

ISSUE 80 AUTUMN 2015

Mobile Payments: The Delay of Instant Gratification

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BY KEVIN GRIEVE

Leading Ideas

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by Kevin Grieve

In October 2014, when Apple debuted its iPhone 6 with an electronic wallet called Apple Pay, people immediately began to wonder whether it would overtake its competitors in the mobile payments business. The company has an impressive track record of releasing products and technologies that quickly disrupt and dominate markets. Nearly a year and well over 100 million iPhone 6 sales later, Apple Pay has emerged as the clear leader — but we're still waiting for disruption. Smartphones have yet to displace cash or credit cards at the retail point of sale.

To put the waiting game for mobile payments into perspective,

consider the history of credit cards. They made their first appearance as Diner's Club Cards in New York City in the 1950s, but it took 28 years for credit cards to be used by 50 million consumers. It took debit cards 12 years and PayPal accounts five years to reach the equivalent penetration level. The same milestone will probably be reached with mobile payments, but to get there, merchants and financial institutions must work together to deliver a seamless experience. Adding further complexity, retailers will need to make a significant investment — an estimated US\$8 billion to \$10 billion across the industry — to upgrade existing technology.

Countless mobile payment systems are active today — Apple Pay,

Google Wallet, the Merchant Customer Exchange (MCX) CurrentC platform, and so on — but none has yet gained significant traction with merchants or consumers or become the standard for mobile transactions. (See “Competing Mobile Payment Solutions,” page 3.) And none of them look likely to seize that role for a while. Several events, all of which took place in early 2015, highlight the rough and rapidly shifting waters ahead for all players: Best Buy, an MCX member, announced it would accept the rival system Apple Pay; PayPal announced it would acquire Paydiant, the underlying technology supporting MCX; and MCX announced that its CEO was stepping down and being replaced.

During the next few years, many competitors, from both financial services and the hardware and software industries, will jockey for control of the sector. Payments for retail purchases through smartphone apps still represent a tiny fraction of transactions for the \$2 trillion worth of goods and services that pass through retail establishments and banks each year in the United States; still, by 2018 digital

wallet transactions will likely grow to represent about 6 percent of total card transactions — the majority being small-ticket purchases made online or within apps. This figure may sound small, but it's a significant shift: Few would argue that e-commerce isn't mainstream, yet Internet sales represented only 6 to 7 percent of all retail sales in the United States in 2014.

Globally, mobile payments are making significant inroads, especially in regions where consumers aren't as accustomed to a physical point-of-sale. In Kenya, M-Pesa, a mobile money service, is used by 19 million people, and 25 percent of the country's commerce flows through the mobile service. In China, Alibaba now has some 350 million active users. The company reports that close to 80 percent of the transactions on its various platforms are made using mobile payments.

Just as people tend to compartmentalize their use of credit cards — one card for daily purchases, another for big purchases, and several for specialty retail — they are likely

to use different mobile payment apps for different brands and different types of transactions. But only a few general-purpose branded e-wallets are likely to be left standing when the industry shakes out; that's the nature of shared platforms. The companies that ultimately control the mobile payments platform may be technology companies or banks

cards are accepted at 99 percent of merchant locations.

2. Interoperability. In its current version, Apple Pay does not support all cards or merchants; some private-label store credit cards and regional debit networks are excluded. Eighty-three percent of the credit-issuing market had agreed to be part of Apple Pay when it launched, but that

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or retailer consortiums, or a combination of all three. The winners will be those platforms that offer five critical elements:

1. Merchant acceptance. Apple Pay is accepted at more than 700,000 merchant locations, but that number is less than 10 percent of the 8 million to 10 million merchant locations in the United States. This is significant: Consumers are less likely to use a credit card that's not accepted everywhere. As a point of contrast to mobile adoption, Visa and MasterCard's traditional plastic

left almost 20 percent of the market unsupported. Recently, Apple has started to expand its coverage. For example, the company worked out an agreement with Discover in April 2015 that will give Discover customers access to the app beginning the following fall. Further expansion will be critical if Apple is to ensure that any customer is able to make a transaction from his or her bank.

3. Security. For consumers and merchants alike, the fear of a breach is currently the number one obstacle to adopting mobile payments. Retailers have taken to heart the experience of Target, whose profits declined 45 percent after its well-publicized security breach in late 2013. The CEO and CIO were let go, and the company spent \$250 million, excluding insurance offsets, to address the issue. Apple advanced the game by "tokenizing" the transaction (removing account information from the data flow) and using fingerprint recognition technology. But until end-to-end encryption is in place to secure the entire transaction, security holes will persist. Financial institutions and merchants will continue to battle global criminal sophisticates.



Illustration by Phil Marden

4. Platform integration. Many single-point mobile innovations exist, but they do not fit together seamlessly. One such app is Milo (acquired by eBay in 2010), which performs online searches for specific products in stores near its users' location. Another app acquired by eBay in 2010, RedLaser, allows consumers to scan a product's barcode in a store and immediately uncover the lowest price for that product, online or at nearby retailers. Some major retailers, including Starbucks and Walmart, have their own mobile apps with payment capabilities.

At first glance, apps like these may seem to offer little more than convenient electronic credit cards. But an app, compared to a mobile-based website, is a more controllable, customizable handheld environment for the retailer. It enables businesses to better analyze customers even as customers gain more intelligence about products and services. With the people on both sides of the point-of-sale becoming smarter about one another, the behavior of shoppers and retailers is poised to change. As part of this transition, retailer loyalty, reward, and payment programs need to be supported by and integrated into shared mobile payment platforms.

5. Marketing data integration. Historically, for a variety of reasons, merchants have been unable to consistently and correctly link an individual consumer record directly to every payment transaction. Today, the convergence of the mobile phone, the payment transaction, and the online environment enables companies to track individual customers from the initial marketing impression all the way through the purchase. Those providers that leverage their mobile platforms for

Competing Mobile Payment Solutions

Apple Pay (Apple) Launched October 2014

Strengths

- Has not attempted to supplant any player in the current ecosystem, which has allowed Apple to create partnerships.
- Uses a combination of tokenized and biometric security.
- Has a strong consumer following.

Limitations

- Its NFC contactless technology is accessible only to iPhone 6 users.
- Disabled by some merchants aligned with CurrentC.
- Is not yet integrated with merchant loyalty programs.

CurrentC (Merchant Customer Exchange, or MCX) 2015 (forthcoming)

Strengths

- Uses QR codes and scanners rather than NFC terminals.
- Is device-agnostic and works with Android and iOS.
- Uses tokenized security.
- Allows customers to use points earned at one store at other retailers within the MCX network.
- Has lower transaction fees for merchants.

Limitations

- Privacy concerns over CurrentC's intentions to share purchasing data with developers, app stores, and phone manufacturers may deter consumer adoption.
- Requires multistep payment process: opening the app, scanning, and confirming the codes.

Google Wallet (Google) Launched September 2011

Strengths

- Accepts store loyalty cards, gift cards, and coupons.
- Allows funds transfer through Gmail.
- Works on hundreds of Android phone models, arguably giving it the broadest global reach.

Limitations

- Limited traction with mobile carriers and merchants.
- Impact of Softcard (the app previously supported by Verizon Wireless, AT&T, and T-Mobile) acquisition unclear.

Samsung Pay (Samsung) 2015 (forthcoming)

Strengths

- Partnerships with major credit cards and financial institutions.
- Proprietary security tokenization technology.
- Could work with retailers that have not directly signed up.

Limitations

- Available only on a limited number of Samsung phones.

Note: This is not an exhaustive list of services in the global mobile payments marketplace.

Source: PwC, "Payments on the Go: Making Sense of the Evolving Mobile Payments Landscape," March 2015

one-to-one marketing — before, during, and after a retail payment transaction — will have a leg up on the competition. They can achieve

the holy grail of consumer marketing: precise marketing ROI calculations for segments of one. For example, a merchant could send a

digital coupon via text and allow consumers to opt in, and then send personalized reminders only to those consumers. The merchant could then track coupon usage from mobile payments to determine the conversion rate and the overall marketing ROI.

Such scenarios hold great promise. But realizing them requires the establishment a complex web of institutional relationships. Who will track the data? Who will store the data? How will different institutions coordinate? Which standards will be used? And what emerging business models can monetize the new value creation? Not all the answers are obvious. But it is clear that traditional banks and financial institutions will find their greatest opportunity by leveraging their data. When financial institutions couple internal data with external data sources, they can begin to help merchants grow their business and provide consumers with a more personalized and robust shopping experience. The winners will convert that data into enhanced solutions across the value chain: targeted local and national offers, multifactor authentication, and security alerts.

The payment providers that stitch together merchant acceptance, mobile solution integration, and marketing fueled by data will be well on their way to success. Once that finally happens — and it will — customer relationships and marketing will never be the same. +

Reprint No. 00347

Kevin Grieve

kevin.c.grieve@strategyand.pwc.com

is a leader with Strategy&, PwC's strategy consulting group. He specializes in financial services and leads its North American cards and payments practice. He is based in Chicago.

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is published by certain members of the
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