the decline of off-line retail has been arrested in recent years. According to an analysis of the European retail market by Gfk, in 2015 '*Pressure of eCommerce in more mature markets slackened and a higher share of purchasing power growth went to stationary retail*.'

The year also saw a 3% increase in turnover within what Gfk calls 'stationary retail' across the EU-28, with Gfk predicting a growth rate of 1.1% for 2016.[2] The Gfk analysts also point to a 2.7% increase in sales area productivity, following two years of decline, as evidence of how '*store retail is gradually adjusting to the new conditions*.' Unprofitable stores have been closed and greater efficiencies have been achieved. However, the sector remains under considerable revenue and cost pressure in the medium-to-long term.

Jeremy Nicholds, former Executive Director, Commercial Development for VISA Europe and former SVP, Sales and Marketing, for MasterCard,

1 Challenges & Opportunities for Merchant Acquirers, Capgemini 2012
2 European retail in 2016, Gfk

The decline of off-line retail has been arrested

Europe and payments technology expert, says that: ***'The threat of online retail and in particular the phenomenon of showrooming [customers checking out products in-store before buying them from a cheaper retailer on-line] means that every physical visit that the customer makes to a store has to count.'*** The experience is everything, with a new emphasis on removing friction from the face-to-face space as well as online.

This importance of the customer experience is highlighted in a report by sales consultant Salesforce: '*Today, the service experience is central to customer loyalty. Customers choose companies that provide real-time, cross-channel, personalized, and effortless service. Companies will meet these expectations head-on by enabling the omni-channel experiences and self-service options customers expect. The most successful businesses will be early adopters of intelligent technologies that allow them to better understand the customer and set the bar for proactive service*.' [3]

An omnichannel mindset would appear to be a prerequisite for any successful retail venture. In a recent report published in the Harvard Business Review, analysing the effectiveness of an omnichannel retail strategy, the authors found clear evidence of the benefits for offline retailers: '*In today's channel-rich environment, omnichannel capabilities drive the engagement of core shoppers with the retail brand and ultimately draw them to the physical store. Traditional retailers with physical stores will do better not only by leveraging the power of the online world, but by synchronizing the physical and the digital worlds to provide shoppers with a seamless, multi-channel experience that online pure plays simply cannot match*.' [4]

One of the characteristics of digital innovation has been the way in which it has raised consumer expectations. If Amazon can anticipate our interests and provide a one-click, seamless buying process, with delivery options customized to our needs, it is not surprising that many ask why their local

3 State of the connected customer, Salesforce 2016

4 A Study of 46,000 Shoppers Shows That Omnichannel Retailing Works by Emma Sopadjieva, Utpal M. Dholakia and Beth Benjamin, Harvard Business Review, January 2017.

department store cannot offer a similar level of service. Daniel Maurice-Vallerey, co-CEO and co-Founder of payments technology company Yello says: ***'We all know that we are becoming less and less patient with our business and shopping experiences. This trend has been accentuated by the online experience where, for example there used to be delivery in three days, then one-day and now one-hour. It means that we want our offline shopping experience to be complete and to be immediate. We want to be able to talk to a single shopping assistant who is going to meet all our needs right away, rather than deal with multiple people and systems.'***

Mike Ausems, co-CEO and co-Founder of Yello, adds: ***'A smart point-of-sale needs to be secure, simple, powerful, open, with universal payment acceptance, at an affordable price.'***

According to analysts Forrester: '*This is a market where increasing customer expectations and declining tolerance for even mediocre experiences force the hand of leaders, mainstream companies and laggards alike.*'[5]

These expectations are being heightened by consumers' fast and relatively frictionless online experiences. In a survey by Sage Pay in the UK, 56% of respondents said that 'the ability to pay instantly' was the aspect of the online experience they would most like to see replicated in-store.[6]

The role for technology

Armstrong suggests that there has been a lack of investment in in-store innovation: ***'Most innovation within the retail sector has been in ecommerce, whereas the physical in-store experience is still extraordinarily impersonal – the technology that is available has not been taken advantage of by merchants or others in the eco system.'***

PWC's Total Retail Survey – a global snapshot of retail trends – reinforces this point about the need for innovation, suggesting that '*For those retailers with the wherewithal to invest, there's plenty of room to become known as a leading innovator.*'

The survey shows that only 13% of global consumers

Our offline shopping experience has to be as complete and immediate as online

5 Forrester Predictions 2-17: Dynamics that will shape the future in the age of the customer (October 2016)
6 Survey conducted by Redshift Research on behalf of OnePay, March 2015

said that store layout and in-store technology were categories in which their favorite retailer is a leading innovator, and only 15% said that their favorite retailer is a leading innovator when it comes to the in-store experience.' [7]

Some of the larger retailers – especially those operating in high margin categories such as fashion – have invested in high-end experiential technologies such as augmented and virtual reality. One of the social phenomena of 2016 was the launch of Pokémon Go, which represented something of a coming of age for augmented reality. These types of visually-enhanced technology will enable retailers, albeit those with deep pockets, to offer more immersive and personalised shopping experiences – for example, enabling people to virtually try-on a new outfit or test a new shade of lipstick – but they are not the answer for most mainstream stores. It will be many years, in ever, before we are walking around our local store wearing a VR headset.

For most consumers, their in-store experiences are compromised by relatively mundane customer frustrations, such as lengthy payment queues and out-of-stocks. Addressing these issues is a far bigger priority for most retailers than jumping on the AR/VR bandwagon. A UK survey by Visa Contactless showed that over 89% of people claimed to have recently left a store because of the length of the queue, with two thirds (65%) admitting they have visited a rival store straight after to get what they need.[8] Even the smartest VR/AR technology cannot compensate for a poor checkout experience.

Payment system innovation

The explosive growth of contactless payments – the latest figures from Barclaycard in the UK show a 164% year-on-year growth in the use of contactless payments [9] – demonstrate the consumer's appetite for convenience, payment innovation and multiple payment options. The irony is that the demand for innovation at the point-of-sale comes at a time when pressure on acquirer margins – through a combination of regulation and demands for greater transparency on merchant fees – might force some acquirers to stop providing payment terminals. According to Capgemini, this tighter economic model 'may eventually lead to the end of free complimentary services and supplies (such as payment terminals) from issuers to merchants' [10]. Rather than focusing on cutting costs or making false economies, acquirers seeking to safeguard their business model should instead be investing, on behalf of their merchant partners in the latest 'third generation' payment systems.

First generation, standalone payment systems facilitated card-based transactions in conjunction with an ECR, second generation payment dongles, a.k.a. mPOS, embraced smart phones, while third generation systems integrate all forms of payment (including real-time) with other retail apps and technologies within in a single, hand-held smart device or smart point-of-sale.

Alessandro Tedoldi, a payments industry veteran who has worked for VISA, Mastercard and ACI,

Lengthy payment queues are a bigger priority for customers than VR/AV

7 PWC, Total Retail Survey, February 2016
8 OnePoll survey for Visa Contactless, November 2014
9 Barclaycard Contactless Spending Index, December 2016
10 Challenges & Opportunities for Merchant Acquirers, Capgemini 2012

describes **the ideal payments system as *'the glue between merchant and customer'* combining payment transactions, delivery options, loyalty programmes and product information.** In contrast, he describes the current (first or second generation) reality in, for example, the brown goods sector: ***'when buying a television, the sales person will have to use different systems to organise delivery, installation and payment. This wastes time and risks frustrating consumers, when all of these functions could be included in a single piece of kit.'***

Openness is critical if the systems are to handle multiple functions and meet the specific needs of individual retailers. According to Capgemini: '*solutions based on open systems can be built using modular architecture, which will make them highly flexible to quickly adapt to a rapidly changing payments landscape… and align with growing security requirements, either to tackle fraud or as a result of upcoming regulations*.'

In-store payment systems also need to integrate effectively with stores' e-commerce activities. Most retailers currently operate separate systems to handle on-line and in-store payments, which adds cost and complexity. This will become ever more important with the growth of in-store mobile e-commerce: for example, the use of mobile apps by Starbucks customers to order and pay for their coffee.

The integration of loyalty and payment represents another area of opportunity. Typically, loyalty programmes and payments work in parallel, making it difficult for retailers to aggregate all the necessary customer data – denying them access to a complete picture of their customers' behaviour - and provide benefits for their most loyal customers.

Despite what appear to be the compelling benefits of mPOS solutions, the take-up to date has been relatively slow. The reasons are best summarized in the introduction to a report written by Editor in Chief and Retail Technology Blogger at RIS News, Joe Skorupa, '*Retailers have been implementing mobile POS in growing numbers for more than five years and there is no doubt that it is headed for mainstream adoption, but it is also clear that many retailers have deep concerns about cost, effectiveness and security. These concerns will need to be overcome before the majority of retailers jump on the mobile POS bandwagon*.' [11] Other commentators have also highlighted the requirement for dual hardware, short battery life and cumbersome size of existing mPOS devices – especially where multiple devices are involved – as barriers to adoption.

The chairman of the UK's National Cyber management Centre, Prof Richard Benham, has warned recently that: '*A major bank will fail as a result of a cyber-attack in 2017 leading to a loss of confidence and a run on that bank*.' [12] This announcement comes at a time of heightened

11 Crossing the great mobile POS divide, September 2016
12 Reported by the BBC, 6th January 2017

awareness of the importance of cyber security and its risks to all facets of the banking system. The acquirer/merchant relationship is potentially a weak link in the security chain, which means that every POS system needs to include the necessary hardware and software safeguards. It also puts the onus on acquirers to ensure that their merchant partners have invested in appropriate training and processes, above and beyond the existing PCI and EMV standards.

The RIS News report asked a representative sample of US-based retailers to define their business performance objectives for mobile POS.
The chart at the foot of this page shows the top four:

The research highlights an interesting tension between speed and engagement at the heart of the mPOS debate, with top scores given to what might appear to be the conflicting objectives of '*move customers out of store faster*' and '*improve face-to-face customer engagement*'. As Skorupa says, '*if mobile POS performs a checkout function, then very little face-to-face engagement will actually occur during a speedy transaction*.'

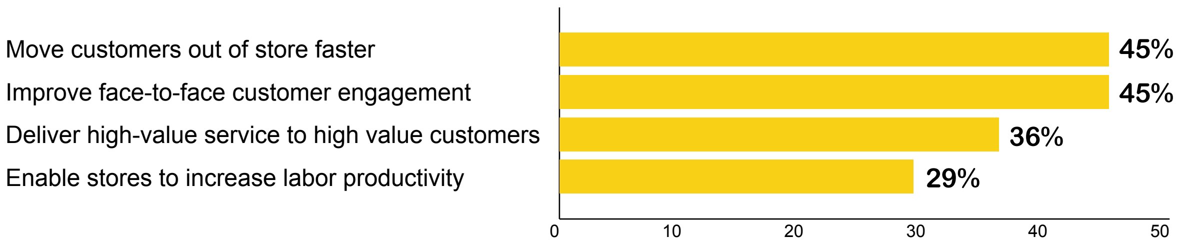
Off-line retail has always been a face-to-face experience in which the human interaction between customer and salesperson or instore expert should add value. This point is reinforced in a report by PWC which shows that the number one thing that shoppers around the world think would make their in-store shopping experience better is '*sales associates with a deep knowledge of the product range*', followed by '*Ease of checkout*' [13]. In the words of the report, '*Retail talent (finally) matters*' and the authors suggest that '*the more sophisticated dimensions of customer service (personalized advice, special after-sales services, and demonstrated deep product knowledge) could be a point of differentiation for retailers, particularly for retailers with a significant physical store footprint*'. They also suggest that '*The commitment of companies like Apple and Nike to in-store customer service and nurturing experienced, knowledgeable staff has raised the bar for retailers everywhere*.' John Lewis' reputation for customer service in the UK also continues to set standards that other's struggle to follow.

Armstrong says that the answer is ***'Making sales assistants more efficient and their jobs more rewarding, rather than replacing them with technology.'***

Whilst Tedoldi warns against technological solutions that encourage customers to '*cross the cashpoint too quickly: it is too convenient for the user*.' The final word on this topic goes to Jeremy Nicholds, who says, ***'Ultimately HI (Human Interaction) is more powerful than AI (Artificial Intelligence)'.***

It is interesting to note the relatively low score in the RIS News research for the removal of the traditional cash-wrap station, with only 10% of respondents considering this to be a business performance objective for an mPOS investment. This is despite the view of many of the experts interviewed for this paper, that mobility – freeing-up retail staff to engage with customers throughout the store and turning 'dead space' occupied by the cash wrap into additional merchandising space – can be a key benefit for retailers. Tedoldi describes how ***'The merchandiser's dream is delivering a fresh experience every time the consumer goes into a store. Fixed payment tills are a big hindrance to delivering the best merchandising experience.'***

Top mobile POS performance objectives (top four)



13 PWC, Total Retail Survey, February 2016

HI (Human Interaction) is more important than AI

According to Nicholds, ***'Mobile payment terminals free up retail staff from being stuck behind a central till and to engage customers on the floor. As well as allowing them to take payments there and then, they are well placed to upsell, including insurance, accessories and the bundling together of other purchases.'***

The most significant retail innovation implemented by Apple within its iconic Apple Store format, has been the removal of checkout lanes. Apple customers can purchase products and services anywhere on the shop floor, without any waiting time. Where Apple goes, other brands tend to follow.

The casual dining opportunity

Beyond the world of retail, Tedoldi believes that the casual dining sector could benefit significantly from payment innovation and open-up new opportunities for acquirers: ***'Businesses such as McDonalds have efficient processes, but the casual dining sector is not super sophisticated. They are able to offer reasonable food at a reasonable price and have speeded-up table-to-kitchen messaging through the use of mobile technology for waiting staff, but the payment process remains a point of inefficiency and frustration for the customer. Payments cannot be made on the same device that was used for taking the original food order and there is no application to make it easier to split bills between customers.'***

This latter point was reinforced in a survey by Barclaycard, which identifies that difficulties in dividing bills is one of the major frustrations for British restaurant-goers [14], with 18% of respondents wanting to see the introduction of bill-splitting apps or tools for large groups. The same survey,

14 Opinium Research, on behalf of Barclaycard, October 2016

also highlights diners' desire for speed of service and 'on-demand' technology: 15% of respondents claim to opt for restaurants where they can pay by contactless and 14% via a mobile device at the table.

There are also problems involved in adding tips to some forms of digital payment, which obviously has big implications for restaurant owners and especially waiting staff dependent on those tips to subsidize their wages.

Once again, the ideal solution to consumers' preference for on-demand convenience is not necessarily the removal of waiting staff and their replacement by automated, self-service technology, but instead using technology to empower staff to deliver the best customer experience. This will also improve operational efficiencies and open-up opportunities for up-selling.

Summary

New technology can be disruptive - undermining the structures and practices of traditional business sectors and disintermediating key players at the heart of those sectors – but it can also be a force for positive change. Merchant acquirers can either retrench in the face on economic and legislative pressures or harness the power of new, third-generation payments technology (smart point-of-sale) to help transform the performance of their merchant partners and open-up new revenue streams.

Despite the hyperbole accompanying AR and VR, the payments process remains the key area of frustration for consumers demanding ever more frictionless services. New payments technology also represents an area of opportunity to save costs, reduce otherwise 'dead' retail space and empower retail and waiting staff to deliver the best and most profitable customer experience.

Yello was founded by payments industry experts Mike Ausems and Daniel Maurice-Vallerey.

Yello's platform, the YelloPad, defines the new generation of payment terminals: secure, simple, powerful, open, with universal payment acceptance and at an affordable price. With its game-changing architecture and business applications it is perfect for both fixed and mobile use.

YelloPad is designed for a wide range of industries including retail, hospitality, healthcare and loyalty, benefitting acquirers, merchants and consumers. YelloPad brings face-to-face marketing and payments together for the first time. Sold by leading acquirers and payments processors and available online at www.yelloco.com, it helps merchants deliver an improved customer experience and increased sales.

Yello

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