

# EXECUTIVE INSIGHT

October 2016

12 Clock Tower Place, Suite 150 | Maynard, MA 01754  
www.mercatoradvisorygroup.com | phone: 1(781) 419-1700 e-mail: info@mercatoradvisorygroup.com

## PAYMENTS IN THE NEW MARKETPLACE ENVIRONMENT

E-commerce growth is changing retailers' focus

*Traditional retailers today are focusing on building better online, mobile, and technological capabilities to keep customers and increase sales. This change is understandable given the popularity and growth of online commerce. Payment providers and brands would be well served by implementing a modern payment architecture encompassing emerging digital technologies and common rules and regulations across all channels.*



**Arthur D. Kranzley**  
**Director Emeritus**

Art has over 40 years of financial services experience, including as executive advisor in advanced and emerging payment technologies, assisting companies in the areas of authentication, security, electronic commerce, mobile commerce, smart card, and credit/debit payments.



## Retailers' Embrace of E-Commerce

Estimated U.S. total retail sales in the Q1 2016 decreased 0.2% from the Q4 2015, while e-commerce sales for the same period increased 3.7%. Comparing year-over-year figures for Q1 2016 vs. Q1 2015, total e-commerce sales grew 15.2%, while total retail sales (including e-commerce) increased only 2.2%. Overall, in the first quarter of 2016, e-commerce sales totaled 7.8% of the total retail sales figure.<sup>i</sup> Probably more notable to retailers was Amazon's financial results announcement that its net sales increased 31% to \$30.4 billion in the second quarter, compared with \$23.2 billion in second quarter 2015.<sup>ii</sup>

In the announcement of Wal-Mart's acquisition of Jet.com for \$3+ billion in early August 2016, Doug McMillon, president and CEO of Wal-Mart Stores, Inc. said:

*"We're looking for ways to lower prices, broaden our assortment and offer the simplest, easiest shopping experience because that's what our customers want. We believe the acquisition of Jet accelerates our progress across these priorities. Walmart.com will grow faster, the seamless shopping experience we're pursuing will happen quicker, and we'll enable the Jet brand to be even more successful in a shorter period of time. Our customers will win."*

The same announcement stated that Jet will maintain its own identity although the two organizations will share and mutually leverage technology solutions. While CEO McMillon's statement hits the nail on the head as to what today's savvy consumers want in the new marketplace environment, Wal-Mart's stated intention to maintain the Jet.com identity is inconsistent with the need for a shopping experience that is full function yet simple and seamless.

## Consumers Will Drive New Marketplace Leadership

Consumer studies indicate that retail shoppers prefer a convenient and frictionless shopping experience with information about products, pricing, and savings easily obtained and understood. Perhaps this is why online shopping, whether by personal computer or smartphone, has grown so rapidly. What better and simpler way is there for retailers to offer consumers the shopping experience they want? The challenge to traditional retailers is how to bring these same attributes to the physical retail environment in a way that is similar to and as simple as the online experience. Ideally, traditional retailers will be able to leverage their physical store assets to complement their online presence and provide unique and differentiating benefits to their customers.

To provide this type of enhanced shopping experience, the retail industry has been focused on developing and implementing systems to support omnichannel commerce. For traditional retailers, this means creating a new marketplace environment that combines and integrates physical and online retail, private-label and third-party products and services, loyalty and rewards promotions and savings, local and regional fulfillment, and pick-up and at-home delivery.

According to Cal Bouchard, director of e-commerce at The North Face, in a quote on nrf.com,<sup>iii</sup> the tactical pieces of omnichannel projects fall into three buckets:

- **Seamless experiences** — ensuring customers can shop in whatever way they want, wherever they want, regardless of their device with consistent branding and a clear story.
- **Seamless inventory** — ensuring customers and store associates can find the products they want, regardless of whether it's in store, in a nearby store, online or sold through wholesale channels.
- **Seamless data** — bringing the best of the online experience into the store and the best of the physical experience online.

This tactical objective of combining the best of both the physical store presence and the online or digital environment was reinforced by Macy's CEO Terry Lundgren, quoted in *Fortune* in November 2015,<sup>iv</sup> who stated:

*"I very strongly believe that consumers are not only going to shop online, they're going to start their journey on their phones, they're going to enter our stores, they're going to interact with our sales associates, learn more about product, try product on, feel the fabric. They may not buy it in store that day, but without that store interaction, it's likely the sale would not occur."*

While the sale might occur only because of a customer's interaction within a store, traditional retailers need to implement seamless omnichannel marketplaces to ensure that the sales occur at their own online sites or in-store and not at Amazon or another competitor's site. All too often consumers will check online options and shop at Amazon because it is easier than following up at the retailer's online site.

## Payments Must Support New Marketplace Environments

A critical component of this new retail marketplace environment (although all too often an afterthought) is the check-out and payment process. This must be incidental to the consumer's overall shopping experience. Check-out and payment needs to be simple, seamless, and consistent across all channels. To be successful, an omnichannel retailer must provide a superior and channel-agnostic customer payment experience wherever and whenever consumers want to shop.

However, the payment process is becoming more complex for both the retailer and the consumer thanks to the plethora of new payment offerings available today designed around channel technologies for features, risk management, security, and authentication. If the payments industry fails to address this growing disconnect with consumers and retailers, current systems will be mothballed and more advanced and frictionless payment options are bound to emerge.

How many different ways does a consumer need to know how to pay by card (e.g., swipe, tap, dip, manual PAN entry, token, one-time virtual account number, signature, PIN, CVV/CVC, etc.)? Similarly, how many mobile and digital wallets does a consumer need to use (e.g., Android Pay, Apple Pay, Samsung Pay, MasterCard Pass, Visa Checkout, Amazon Pay, PayPal, Walmart Pay, etc.)? And if a consumer buys something online with a digital wallet, can it be returned in-store with a card associated with the same account as the wallet and how is the return transaction to be processed?

As retailers implement more omnichannel systems to address today's busy digital consumers, emphasis also must be made on keeping the entire payment process simple and linked across all channels for transaction authorizations, refunds, returns, adjustments and cancellations. Currently, payment products and systems address these multiple channels separately and are not integrated components within a modern payments ecosystem.

## Repositioning Modern Payments into Three Layers

To order to manage payments effectively in the new omnichannel marketplace environment, providers would be well served to rearchitect the way they proffer the myriad of payment products and options. All types of payments supporting multiple channels today and emerging payment solutions embedded in other applications, including those associated with the "Internet of Things" can be simplified through a three-layer payments architecture. Any payment product positioned within this architecture can be easily understood by consumers and retailers and will support the investments being made by traditional retailers in new omnichannel marketplaces. Moreover, products developed and implemented with a common set of rules and procedures built around this three-layer architecture will provide both consumers and retailers with convenient, safe, easy-to-use, and integrated payment alternatives. The layers are:

### 1. Core Account

In any payment, there is a core account where funds are sourced, and any payment product must ensure that the consumer is knowledgeable and clear about the provider and brand(s) associated with the account. This account could be a credit account or deposit (debit) account, and the provider might be the consumer's bank, mutual fund, or credit union. Even in the case of stored-value (prepaid) accounts, the consumer needs to be aware of the underlying source of funds that are swept into the stored-value account. Branding associated with the core account should be clear as well, and may include the bank brand, payment association brand, and/or the merchant brand when combined with a prepaid account.

### 2. User Interface

In the past, the primary user interface (UI) for payments at the point of sale and online has been a consumer's credit or debit card. As alternative form factors have been introduced, the UI has all too often been identified on a stand-alone basis as the payment product without recognizing the core account.

The user interface is the method or device through which the consumer accesses his or her funds in the core account to make a payment. If the same core account is linked to multiple user interfaces, then payments,

refunds and returns should all be processed exactly the same (e.g., without regard to where or how a product was purchased and where or how it was returned). User interfaces include credit and debit cards, mobile phones (along with merchant apps and mobile wallets), digital wallets, and embedded or contextual payment applications where the core payment account is programmatically accessed (such as Uber, Amazon Prime, and EZPass). Payments are moving away from a card-centric environment with its own rules and regulations to a digital environment that requires a common set of rules applicable across all user interfaces.

### 3. Access and Authentication

The third layer of payments is the way the core account is accessed through the user interface and the way the consumer is authenticated in compliance with the requirements of the entity holding and protecting the source of funds. Access can be made under a number of authorization and authentication techniques tailored around the core account and user interface. Authorizations might be real-time or off-line depending on location and risk management controls, and authentication might range from signature to PIN or password to preprogrammed or prearranged for contextual or embedded payments.

Only when payment products and the associated rules infrastructure are architected consistent with these three layers will payments be able to support consumer and retailer needs across all in-store, online, mobile, contextual payments, and future payment channels. Moreover, a clearer understanding of the underlying components associated with payments will enable consumers to shop and make purchases on an integrated basis without the complexities being added today by the number of unique and disjointed options and alternatives being thrust upon the market.

As an example of this repositioning of modern payments, two recent announcements by PayPal indicate that it is enhancing and rearchitecting its payment solution and is cognizant of these three payment layers. PayPal's alliances with Visa and MasterCard suggest that it could be the first to offer a ubiquitous payment solution that is simple to use and seamless across conjoining physical, online, mobile, and embedded channels in the new marketplace environment.

Prior to these announcements, the PayPal wallet could be used for e-commerce and mobile transactions, and a PayPal debit MasterCard card could access funds in a PayPal account at the point of sale and ATMs. However, with the Visa and MasterCard alliances, PayPal is recognizing the core account by promoting both Visa and MasterCard accounts as funding accounts for the PayPal wallet. In addition, these alliances will extend acceptance of the PayPal wallet to all merchants accepting Visa and MasterCard contactless Near Field Communication (NFC) payments, expanding the functionality of the PayPal wallet beyond online shopping to in-store shopping.

According to Dan Schulman, president and chief executive officer at PayPal, in the PayPal Visa press release<sup>v</sup>:

*“This agreement opens new avenues for PayPal to collaborate with Visa, financial institutions, and others in the payments ecosystem to deliver greater value, more choice, and new experiences for our joint customers wherever they transact - online, in-app or in-store.”*

In the PayPal MasterCard press release,<sup>vi</sup> Schulman went on to say:

*“Customer choice and partnership are fundamental principles for PayPal that guide how we operate as a company, giving our customers greater opportunities to more easily manage and move their money online, in app and in-store.”*

## Conclusions

Creating a layered payment architecture will enable consumers to shop conveniently and seamlessly across all channels using the core accounts and user interfaces they prefer. For the omnichannel merchant, a consumer will be able to make a purchase in-store, or if inventory is short, conveniently order online and pay on his or her mobile device while in the store. Later, goods can be picked up in-store or delivered, ensuring completion of the sale and a satisfied digital customer. The same payment solution could be extended to support contextual and embedded payments in applications where payments are automatic when goods and services are procured.

The payment scenario for the new omnichannel marketplace environment revolves around a simple payment architecture that trumps payment products and programs focused on individual channels. Payment providers and brands would be well served by implementing this type of modern payment architecture encompassing both traditional payments and emerging digital payment technologies and by creating common rules and regulations applicable across all channels.

## Endnotes

<sup>i</sup> Census Bureau of the Department of Commerce, May 17, 2016

<sup>ii</sup> Amazon.com, Inc. Quarterly Report for the Quarter Ended June 30, 2016

<sup>iii</sup> Jennifer Overstreet, “A Peek inside the North Face Omnichannel Strategy,” July 23, 2014.  
<https://nrf.com/news/peek-inside-the-north-face-omnichannel-strategy>

<sup>iv</sup> Phil Wahba, “Macy’s CEO Defends Role of Stores in E-Commerce Era,” November 11, 2015,  
<http://fortune.com/2015/11/11/macys-ecommerce>

<sup>v</sup> PayPal and Visa Press Release, July 21, 2016.  
<https://www.paypal.com/stories/us/paypal-visa-enter-partnership-to-extend-consumer-payment-choice>

<sup>vi</sup> PayPal and MasterCard Press Release, September 6, 2016.  
<https://www.paypal.com/stories/us/paypal-and-mastercard-expand-partnership>