

The New Payments Challenge – How to Become Compelling to Merchants Again

While a changing payments landscape presents new value-creating opportunities for merchants, the payments industry itself must adopt more effective marketing and sales techniques to merchants if it is to share in the spoils

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There is a new assertiveness among merchants in their dealings with the payments industry. Around the globe, merchants of all kinds are seizing new opportunities to harness payments services and payments-related technology to help them toward their goals. For those who supply payments services to merchants (such as issuers, acquirers, processors, hardware providers, etc.) the opportunities are huge.

Many merchants are frustrated, however, with what they perceive as the inability of payments industry suppliers to address their changing needs. How suppliers respond will be critical in determining how quickly the industry expands, and who ultimately benefits.

This paper looks at how the payments landscape is changing in terms of merchants' needs and supplier market dynamics. We show how suppliers can respond by changing the way they market and sell to merchants, in order to drive innovation and ultimately profitable growth.

The Challenge of the New Payments Industry Landscape

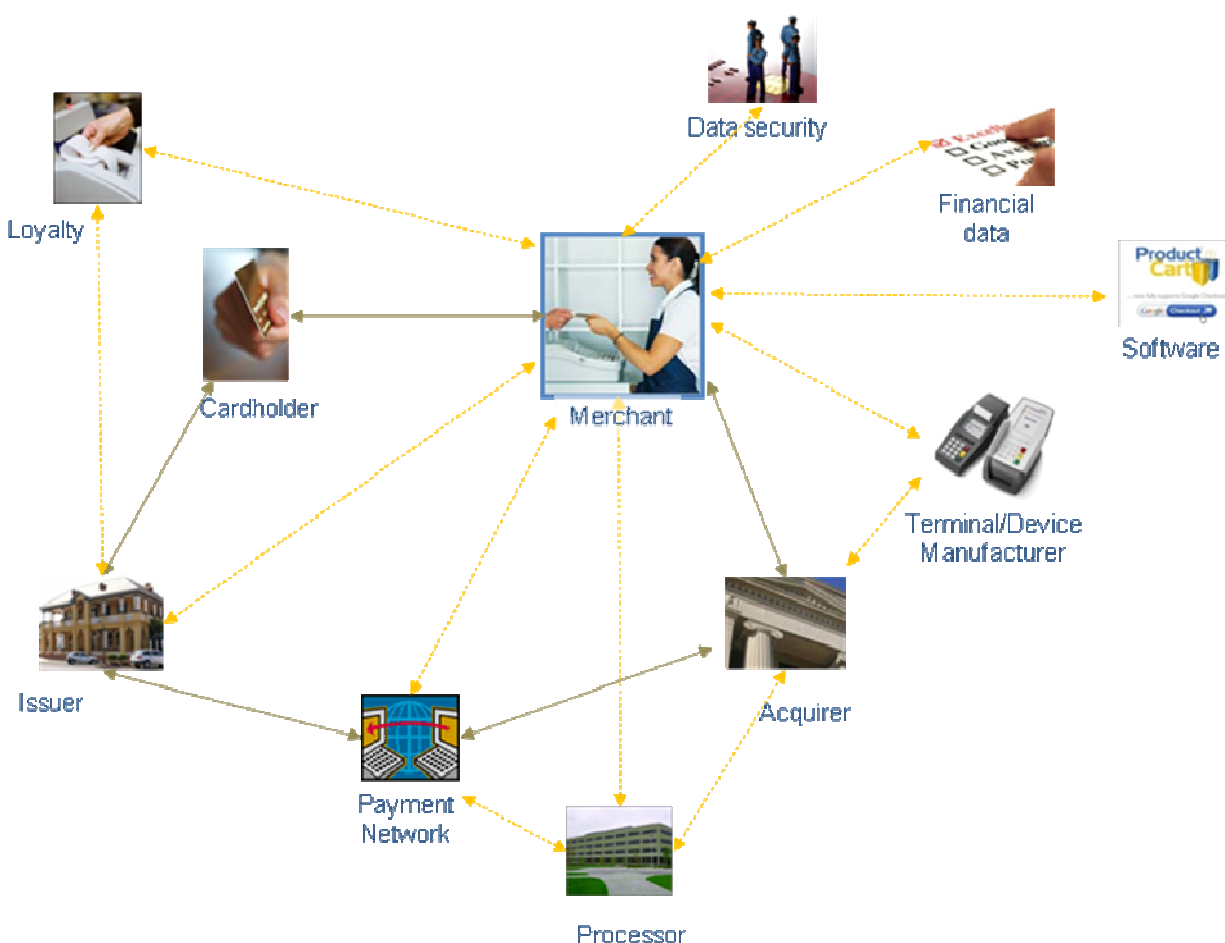
Merchants are looking at what they contribute to the payments industry, in terms of gross volume and fees, and demanding more value back. They are looking for enhanced capabilities, but they also want better value. Major retailers have grown adept at squeezing suppliers of all types, and now they are focusing their sights on the payments industry. By unbundling elements of the payments value chain and then re-tendering, they are seeking to drive down margins. Existing suppliers, such

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as acquirers and co-brand issuers, increasingly risk being disintermediated for large parts of their business unless they can demonstrate added value.

At the same time, new firms are entering the payments market offering increased choice and lower costs to merchants of all sizes. Whether they are processors, hardware manufacturers or software and data providers, these technology firms all share a capacity to accelerate innovation and competition in their target markets and present a direct challenge to incumbents. Above all, there is the threat that a technology giant such as Google, Microsoft or Nokia will find the necessary traction to launch a game-changing alternative solution that will leave traditional payments providers without a market.

The New Payments Industry Landscape



Payments industry suppliers of all types, from issuers and acquirers through to processors and device manufacturers, must address two challenges in order to succeed. First, they must adapt to merchants' evolving needs in order to serve them better. Second, they need to compete more effectively in terms of marketing and distribution. This document discusses how this can be achieved,

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and introduces some of the techniques to help suppliers compete successfully for merchants' business.

What Merchants Want from their Payments Industry Suppliers

In the past, the payments industry often took merchants for granted. Established suppliers think they're aware of merchant needs, but there remains a real gulf between what has historically been provided, and what could potentially be delivered to help merchants achieve their objectives. Let's quickly run through the possibilities.

First, there are the core payment needs. A growing number of payment methods are available to consumers. When you buy a watch, or a basket of groceries, or check out of a hotel, you expect to be permitted to pay through one of several methods, for example: cash, check, debit card, credit card, charge card, store card, voucher/gift card or pre-paid card. If the payment is being made over the Internet or through a mobile phone, still more methods are available, including PayPal, BillMeLater and Google Checkout. The choice can be bewildering. Merchants need help in offering the right payment methods, cost-effectively, for their line of business.

LEVERAGING PAYMENTS VALUE TO SUPPORT MERCHANT NEEDS	
<i>Traditional Merchant Requirement</i>	<i>New Merchant Requirement</i>
<p><i>Issuer provides cardholder with revolving line of credit</i></p> <p>↓</p> <p><i>Increases consumer spending power</i></p> <p>↓</p> <p><i>Increases sales for the merchant</i></p>	<p><i>Increased customer loyalty and insight</i></p> <p>+</p> <p><i>Accelerated throughput</i></p> <p>+</p> <p><i>Simplified processes and secure infrastructure</i></p> <p>↓</p> <p><i>Improved ROI</i></p>

Looking beyond the payment transaction, there is a range of associated opportunities for the merchant to drive sales, which should also be addressed by the payments industry. Payments providers can help the merchant to improve customer experience, loyalty and spend. Contactless

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cards accelerate payment, thereby reducing waiting times at the checkout and increasing throughput. Point of sale messages derived from payments data enable staff to offer promotions in real-time based on recency, frequency and value. Payment card providers can facilitate co-marketing across multiple brands in order to help merchants acquire new customers, cross-sell and extend loyalty.

At the other end of the spectrum, there are a growing number of ways in which payments suppliers can help merchants to reduce costs. Merchants will be very keen to hear from suppliers who can lower their total cost of ownership without jeopardizing security. One European retailer operating across 11 countries had the equivalent of 30 full-time staff tied up with payment-related internal processes. These processes included reconciliation and reporting across countries, and maintenance of different payment rule sets and technology platforms. Through a combination of software and other services, an international acquirer was able to free up 80% of this resource for other tasks.

The following table shows how the generic merchant requirement has evolved over time. But there is also considerable variation between individual merchants, dependent on sector, scale, strategic outlook and a host of other factors. A major retailer like Wal-Mart or Carrefour may already have adequate support in managing their loyalty schemes, but they could be very interested in standardising payments platforms across countries. An upscale fashion chain, on the other hand, may only see a customer four times a year. Driving loyalty is difficult in such situations, and if the payments provider can tell when the customer last visited and how much they spent, this can be enormously valuable in leveraging loyalty benefits.

To summarise, the payments industry can help merchants to accept payments, increase sales, and cut costs – all pretty fundamental. So why aren't more suppliers hitting the bull's-eye?

Competitive Developments in the Payment Industry

The supply-side of the payments industry is becoming increasingly dynamic and competitive. In every market around the world we see acquiring banks, processors and technology providers of all kinds jostling for position in a quest for industry dominance.

The acquirer market has been consolidating for a while, and this has destabilised the acquirer-merchant relationship. By 2006, the Top 10 acquirers in the U.S. held 88% of the Visa/MasterCard Sales Volume, up from just 49% in 1989 (see Nilson Report, March 2007). Many expect the same pattern of consolidation to happen in Europe, as soon as cross-border acquiring becomes the norm. Banks will need to reconsider where acquiring fits into their strategy. Acquirers were traditionally the divisions of banks that provided the primary payments relationship with the merchant. Over time, however, the business has become less about managing domestic credit risk, and more about high-volume, low-margin international processing business. Many banks don't see a future role for

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themselves here. Those that choose to remain are likely to be operating on a larger scale than before.

In parallel, payments processors are expanding. Companies like First Data, IBM, TSYS and many others, are taking on more processing business from acquirers, networks and merchants. They are extending their offerings to merchants through the inclusion of managed services for pre-paid cards, security risk management, and data analytics. Their challenge remains how to reach and sell to large numbers of merchants in order to build sufficient demand.

We are also seeing a wide range of new technology firms entering the payments industry. These include hardware manufacturers, software developers, and data and service providers. The global concentration of the Top 3 POS terminal manufacturers, for example, currently stands at 68.9% (Nilson Report, Dec 2007). Many of these vendors rely on incumbent players such as the banks to act as their distribution channels.

Given this state of flux it is not surprising that suppliers are losing sight of evolving merchant needs, and merchants are confused as to what is on offer, and from whom. So what needs to change?

Moving Towards Payments and Technology Convergence

The influx of new technology players accelerated a trend which has been building momentum for some time: the convergence of the payments and high-tech industries. Some of the distinctive and challenging features of the high-tech environment are now being faced by payments industry players too:

- **Creating a compelling value proposition from complex products:** Technology does not usually sell itself. It is often necessary to combine one product or service with another until a complete solution can be found that meets the customer's full requirement. Once an acceptable solution is defined, it then needs to be articulated as a compelling value proposition for its intended audience. In Europe, some acquirers are adopting a solution-selling approach in order to make their services more compelling to international merchants.
- **Accelerated lifecycle of the firm:** Technology companies typically form quickly, expand at a rapid rate (frequently >30% p.a.), until they become merged or acquired, whereupon their brand and identity may change. The pace of change and constant flux in the supplier market creates considerable confusion for customers. To avoid jeopardizing sales, this instability needs to be overcome. We see this happening, for example, among the manufacturers of Point-of-Sale terminals such as VeriFone, Ingenico and Hypercom.
- **International / Global outlook:** Most technology players are international in outlook from the start. They know how to build awareness internationally, and how to achieve coverage rapidly and efficiently in multiple geographies. Thus we see small payments technology firms

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marketing their services across multiple countries, while many acquiring banks remain domestically focused.

The payments industry still retains some distinct characteristics, of course. Banks are still critical players, especially as payments guarantors and provider of big-ticket payments services, for example. Their roles will evolve over time, but banks are likely to remain the institutional lynchpin of the system in most markets for some time to come, and will remain important as a distribution channel for other payments industry products and services. Understanding the strategic response of individual banks to these developments is therefore of great importance to most payments industry suppliers.

First Steps to Better Marketing to Merchants

In order to succeed, payments suppliers need to sharpen their act in three areas:

1. Merchant Segmentation Based on Merchant Needs

As merchants grow more sophisticated and more demanding in their requirements, and the spectrum of possible payments-related services expands, which ones are going to interest your customer? Segmentation enables suppliers to target groups of customers more precisely. Many payments suppliers already segment merchants based on historic sales, account potential or sector (e.g. supermarkets vs. gas stations vs. convenience store). Needs-based segmentation allows other relevant variables to be taken into account, for example loyalty strategy, geographical spread, internal financial processes or technical architecture. These variables can have a significant influence on which payment services a particular merchant will value. The right combination of customer and product research, combined with quantitative analysis, can speedily develop a needs-based segmentation that is both targeted and scalable. The outputs will guide communications, distribution, and new product development, as well as building quality and consistency into all subsequent marketing work.

2. Sharpen the Value Proposition and Messaging

How clear and distinctive is your value proposition to a target merchant? Products are getting more complex, the supplier landscape is shifting, and merchant needs are evolving rapidly. The successful payments supplier must help the buyer to eliminate confusion.

A full merchant-ready solution may require hardware manufacturers, acquirers, processors and schemes to work together. Recognising this requires objectivity. Based on our own experience in payments and high-tech, a value proposition needs regular refinement, and a full refresh is usually justified about every three years – possibly more frequently if new target segments are

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developed. This ensures continued impact while obsolete material is removed and messaging clutter is kept to a minimum.

The right messaging framework will enable you to communicate effectively with different buyers at each stage of the buying cycle. Strategically planned communications move merchants over time through the stages of awareness and interest to procurement and purchase. The result is the right message, at the right time, through the right channel, to the right buyer.

3. Sort Out Distribution

Suppliers need to review the strengths and capacity of existing distribution channels, and determine the right go-to-market strategy for the future. Channels will typically include field representatives, telephone and web channels, and distribution partners. How can you cover the whole of your target market cost-effectively, both domestically and internationally? Which products can be sold through which channels? Where do you need to hold the primary relationship with the merchant, and where can you safely use third parties? The answers to these questions will help you to understand how to manage your sales and distribution channels.

Those who distribute their merchant products and services through banks need to ensure they understand each bank's strategy for payments going forward. In the future there is likely to be fewer acquirers, and the larger ones that remain will perform more processing than previously capable. Some banks have growth ambitions for their acquiring functions, both domestically and internationally, whereas others may pull out of the market altogether. Suppliers need to adjust distribution strategy accordingly.

Concluding Thoughts

Based on our experience from payments and high-tech projects, we believe these three steps are likely to benefit any payments-related enterprise. However, they do not represent a complete solution. Typically organizations will also want to look at other aspects of their offering, including product assortment, channel strategy, solution-selling and demand generation. These will form the subjects of future Payments White Papers from MarketBridge.

Looking ahead, we see further tensions between merchants and the payments industry. An empowered merchant community is now submitting the payments industry to the same scrutiny it applies to its other suppliers. Merchant lobby groups are increasingly active, and we are seeing regulators intervene in the payments industry on their behalf in Europe, Australia, USA and many other markets.

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We also see increased opportunities for payments suppliers to add value to merchants and compete for share of a steadily growing payments market. Those who quickly embrace the merchant marketing challenge stand to dominate this market for years to come.

About the Authors

Mathew Stewart is Vice President of MarketBridge Europe, where he leads the Payments Industry group. For over 20 years he has worked with payments and other financial services organizations, with a focus on marketing and sales. Stewart was previously Vice President at Capgemini, where he helped to compile the Capgemini Worldwide Payments Report.

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About MarketBridge

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