

Consumer Online Shopping and Payment Experience Shape In-store Expectations

Cisco Internet Business Solutions (IBSG) Primary Research

Introduction

The retail banking payments industry is ripe for disruption. Some analysts say the industry has not produced a game-changing innovation since the introduction of plastic. In the online/virtual space, the industry has proven particularly vulnerable to value propositions offered by players such as PayPal, Bill Me Later, and Amazon Payments. Banks are at risk of losing customer interaction in this emerging payments value chain.

As consumers and physical merchants increasingly have become accessible via high-speed networks, mobile devices and edge networking open opportunities for new players to bypass the existing payments value chain. In this new reality, electronic payments have the potential to disrupt the payments industry in the way that MP3 disrupted the music industry. This rapidly evolving environment raises many questions for retail banks about how to stay competitive. Understanding how consumer behavior impacts the payments industry is critical; U.S. payments volume is nearing US\$1.5 trillion and is expected to grow at 10 to 13 percent per annum.¹ Current industry estimates indicate that payments represent 35 to 45 percent of banking revenue and 30 to 40 percent of operating profits, and indirectly touch at least 60 percent of banking revenue.

Cisco Internet Business Solutions Group (IBSG) conducted a survey of more than 1,500 consumers to understand how behaviors and perceptions are changing relative to commerce (shopping and payments), and to explore the types of value propositions that will resonate with these connected consumers. The research was conducted with consumers aged 18 and older living in the United States.

Consumers Are Running Ahead of Banks

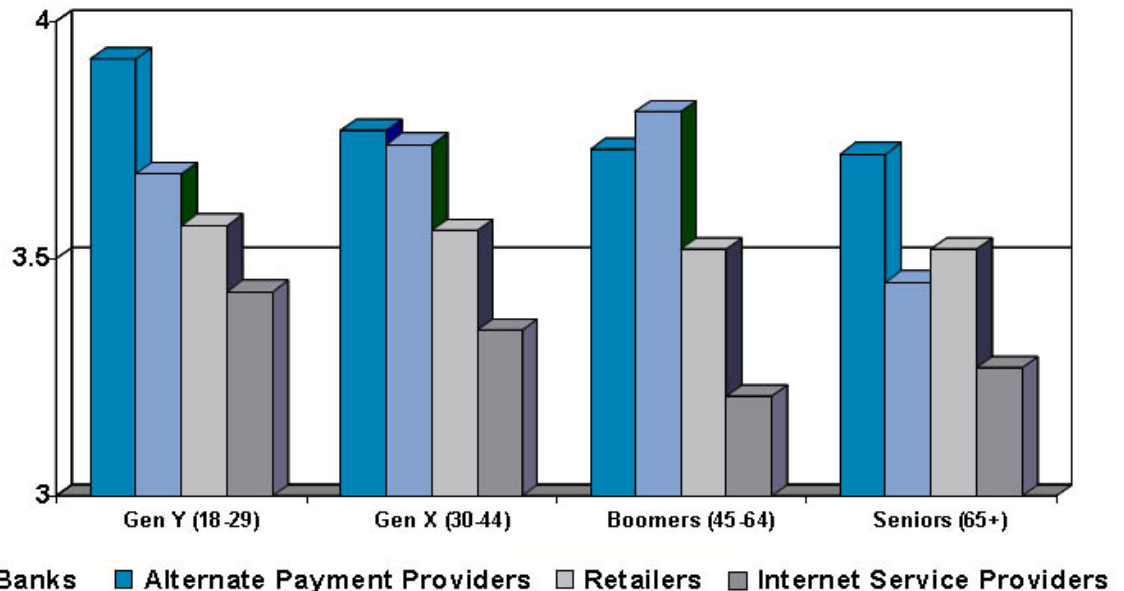
Consumer demands are changing. They expect greater choice and have higher service expectations. Convenience and security are the minimal stakes of the game, and therefore are difficult elements around which to build sustainable differentiation. Consumer preferences are shifting toward community, transparency, and flexibility—they are looking for better, more proactive solutions around life events and “need states.” This creates opportunities for banks to build differentiating strategies by becoming more relevant to life circumstances—to create “Connected Life” solutions.

The consumer segments most interested in Connected Life solutions, however, are already moving toward alternate payment mechanisms. Consumers believe non-banks can provide at-par (if not better) payment solutions. In our survey, the difference between those who



“trust” or “trust very much” banks for payment solutions versus alternate payment providers (like PayPal) is negligible (67 percent for banks versus 64 percent for alternatives). Boomers (ages 45 to 64) actually show a level of trust in alternate payment providers that exceeds their trust in banks (see Figure 1).

Figure 1. Consumer Trust in Payment Providers for Online Purchases (Mean, 1-5 Scale)



(Scale = 1 to 5; 1 is “Distrust Very Much” → 5 is “Trust Very Much”)

Source: Cisco IBSG, 2008

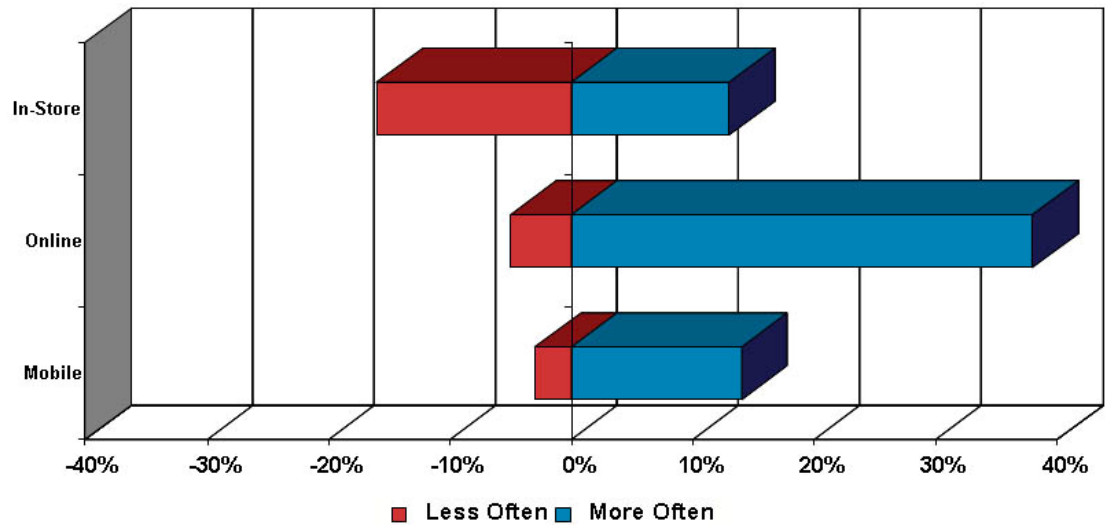
Merchants, advertising agencies, consumer packaged goods (CPG) companies, banks, and new financial services entrants are all trying to capture consumer attention and be relevant at the moment of purchase. Our research shows that “Connected Consumers” will value and respond to targeted offers surrounding point of purchase. They are already making choices based on the messages they receive outside of traditional sources such as newspapers and ads. Consumers expect highly customized offers and the ability to react immediately to those offers via the device of their choice (mobile, set-top box, desktop). Consumers can be found and reached in more ways than ever, including location-based services, set-top boxes, smartphones, dual-mode devices, digital media, and widgets. Worldwide mobile Internet penetration is expected to reach 40 percent by 2012.² Increasingly, consumers will demand “stateful” interactions as they move from device to device.

Consumers Want a Connected Commerce Experience

We’ve seen the evolution of commerce go through three waves since the introduction of the Internet. **In the first wave**, retailers replicated or augmented offline business models with online storefronts. Although security concerns were high, traditional payment mechanisms dominated during this wave. **In the second wave**, new business models that exploited the unique attributes of the Internet began to emerge. Amazon, eBay, Google, and others

introduced us to long-tail effects, clickstream analysis, on-demand support/advice, real-time recommendations, and hyper-targeted advertising. Consumers clearly value the types of propositions enabled by the second wave of Internet commerce. Consumer shopping preferences are rapidly moving toward online and mobile commerce (see Figure 2).

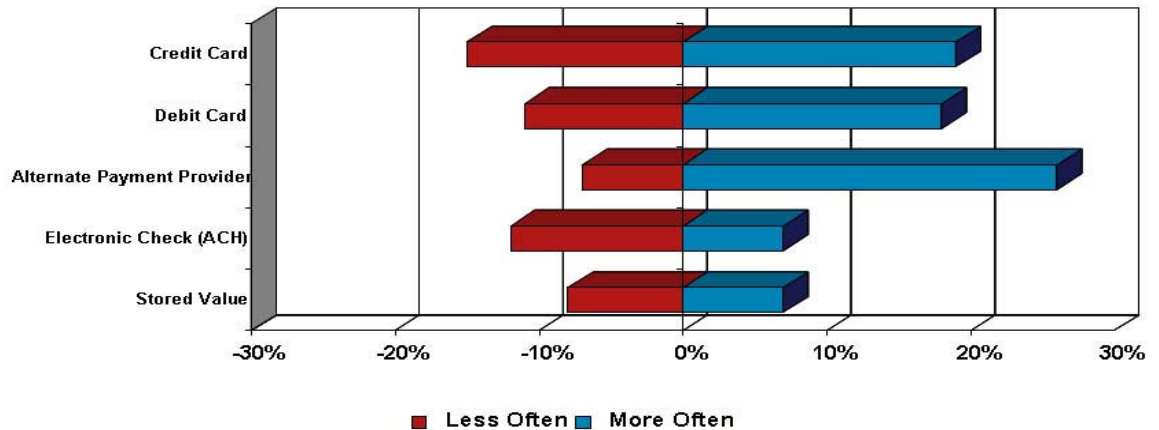
Figure 2. Expected Change in Shopping Frequency over Next Two Years



Source: Cisco IBSG, 2008

Of those who shop in a physical store several times a week, 47 percent expect to shop online more frequently over the next two years, while only 16 percent expect to shop more often in physical locations. Fifty-two percent of those earning personal income greater than US\$125,000 per year expect to shop online more frequently, while only 18 percent expect to shop in physical stores more often.

Alternate payment providers, such as PayPal, have grown dramatically during this current wave. Thirty-five percent of all respondents cite “frequent” or “very frequent” use of alternate payment providers in online payments, and consumers indicate expectations of more frequent usage in the future (see Figure 3).

Figure 3. Expected Change in Payment Mechanism Usage for Online Purchases over Next Two Years

Source: Cisco IBSG, 2008

While Internet merchant volume is growing, physical merchants still make up more than 90 percent of the volume. **In the third wave** of commerce evolution, which is just beginning, we see physical commerce beginning to explore business models and value propositions introduced in virtual commerce. We've come full circle; this is "connected commerce" in the physical world, enabled by connected consumers and their portable, networked devices, and by merchants with IP-POS (point-of-sale) systems or advanced routers that sit just behind the POS system. Consumers exhibit specific frustrations related to the physical-store shopping experience that can be addressed by connected commerce:

- 50 percent say the checkout process takes too long
- 48 percent say items were not in stock
- 46 percent say they were unable to find the items they wanted
- 22 percent say they "did not always have applicable coupons or offers with me"
- 20 percent say it was hard or time-consuming to keep track of receipts

Mobile Payments Are Gaining Rapidly

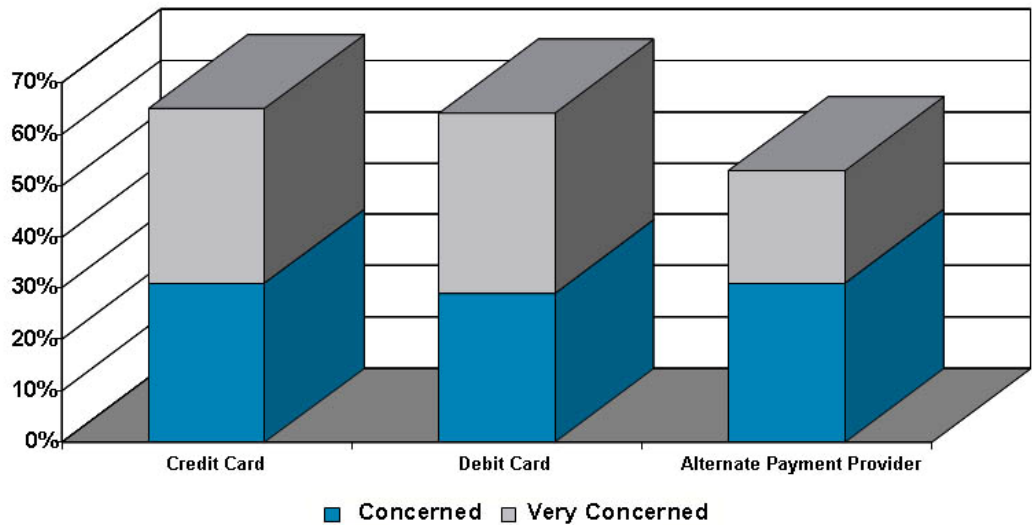
Twenty-three percent of survey respondents expressed interest in using a mobile device to make contactless payments in physical stores, and that number is expected to grow. Among frequent users of contactless cards, 58 percent indicate a strong interest in swiping a mobile device with embedded chip at checkout, as do two-thirds of current mobile banking users.

Of those who have not yet made a purchase using their mobile device, the top four inhibitors are:

- Do not understand the value (42%)
- Cannot access the web on the mobile device (35%)
- Concerned with losing the device with payment information stored on it (31%)
- Worried about fraud, identity theft, or other security breaches (30%)

Providers who effectively address the above concerns will be well-positioned as commerce increasingly goes mobile. To the extent the last two inhibitors both represent security concerns, alternate payment providers currently have the advantage of lower security concerns on the part of consumers (see Figure 4).

Figure 4. Security Concerns for Mobile Payment Mechanisms



Source: Cisco IBSG, 2008

The Opportunity for Financial Institutions

Given established relationships with both consumers and merchants, banks can provide the identity and data trail as consumers move from store to store. The network is the linkage between the physical and virtual worlds. New technologies supported by intelligent networks and edge applications afford advanced functions and security at point of sale. The intelligent network brings new visibility to commerce events, and is an important development in the evolution of physical commerce because it allows for real-time monitoring and filtering, storage at the node, personalization, and multidevice bridging.

Banks have several options to remain competitive or to extend their positions:

Faster, cheaper, better: Offer superior payment products with greater transparency, security, speed, and flexibility. In our survey, 50 percent of respondents indicate “checkout process takes too long” as one of their biggest inconveniences when paying for goods. Twenty percent cited security concerns at checkout. In our research, only cash scored low on security concerns. Nearly 60 percent of respondents who have set up “one-click” online showed strong interest in “one-click” checkout via a terminal in physical stores.

“Rich” loop alternative: Bankers are now familiar with the threat of a closed-loop payment model (PayPal-like) that allows users to make and receive payments without intermediation, bypassing payment networks and processors, and reducing fees for merchants and consumers. Eighty-seven percent of current mobile alternate payment provider users (of services such as PayPal, Obopay, etc.) indicated strong interest in using mobile SMS (Short Message Service) or a similar method to initiate payments in physical stores. The opportunity for banks that have strong issuing and acquiring market share to build a closed-

loop system is often discussed in the industry, but another alternative is one where banks use traditional payment networks to process payments and supplement those with recommendations, offers, and payment options generated by combining POS, inventory, advertising, and client-spend information. These banks could use such value propositions to fend off the risk from players such as RevolutionCard and PayPal.

Spend management: Offer transaction “tagging” at POS, using financial and non-financial information to help consumers make sense of their spending patterns, and to provide guidance on “normal” ranges drawn from aggregate users fitting certain segmentation characteristics (similar to the “norming” data provided by TurboTax). Thirty percent of survey respondents cited either receipt management or spend tracking as one of their biggest concerns post-checkout. Fifty-four percent of Gen Y respondents (ages 18 to 29) would be interested in a service that automatically disaggregates purchases into item-level (SKU-level) detail and categorizes spending for budget purposes.

Loyalty program outsourcing: Manage loyalty programs for and across acquired merchants to lower the cost of running these programs and improve ease of use and benefit accumulation for consumers. Consumers are overloaded with cards, whether payment or loyalty. Based upon survey data, we estimate consumers carry an average of 6.4 cards with them at all times, and leave another 2.2 at home. More than 24 percent of survey respondents carry at least two store-based loyalty cards with them at all times, and at least 32 percent have multiple store-based loyalty cards that they may leave at home. Sixty-five percent of respondents that carry four or more loyalty cards stated they would be “likely or very likely” to use a service that consolidated their loyalty cards if offered by their payment provider.

Advertising model: Provide advertisers such as packaged goods manufacturers with direct access to consumers at or near point of sale to offer real-time, targeted recommendations and promotions drawn from profile, transaction, and behavior analytics, replacing or augmenting today’s couponing model. Sixty-eight percent of current mobile banking users would be interested in a service that delivered personalized offers to mobile devices while consumers shop. An overwhelming 76 percent of all respondents and 81 percent of Boomers (ages 45 to 65) and Seniors (ages 65+) indicated a high likelihood of making purchases based upon discounts that are automatically applied at checkout.

Merchant ecosystem: Build a subscriber referral model for merchants to bid for customer attention across other merchants. Seventy-two percent of current mobile banking users would be “likely” or “very likely” to use a service in which their payment provider alerted them to special offers from nearby merchants at checkout.

Payment broker: Provide “LendingTree”-type intermediation, customized payment terms, or offer “matching” at consumer point of purchase. Seventy-three percent of contactless card users and sixty-nine percent of current mobile banking users would like to receive competing offers from their primary payment provider if offered special terms at a merchant (for example, 90-day same as cash).

Each model above shows very different economics, which become more compelling when employed in combination. Assuming a conservative impact of 2 percent net growth on existing payment revenue, the total estimated value for the average “top 20” U.S. bank could exceed US\$112 million per year by 2015.

Innovation Paves the Way for Connected Commerce

The retail payments environment is ripe for innovation, and banks need to look for innovation opportunities in product, distribution, service, process, and business models. Cisco Internet Business Solutions Group's research demonstrates that there is a ready market of connected consumers that will value and respond to propositions that deliver better-integrated payments and shopping. New technologies around intelligent networks, edge applications, and digital media distribution afford advanced functionality and security at point of sale.

Evolving consumer expectations of conducting commerce are as relevant when consumers are shopping for financial services products as they are to retail shopping. While this executive summary discusses the opportunity for banks to participate in the transformation of the retail industry, the same lessons apply within the banks' own retail locations. For more information about transformation in the retail banking and payments industry, please contact:

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¹ Presentation to UBS Global Financial Services Conference, Visa, May 28, 2008.

² IDC, 2008.