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November 2019

2020 OUTLOOK: MERCHANT SERVICES

U.S. merchants willing to invest in digital solutions that drive consumer engagement will be rewarded in 2020.

The saying that Wall Street financial markets climb a wall of worry applies to the U.S. retail sector as well. Entering 2020, merchants are concerned about rising consumer debt, tariff wars, and thoughts of recession. While some of these worries may be overstated, 2019 has seen the reality of thousands of store closings and a steady stream of retail bankruptcies. But 2020 holds promise for merchants to withstand these turbulent times by finding ways to grow sales across a variety of consumer shopping channels. This Mercator 2020 Outlook provides insights on where merchants and their payment providers can capitalize.

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Looking Ahead: Mercator's Predictions for 2020 for Merchant Services in the United States

This 2020 Merchant Services Outlook highlights leading payments trends and solutions that merchants, developers, and payment providers should have as focus areas for the coming year. Like any new year, 2020 will bring some surprises, so Mercator will be intently watching merchant payment developments throughout the year. We welcome your views as we approach the end of the decade as well.

Looking Back at Mercator's 2019 Predictions for Merchant Services

Looking back at the predictions we offered in last year's Outlook on merchant services in the United States (Mercator Advisory Group's *2019 Outlook: Merchant Services*, released in November 2018), we are pleased to report that our crystal ball was especially prescient. Mercator's predictions for 2019 are listed the first column of the table below. The quotations from the press, in the right-hand column, state what actually has happened.

What We Predicted for 2019	What Actually Happened
"2019 will be the year of online ordering business for the grocery store market segment in the United States."	"Online grocery sales have grown more than 15% on a year-over-year basis and now account for 6.3% of total grocery-related spending by households in the U.S." —*Progressive Grocer, 9/13/19*
"M&A activity will continue unabated."	"Payments companies drove M&A activity in the financial-technology sector in 2019's first nine months. Payments firms were involved in four of the top 10 deals tracked by Berkery Noyes Securities LLC. The value of the payments mergers totaled $94.1 billion." —*Digital Transactions, 10/11/19*
"Self-service kiosks will become a common device in QSRs and fast casual restaurants."	"Usage of self-service kiosks continues to rise. QSR and fast casual restaurants can use kiosks to grow sales, increase throughput and prevent customers from leaving. Customer usage of kiosks is up from the previous year." —*Restaurant Technology News, 8/19/19*

U.S. Merchants Face Hybrid Shoppers and Too Many Stores

Hybrid Shoppers and Their Expectations

Entering 2020, U.S. merchants will confront a variety of industry dynamics, some new and others more familiar. Consumers are increasingly hybrid shoppers, meaning that they browse, order, and pay using multiple channels—online, mobile, and in-store. So merchants must be ready to handle a transaction seamlessly wherever it occurs. Since consumers continue to seek convenience and immediacy, merchants that provide those qualities will win their business. Mobile apps and online ordering have enabled the on-demand economy to generate high volumes of payment transactions in services ranging from ride hailing to meal delivery. Consumers are also won over by personalization and customized marketing offers. Merchants with engaging customer loyalty programs will achieve more frequent visits and higher spend per transaction.

Still Too Many Brick-and-Mortar Stores

Despite reports of the demise of the physical store, its end is not in sight. For many consumers, shopping is a social experience and engaging activity. Nonetheless, the United States is oversaturated with retail space. According to the International Council of Shopping Centers, the U.S. has 23 square feet of retail space per person. In contrast, the United Kingdom and France each have 5 square feet per person. The disparity is somewhat explained by the popularity in the U.S. of the big box store, which adds mega-space to the cumulative retail footprint. It's expected that 2020 will bring continued store closings, especially among mall anchors. However, many mall operators have begun changing their tenant mix by adding more dining and entertainment options. Expect to see more housing, grocery, and healthcare services in mall properties as well. With these changes to the mall makeup, retailers that remain in malls should benefit from higher daily foot traffic throughout the day and evening.

Online Ordering Drives Grocery and Restaurant Sales

Online Grocery Sales on the Rise

2019 has been a breakout year for U.S. online grocery sales. While e-commerce drove growth for retail sectors, the grocery vertical was late to the party. 2020 will see online grocery orders on a continued upward path. As discussed in Mercator's June 2019 research report, *U.S. Online Grocery Shopping Takes Off but Remains a Challenging Channel* (see hyperlink in References), national and regional supermarkets have made considerable investments in technology to spur online sales. From warehouse robotic systems for product picking to intelligent delivery systems, order fulfillment to home or office has never been faster. Major grocers including Ahold Delhaize, Albertsons, Amazon, Kroger, Target, and Walmart have made online sales a key initiative. Mercator expects U.S. online grocery sales to double in the next four years, reaching an annual level of $50 billion by 2023.

Grocery online sales receive support from delivery partners such as Deliv, Instacart, Peapod, Postmates, and Shipt. They have enlisted armies of shoppers and drivers to roam grocery aisles filling shopping baskets for delivery, which is usually within two hours in most metro areas. Grocers are divided on whether to use in-house or outsourced delivery resources. The answer right now is that both options can be effective if executed properly.

Restaurant Meal Delivery Continues to Gain

Food delivery has become one of the most sought after services in the on-demand economy. Consequently, both independent and chain restaurants now find meal delivery a mandatory offering. Delivery is no longer limited to pizza, and all restaurant segments from quick service restaurants (QSRs) to casual dining to fine dining are in the mix. This also plays into the themes of convenience and immediacy sought by time-strapped consumers. As with grocery delivery, the on-demand digital economy has also produced its own version of third-party delivery aggregators like DoorDash, Grubhub, and Uber Eats. These firms are now locked in heavy competition to serve restaurants who need an online order and delivery service to satisfy the food cravings of dine-at-home customers.

Aggressive market share competition among the aggregators and restaurants' unhappiness over delivery fees will be key issues to watch in 2020. Grubhub was once the market share leader but has been overtaken by DoorDash and Uber Eats. Competition doesn't help delivery company profits, as they are wooing customers with deals and discounts to boost demand and grab market share. Expect consolidation of delivery aggregators to occur in 2020 since there is too much delivery capacity and not enough profit. But this could take a while to play out, so consumers will enjoy widespread discounted delivery prices on their online restaurant food orders.

Delivery Aggregators Will Cross Over Between Grocery and Restaurant Verticals

The delivery aggregator business model of developing a network of product pickers and drivers can be transferable across different verticals, so competitors are looking to jump into new markets. For the most part, players like Instacart, Peapod, and Shipt ply the grocery store vertical, while DoorDash, Grub Hub, and Uber Eats cater to restaurant meal delivery. While delivery is still an expanding business, there is plenty of competition and rising costs, so scale and volume are ways to offset financial pressure. The restaurant delivery firms may have an edge over grocery since there is a higher degree of difficulty in selecting someone's steaks, swordfish, and avocados compared with picking up a ready-to-go restaurant meal.

Technology Solutions Boost Customer Engagement

Autonomous Checkout Stores Will Multiply

We believe 2020 will be a growth year for autonomous store checkout systems among U.S. retailers. Amazon Go will continue to open stores in selected cities, although this expansion is occurring more slowly than was expected. The pace could pick up quickly given the many additional opportunities for Amazon Go systems at airport locations and even as small grab-and-go sections at Whole Foods or other grocers. But while Amazon Go garners most of the headlines, there are several other developers to watch in 2020, including AiFi, Grabango, Standard Cognition, and Zippin. They employ variations of Amazon Go using cameras, sensors, and artificial intelligence algorithms that track customers and identify products they select. Some require a mobile app to gain store entry, and others allow customers simply to use a payment card to enter and shop. They all address the consumer's preference for convenient in-store shopping without waiting in checkout lines.

As with Amazon Go, the autonomous store technology and related installation costs run high. Some developers are working on lower-cost systems that can scale up to a 100,000 square foot store, which is much larger than the typical 2,000 square foot convenience store that has been the target size for Amazon Go. This would be a game changer and enable many more supermarkets and other retailers to operationalize self-checkout systems. Larger-footprint grocers and warehouse clubs are among the retailers looking at self-checkout systems. We will see a major store chain announcing an autonomous checkout system during 2020.

Mobile Order and Pay Apps Become Key Connection with Consumers

Mobile devices, primarily smartphones, will be increasingly important to merchants as a customer engagement tool. Single-merchant mobile pay apps have the greatest influence on consumers' mobile buying behavior. Starbucks attributes 41% of its Q1 2019 sales to its rewards program members, which demonstrates the power of customer loyalty, especially when there's an integration of payment, points earned, and personalized marketing offers. Universal pay apps from Apple, Google, and Samsung cannot deliver as deep customer engagement. QSRs will continue as a sweet spot for mobile pay apps. Additionally, gas stations with convenience stores will increase their reliance on mobile apps. These merchants possess frequent-visit, grab-and-go buying cadence and offer mobile apps for geolocation and pay at the pump for fuel. Vendors in the travel industry, especially airlines and hotels, are becoming more mobile-connected with customers as well. Not to be left out are the physical stores such as electronics, home improvement, and multidepartment big box retailers, which will increase the volume of click-and-collect sales originated from a mobile app. Given the opportunities for mobile payments in so many verticals and given that consumers have now become more comfortable paying via a smartphone app, the card processing networks and issuers will be intensely competing for top-of-wallet position.

AI Meets Conversational and Contextual Commerce

Customer personalization will be enhanced in the coming year as some QSRs will use artificial intelligence across various sales channels. McDonald's is using customer personalization as a key feature of the ordering experience and has acquired technology that uses AI to better understand speech. Part contextual commerce and part predictive analytics, the burger chain's technology will look at a customer's location, current weather conditions there, and past buying behavior to suggest food and beverage items. When ordering from the mobile app, customers can choose to get their selection in-store, via drive-thru, or at curbside pickup. Large self-service kiosks are also being installed in-store as a way to connect with customers that want to avoid lines at the counter. QSRs and fast casual cafes are ideal for such customization strategies because customers will expand their orders and try new items when presented with appetizing suggestions.

Sports Betting Opens Up a Whole New Ballgame

The U.S. Supreme Court in 2018 gave the green light to the states to determine their own sports betting regulations. This opened a wide window of opportunity for states, gaming firms, and payment providers. The prime example is New Jersey, where 80% of sports betting occurs online via computers and mobile devices. The Garden State saw over $2 billion in online sports gambling in its first year of operation. Sports fantasy gaming firms DraftKings and FanDuel are primed to capitalize on the upward trend of online betting and are partnering with some major casinos such as Caesars Entertainment. Traditional casino table games and slots have become a saturated market, so sports betting opens up a big addressable market. Watch for more states to get in on the action as they salivate over the sizable tax revenue opportunities.

Remaining Thoughts as We Look Ahead to 2020

Merger and acquisition activity in merchant services will continue in 2020. The megadeals from 2019 will need further digestion going into 2020 among the six players that made moves—Fiserv–First Data, FIS–Worldpay, and Global Payments–TSYS. But there will be smaller deals completed as well. Companies with technology expertise in fraud detection, mobile apps, and vertical market solutions, especially healthcare, will be key targets.

E-commerce gateways will increase their presence in the payments landscape. Cross-border e-commerce, especially business-to-business, or B2B, will see continued growth. Watch for one or more gateways (such as Shopify or BlueSnap) to be part of a merger or acquisition involving a merchant acquirer, card network, or fintech.

Friendly fraud incidence is rising. Merchants are feeling increasing pain from friendly fraud (when cardholders dispute legitimate charges on their cards, resulting in a chargeback). As a consequence, more vendors will provide solutions ranging from fraud detection to chargeback intervention, partnering with payment processors, gateways, card issuers, and networks. Most solutions use automated dispute resolution to reduce merchants' labor required to investigate chargebacks.

Alternative POS lenders will expand their retail presence. Consumers looking for extended payment plans for big-ticket items will have more options to complete a purchase. Lenders such as Affirm, Financeit, Klarna, and Splitit are teaming with retailers, especially sellers of home improvement services, furniture, and electronics.

Small business will find more sources for working capital loans. Competition will intensify among nonbank lenders PayPal, Square, and Stripe that use payment transaction data to determine the creditworthiness and payback ability of their small business clients. Also, expect more fintechs and alternative lenders to cater to small business owners, and take market share away from established commercial bankers.

Customer loyalty programs proliferate. These will use personalization and gamification to attract customers and extend customer relationship cycles. Successful loyalty programs will apply a seamless structure so to keep customers engaged across in-store, mobile, and online buying channels.

References

Related Research by Mercator Advisory Group

Square and Clover Delivering Merchant Services Beyond Payment Acceptance (September 2019)

U.S. Online Grocery Shopping Takes Off but Remains a Challenging Channel (June 2019)

Intelligent Vending Technology in the U.S.: Reinventing an Industry (June 2019)

Gamification and Other Strategies for Merchants to Enhance Customer Loyalty (May 2019)

2019 Outlook: Merchant Services (November 2018)

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