



Retail Payments: Consumer Control And The Need For Speed

Benchmark Report

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Executive Summary

Key Findings

When it comes to payments, times are changing. Fast. Retailers find themselves in an uncertain world: after a few rough years of data breaches, theft, and fraud, retailers are already feeling pretty beat up. But despite a resulting emphasis on data security and privacy, retailers find they have no room to pause while they secure their enterprises as tightly as they would like. Consumers are moving fast, and retailers must keep up.

Some highlights of the report include the following:

- In the **Business Challenges** section of this report, retailers express major concerns over data security and privacy, but still find themselves pushing innovations at the tactical level, as they respond to consumer desires for easier – and more digital – ways to pay.
- Retailers report many sources of innovation – and inspiration – in the **Opportunities** section, but the primary driver behind retailers' perceived opportunities is the desire to meet consumer needs.
- While budgets are always tough, especially for technologies subject to "the store multiplier effect," retailers also report **Organizational Inhibitors** related to rapid technology advancements and the increasing sophistication of hackers.
- Most encouraging, retailers report something of a technology investment thaw when it comes to **Technology Enablers**. While there is still a long way to go to payments maturity, retailers have staked out a few strategic areas where they plan near-term and long-term investments.

Based on our data, we also offer several in-depth and pragmatic suggestions on how retailers should proceed. These recommendations can be found in the **Bootstrap Recommendations** portion of the report.

We certainly hope you enjoy it,

Nikki Baird and Brian Kilcourse

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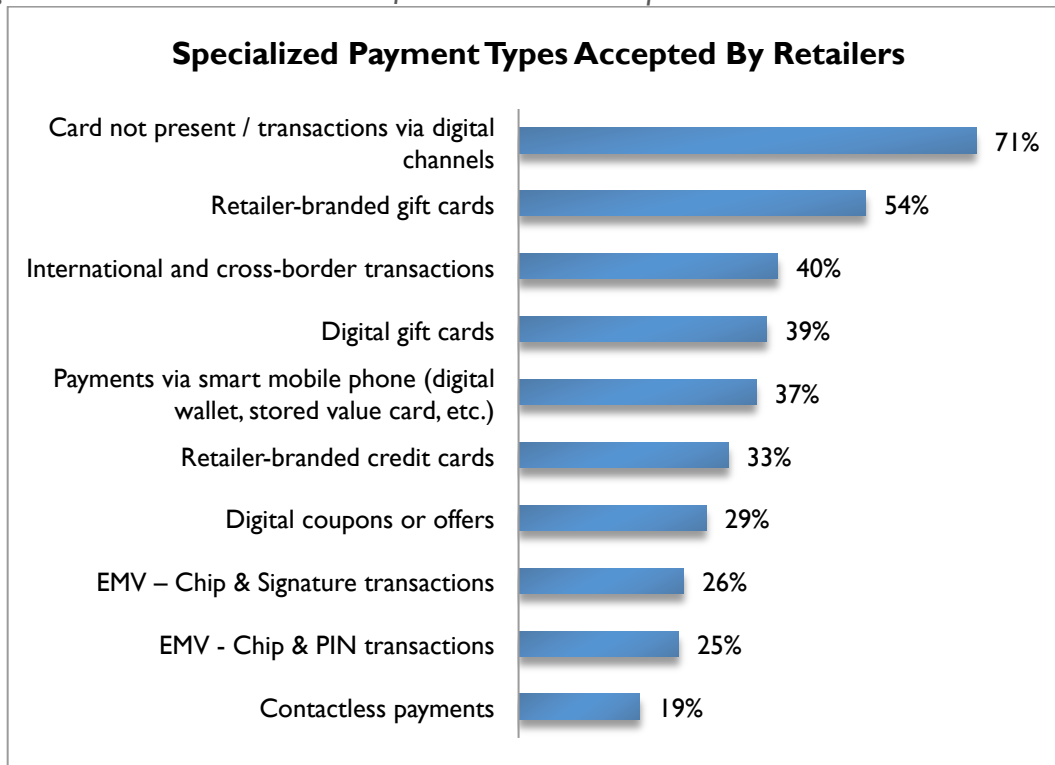
Research Overview

The Realities of Payments

RSR last took the pulse of retailer payment strategies in 2013. At that time, retailers were cautiously optimistic about what the future would hold. While they felt uncertain about which players would ultimately dominate the payments landscape – Telecom companies, Traditional payment networks, or Tech giants? – retailers did hold firm to the idea that whatever the future held, first and foremost they would follow their customers' lead.

Fast forward to today, and times have changed. Significantly. As digital channels proliferated, so too the ways retailers can accept payments. It's a two-way street, with digital forms of payment also having an impact on retailer offerings, from gift cards and coupons to other discounting strategies. In fact, at least a third of all retail respondents to this year's survey accept as many as six different payment types, including digital gift cards and mobile wallets. They must also support "card not present" transactions and the even trickier cross-border payment (Figure 1).

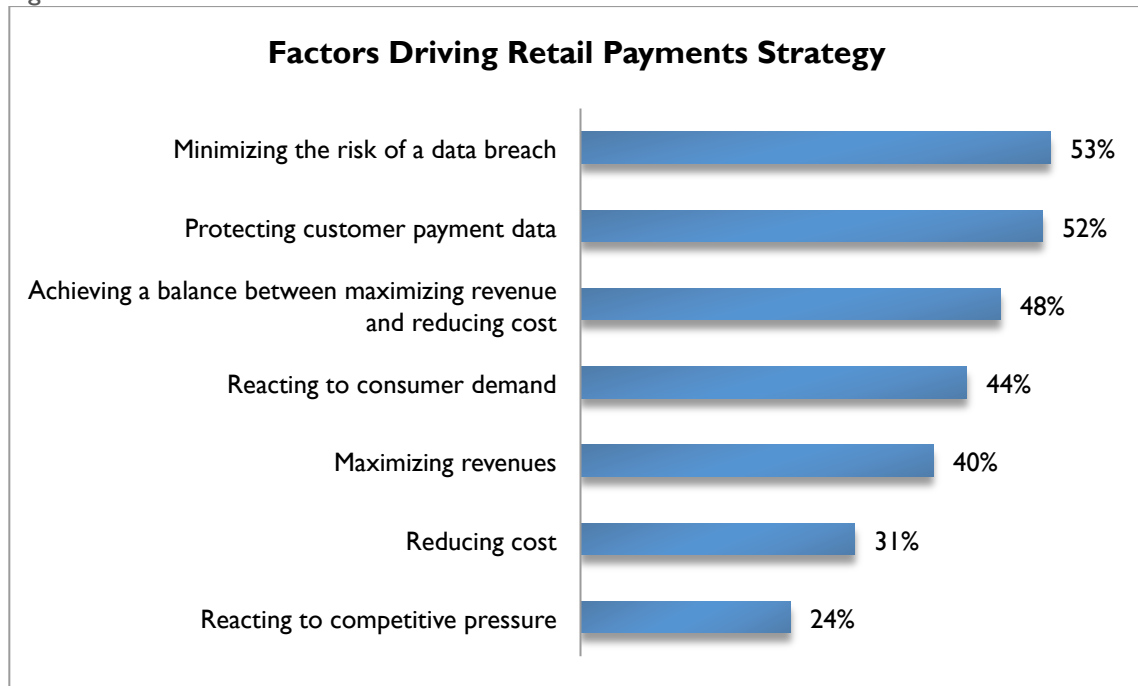
Figure 1: The Last Moment Of Truth Gets Complicated



Source: RSR Research, April 2015

But alongside these new ways to pay, retailers find themselves in a more uncertain world. As new payment methods and innovations emerge, so do new risks and vulnerabilities. And after a few rough years of data breaches, theft, and fraud, retailers are already feeling pretty beat up. This is where they have made big changes to their payments strategies. In past years, keeping up with customers was the priority. This year, it's all about security and privacy (Figure 2).

Figure 2: Customer Goals Succumb To Hacker Fears



Source: RSR Research, April 2015

There are some differences in priority depending on retailer size – the biggest retailers, as larger targets for thieves and hackers, are driving a lot of the response around security and privacy. But there are also differences depending on vertical. Grocers, slow to sell through digital channels, have something of a sheltered view of payment strategies and their role in their businesses' future, while fashion retailers see payments, particularly Apple Pay, as a way to differentiate their brand. Retailers who bring in most of their revenue online see even the definition of "security" very differently than their store-based peers (they worry more about fraud through identity theft, rather than exposure to hackers). This shapes both their perceived opportunities and their technology investment plans.

But whether online or off, fast fashion or slow grocery, the smallest retailer or the largest, security and privacy have increased in priority. Will these concerns drown out all other innovations in the payment space? Are retailers too busy plugging data leaks and vulnerabilities to pay attention to new ways that consumers pay, and what it might mean for their own business? That's what we set out to discover.

Retail Winners And Why They Win

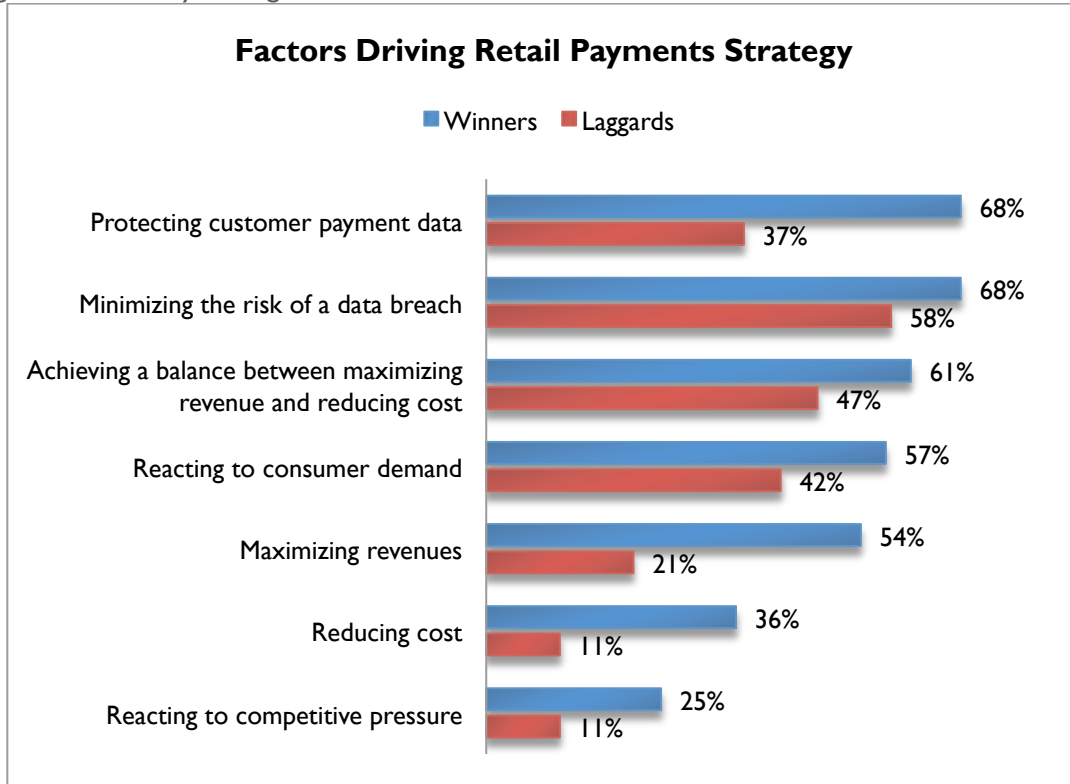
In our benchmark reports, RSR quite frequently cites differences between retailer over-performers in year-over-year comparable sales and their competitors. We find that consistent sales performance is an outcome of a differentiating set of thought processes, strategies and tactics. We call sales over-performers "Retail Winners."

RSR's definition of these Winners is straightforward. Assuming industry average comparable store/channel sales growth of **4.5 percent**, we define those with sales above this hurdle as "Winners," those at this sales growth rate as "average," and those below this sales growth rate as "laggards" or "also-rans."

Retail Winners see things differently, and payments strategy is no exception. As RSR has found in past benchmarks on customer data security, retailers traditionally put data security and consumer privacy in two separate buckets: security was all about PCI and securing payments, while consumer privacy was much less of a concern. After all, what value could there possibly be for thieves in a customer database, really?

After the Target data breach, and subsequent phishing attempts using the stolen email addresses, that perspective has changed. **Retail Winners, at least, are now giving consumer privacy equal weight with security** (Figure 3).

Figure 3: Heavy Weights

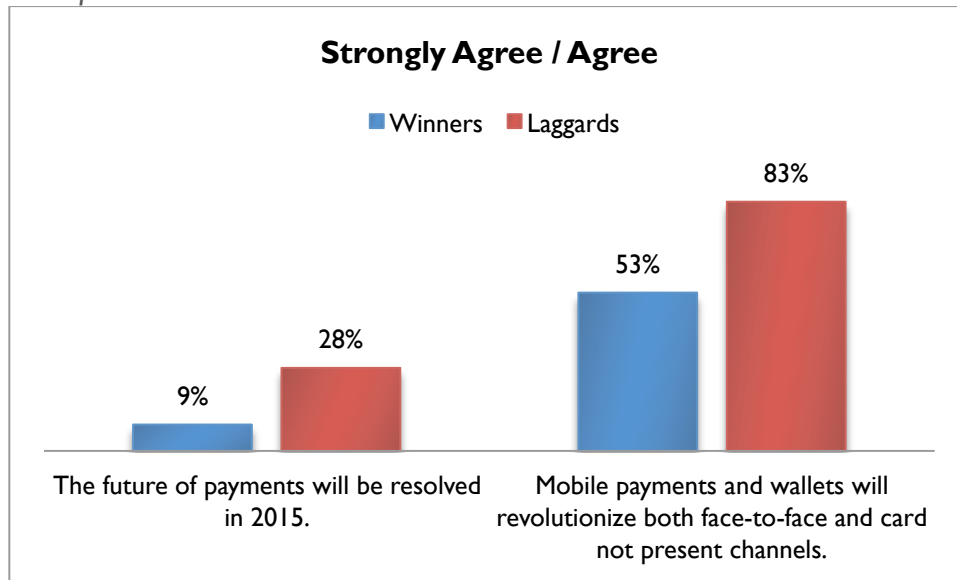


Source: RSR Research, April 2015

This shouldn't be a surprise. RSR consistently finds that Retail Winners are more focused on the customer experience in general and on making sure they deliver what customers want. But when it comes to payment strategies, this manifests in a point of view around payments that is fundamentally different from their peers. Across the board, Retail Winners place more emphasis on multiple factors that drive their payments strategy – this highlights the overall importance they give to the subject.

But this emphasis also comes with a strong dose of reality. Winners are more likely to be pragmatic about what the future holds for payments. Laggards tend towards "silver bullet syndrome," where they embrace new technology in the hopes it will solve all of their problems. Unfortunately, that tendency is very much present when it comes to payments (Figure 4).

Figure 4: Optimistic Or Unrealistic?



Source: RSR Research, April 2015

This somewhat unbridled optimism colors many of the major differences between Retail Winners' payment strategies and those of their peers: from the business challenges they feel to the technology solutions they look to invest in to address these challenges.

Methodology

RSR uses its own model, called The BOOT Methodology[®] to analyze Retail Industry issues. We build this model with our survey instruments. See [Appendix A](#) for a full explanation.

In our surveys, we continue to find the kinds of differences in thought processes, actions, and decisions cited above. The BOOT helps us better understand the behavioral and technological differences that drive sustainable sales improvements and successful execution of brand vision.

Survey Respondent Characteristics

RSR conducted an online survey from February - March 2015 and received answers from 117 qualified retail respondents. Respondent demographics are as follows:

- Job Title:

Executive/Senior Management (C-level or VP)	26%
Middle Management (Director, Manager)	39%
Individual Contributor and Other	35%

- Functional Area of Responsibility:

Channel Management	11%
Finance	11%
HR	2%
Information Technology	33%
Logistics/ Supply Chain	2%
Marketing	11%
Merchandise Management	6%
Procurement	1%

Store Operations Management				22%
• 2014 Revenue (US\$ Equivalent)				
Less than \$5 million				25%
\$6 - \$49 million				10%
\$51 million - \$249 million				16%
\$250 million - \$499 million				7%
\$500 million - \$999 million				8%
\$1Billion to \$5 Billion				20%
Over \$5 Billion				15%
• Products sold:				
Fashion/short lifecycle				33%
Seasonal				9%
Basic/replenishment				15%
Perishables				6%
Consumer Electronics/ Durable goods				12%
Other (food service, hospitality, etc.)				24%
• Headquarters/Retail Presence:				
	<u>HQ</u>	<u>Stores</u>	<u>Web</u>	
USA	81%	79%	67%	
Canada	1%	23%	32%	
Latin America	0%	13%	15%	
UK	2%	20%	18%	
Europe	9%	15%	20%	
Middle East	2%	9%	7%	
Africa	1%	6%	9%	
Asia/Pacific	4%	20%	22%	
• Year-Over-Year Sales Growth Rates (assume average growth of 3.5%):				
Worse than average (“Laggards”)				16%
Average				55%
Better than average (“Retail Winners”)				29%

Business Challenges

The Untamed World Of Payments In The Digital Age

In 2013, retailers said the uncertain technical future of payments was their top business challenge, followed by keeping up with consumer adoption and use of technology as part of their shopping process. How times have changed. Keeping up with consumers has fallen to #4 on retailers' priority lists, followed by technology concerns at #5. Both have taken something of a back seat to fraud, security, and PCI (Figure 5).

Figure 5: Putting Fraud First



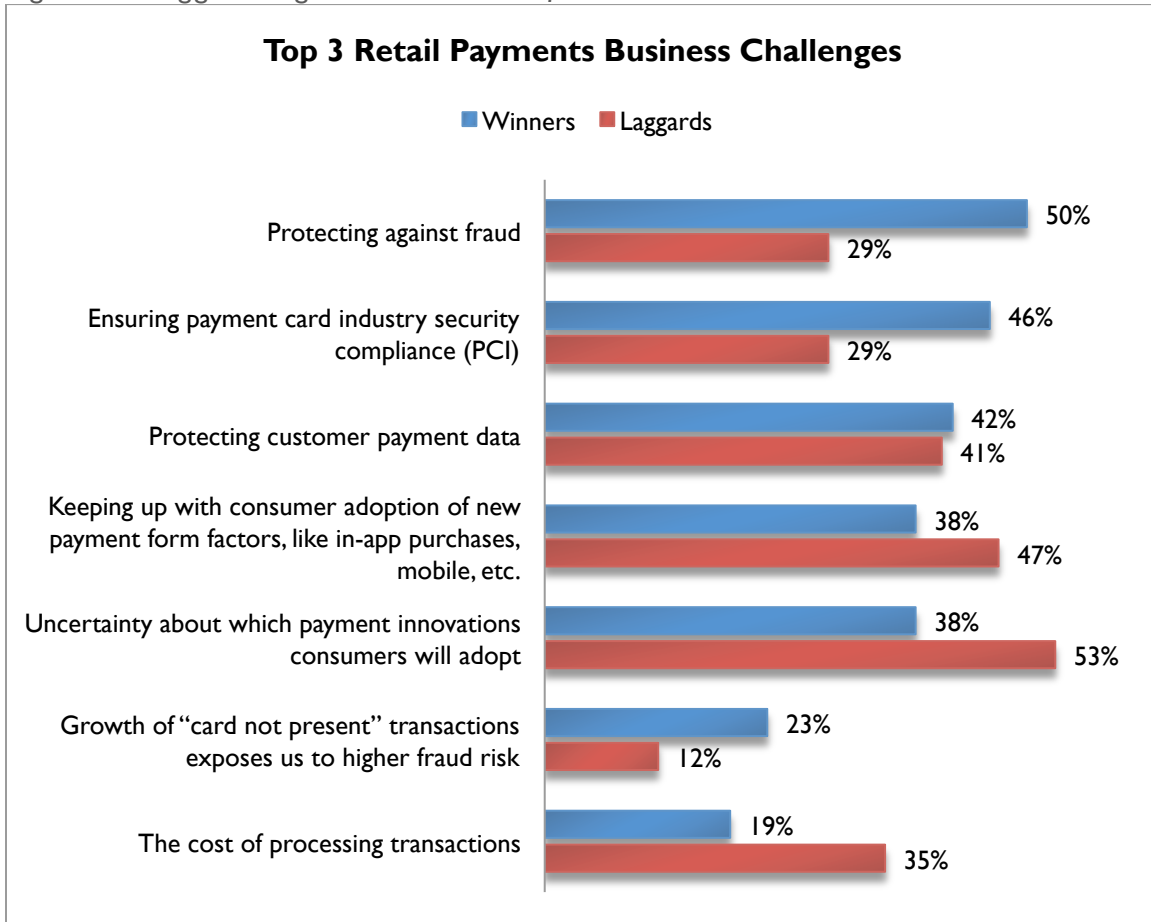
Source: RSR Research, April 2015

However, it is not quite as clear of a shift as it seems. Digging deeper, it rapidly becomes clear that Winners drive much of the shift in priorities. Winners place protecting against fraud as their top business challenge, followed by ensuring PCI compliance and protecting customer payment data (Figure 6, below).

It is laggards who are still focused on consumers – on the uncertainty around which payment innovations consumers will adopt, and how retailers can possibly keep up with new, technology-driven payment form factors.

Unfortunately, it is not a change of heart (suddenly putting customers at the center of their business) that keeps laggards focused on customers. It's cost. Laggards have chosen to focus on the cold, hard costs of investments they must make to keep up with evolving payment forms, ignoring the risk of cost that comes from not prioritizing fraud and customer data security.

Figure 6: Laggards Ignore The Risk Of Dollars In Order To Save Pennies



Source: RSR Research, April 2015

The winds have changed across multiple dimensions:

- As the largest retailers make progress on securing data, it is smaller retailers who now are starting to feel exposed: 62% of retailers with less than \$50 million in revenue ("small" retailers) said that protecting against fraud is a top-3 priority, vs. 52% of those with revenue over \$1 billion ("large" retailers). And 56% of small retailers prioritize protecting customer payment data vs. 41% of large retailers.
- Hard goods retailers, particularly those selling consumer electronics and durable goods, place the most emphasis on managing fraud: 80% of these respondents rated it a top-3 priority vs. 56% overall.
- Store-based retailers are not as concerned with fraud as their online peers (48% vs. 69%). But with their physical checkout lanes and the technology that must be placed in those lanes, store-based retailers are understandably more concerned about which new technologies consumers adopt and the cost of keeping up with those innovations. In fact, online retailers see keeping up with changing payment mandates as merely a cost of doing business: none rated this a challenge vs. over a quarter of store-based retailers.

Change Begins With Tactics, Not Strategy – At Least For Payments

External business challenges may drive strategy, but at the tactical level, the business appears to be trying to take on both security issues and new innovations as well. Retailers report that while protecting customer payment data is their number one priority, integrating new digital payment capabilities into old processes and systems, and making it easier for consumers to pay with their mobile devices are not at all far behind on the list (Figure 7).

Figure 7: Payment Tactics – Trying To Do It All



Source: RSR Research, April 2015

It's interesting to note that even though preventing fraud was reported as retailers' top external business challenge, this does not translate to a tactical priority – only 33% of respondents said that lowering their fraud rate was important, suggesting they may have already done some work here. For laggards, once again cost remains a challenge:

- 76% of laggards report that integration challenges for new payment types are a top-3 issue, vs. 57% overall.
- 47% of laggards report that their current infrastructure is costly to maintain and difficult to change. This is vs. only 19% of Retail Winners.
- Ironically, laggards don't see fraud as a place where costs could be prevented: only 12% cite reducing fraud as an issue vs. 38% of Winners.

Costs theoretically are also a major consideration for the largest retailers (over \$1 billion in revenue). However, while large retailers do report that integration is their biggest operational

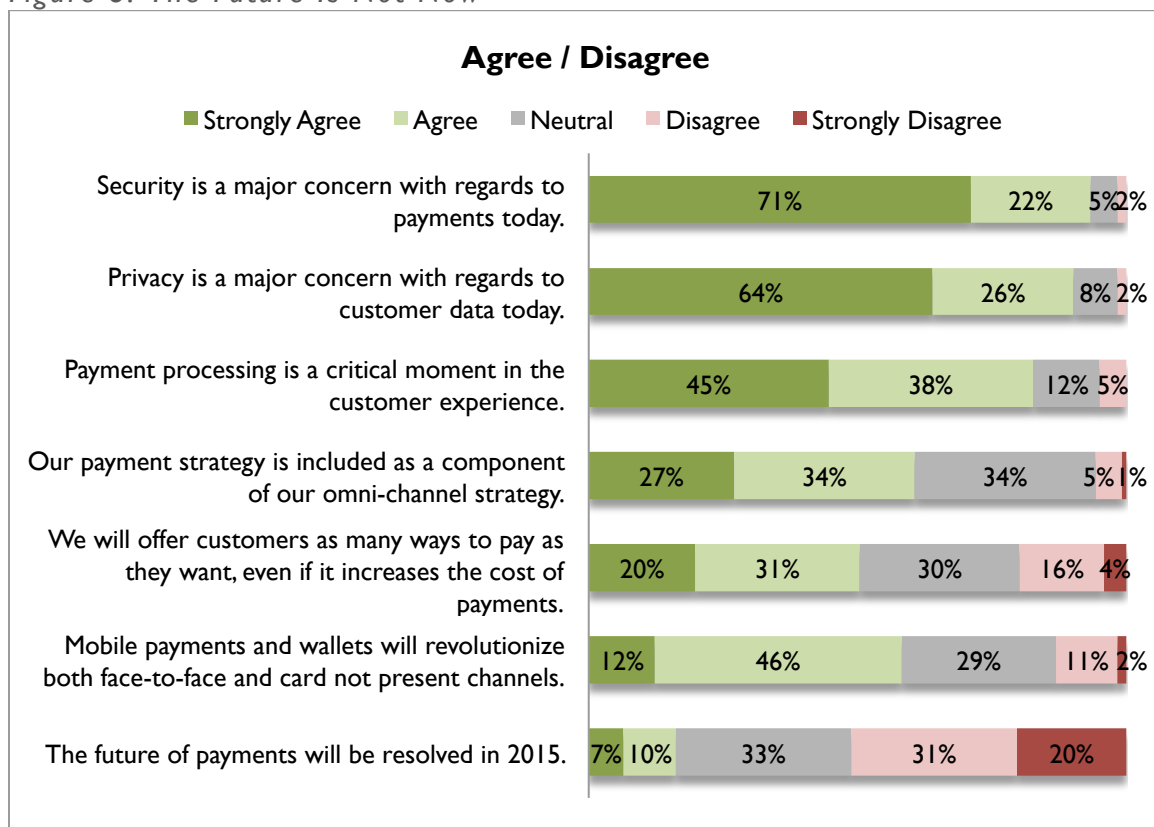
issue (69% vs. 57% overall), only 31% report that their infrastructure is costly and hard to maintain. Additionally, exactly 0% of large retailers reported that they are waiting for the dust to settle from their PCI investments before they can act. **Spending on PCI compliance no longer delays spending on other payment innovations.**

The Future of Payments

We asked retailers to agree or disagree with a series of statements related to payment strategies. Ranked in order of the percent of respondents who strongly agreed with these statements, the chart (Figure 8) becomes a summary of the business challenges that retailers face:

- Security and privacy issues have moved to the fore.
- While retailers believe that processing payment is critical to the customer experience, few see it as an important part of their omni-channel strategy.
- Retailers want to be able to offer differentiated experiences that include the payment process, and they have high hopes for mobile and digital wallets.
- But few retailers appear to believe that 2015 is the year when payment challenges will be resolved.

Figure 8: The Future Is Not Now



Source: RSR Research, April 2015

So what benefits do retailers hope to achieve through their payment strategies? Let's turn to their perceived Opportunities to find out.

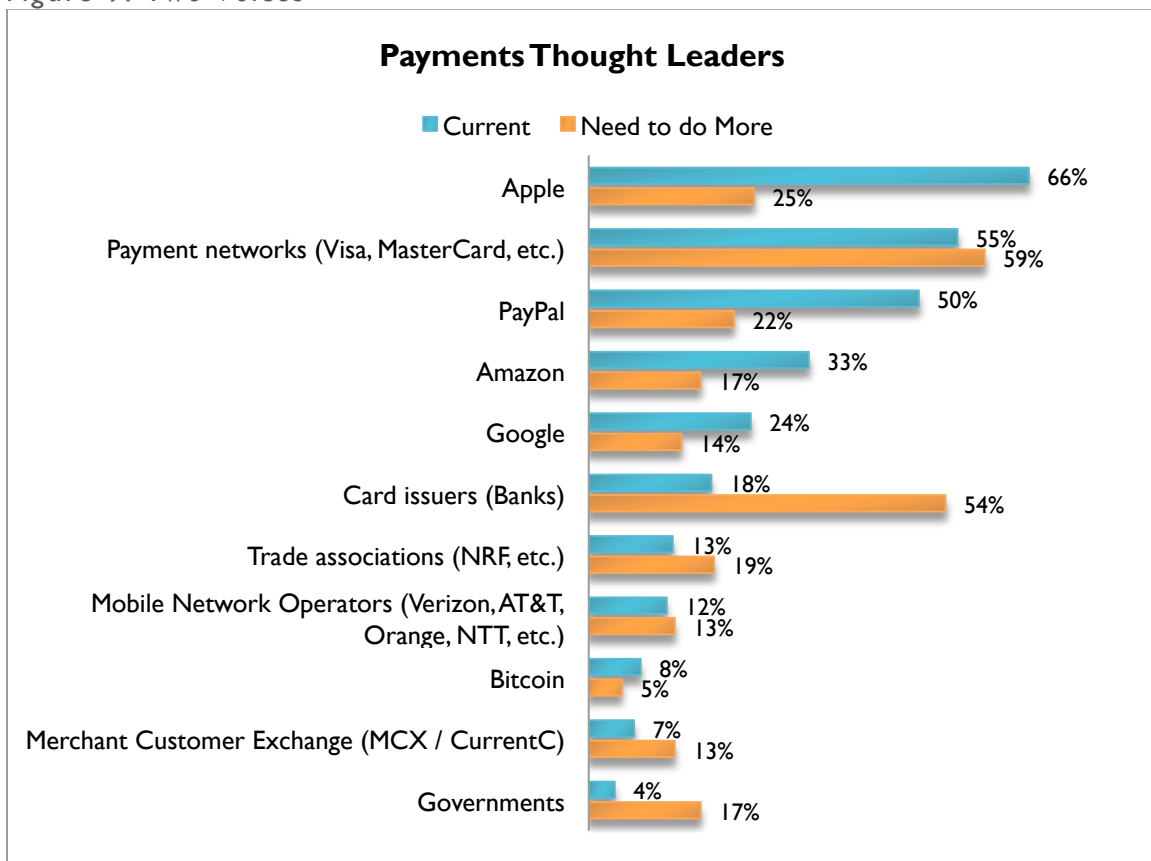
Opportunities

Looking For Something New

The fundamentals of payments have held steady for a long time. Consumers either pay with money they have or money they can borrow. As we saw earlier in this report, *how* payments are made, and particularly how electronic forms of payment are used and transmitted is the big issue today. While the fundamental underpinnings of credit payment networks are 50 years old and debit networks are 25 years old, the growth of card-not-present transactions for both credit and debit, and the increased use of open networks to transmit those transactions to the payment networks, has created new levels of risk for retailers and consumers.

To date, most efforts have been focused on plugging known holes in the transaction lifecycle. But retailers, payment processors, and banks all know security is a moving target, with data breaches getting more sophisticated all the time. So while retailers are looking to the incumbents (payment networks, particularly) for leadership on the area of payment systems innovation and security, they are just as interested in hearing from new players, especially Apple and PayPal (Figure 9).

Figure 9: Two Voices



Source: RSR Research, April 2015

It's interesting to note that for Apple and PayPal, retailers seem generally satisfied with what they hear from those companies. Winners are particularly focused on Apple (82% vs. 63% of laggards). On the flip side, issuing banks fall far short of retailer expectations, and again, Winners are most dissatisfied (67% vs. 47% of laggards). Payment networks, the legacy gatekeepers in

the relationship between issuing banks and retailers (or ‘merchants’, in payment processors’ lingo), are still very much in a leadership position, but retailers across all sizes and verticals are looking for more.

It’s worth noting that the value retailers give to payment networks’ thought leadership is virtually unchanged from our 2013 study (56% in 2013 vs. 55% now). However, probably as a result of the high profile data breaches that have occurred since 2013 as well as the looming EMV mandate in the United States, retailers are more anxious than ever for guidance from payment networks (59% now compared to 44% in 2013). This finding points to a golden opportunity for the payment networks to re-establish their pre-eminence when it comes to the future of payments. But retailers also want to hear from issuing banks, thus far perceived as almost silent.

These results point to the fundamental conundrum, brought about by the mass adoption of digital shopping (particularly *mobile* digital shopping), that retailers grapple with: while the greatest volume of transactions continues to go through stores, new players like Apple and PayPal are “mobile natives”, and not bound to stores. And so, retailers are looking to both traditional players for help in modernizing *and* securing the existing business, and to new players for innovation. Retailers are listening to both voices at the same time.

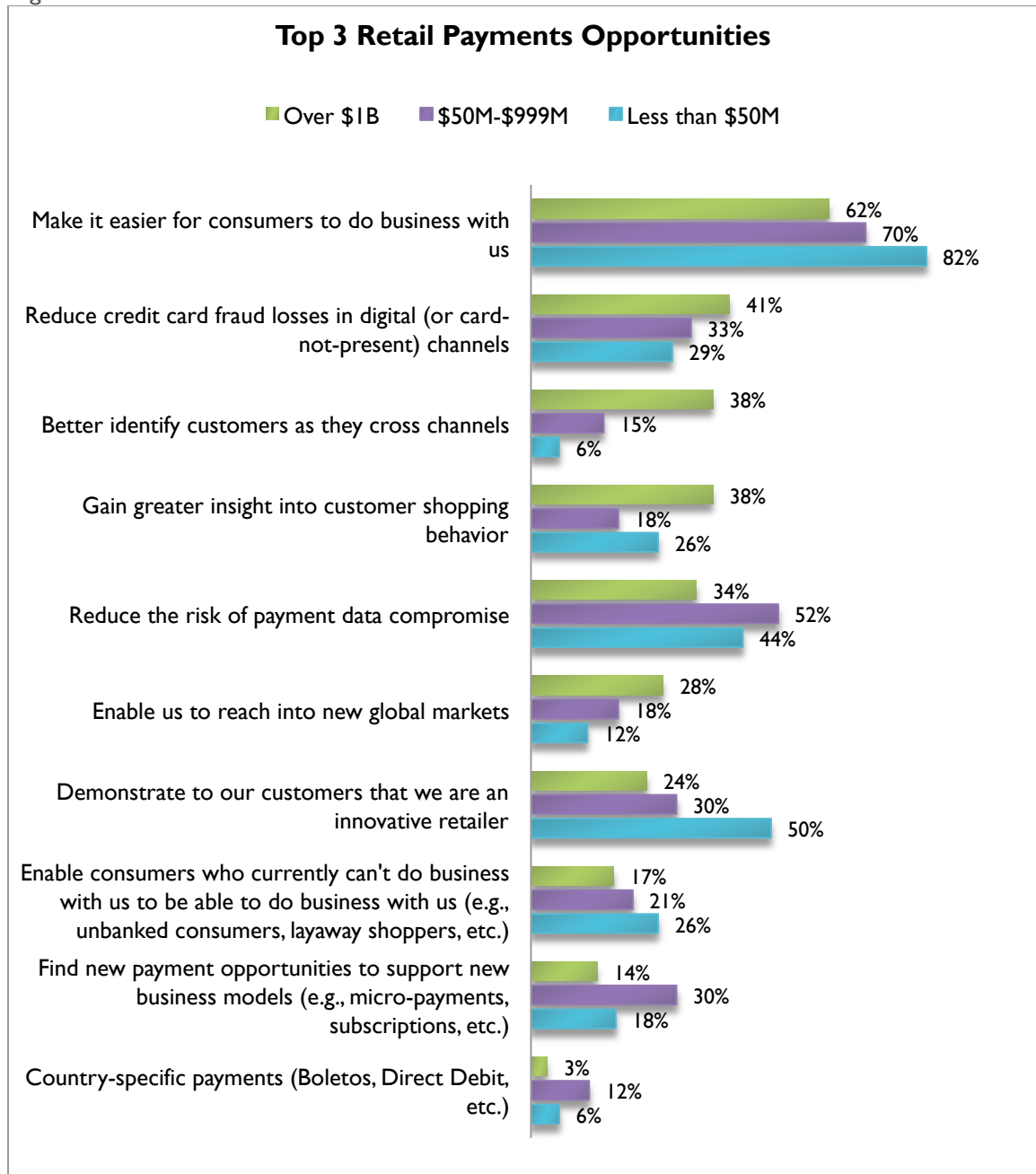
It’s Still About the Customer

While we saw in the **Business Challenges** section of this report that data security and consumer privacy have moved to retailers’ top-of-mind concerns, making payments easier for customers represents the greatest opportunity (Figure 10, below).

This is particularly true for very small retailers – those who generate less than \$50M in annual revenues. That group’s second most frequently cited top-three opportunity is to be seen as innovative, a fascinating development. Large retailers (over \$1B in annual sales) also want to make payment handling easier for consumers, but they don’t feel any great need to be innovative.

Curiously, given the challenges noted earlier, the largest retailers are less concerned about the risk of payment data compromise than other retailers, but they are more concerned about losses from digital and card-not-present fraud. Likely this is the result of efforts they have made to secure their payment handling. Still, they remain “deep pockets” targets for fraudsters and bear the greatest financial risk if a breach does occur. What those retailers are keen on is to gain a better understanding of consumers’ cross channel behaviors, and they believe that analyzing payment patterns is one way to achieve that.

Figure 10: Focus On The Customer



Source: RSR Research, April 2015

A Competitive Wedge?

Examining retailer attitudes based on their performance reveals an interesting difference: average and under-performers are far more concerned about making it easier for consumers to do business with them than Winners (laggards: 71%, average: 79%, Winners: 58%). Although for all three performance groups it is still the #1 opportunity, it represents a potential wedge for average and under-performers to gain some ground with consumers.

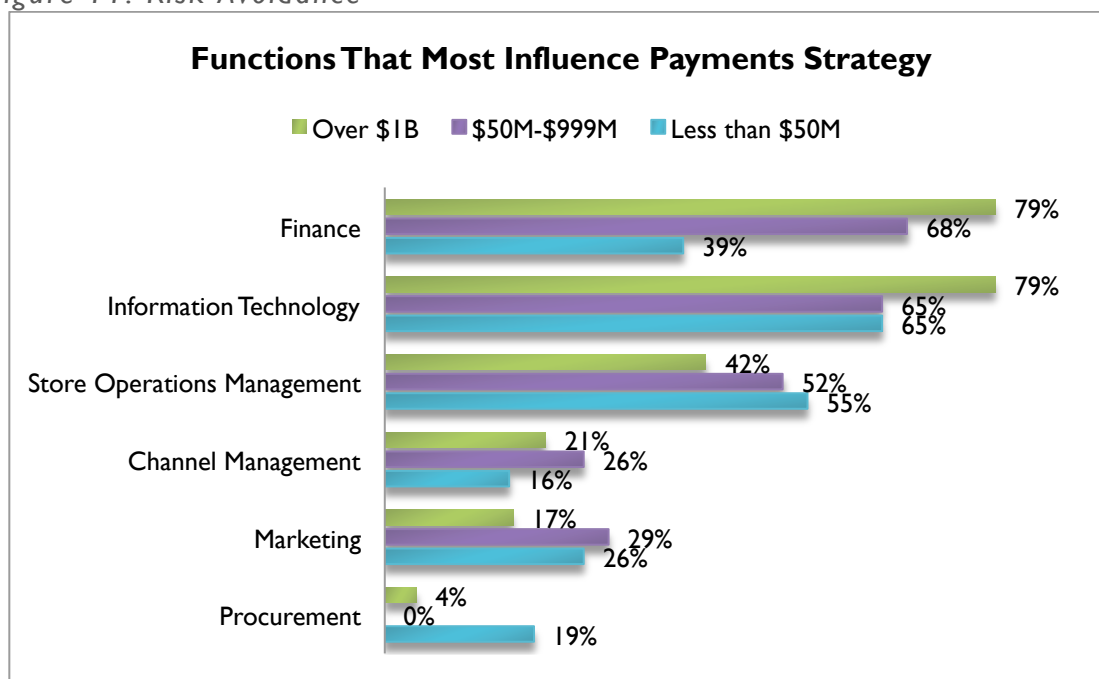
The opportunity for laggards in particular is further emphasized when we looked at how they scored the opportunity to “enable customers who currently can’t do business with us” to be able

to do so (47%) – in fact, it was the second most frequently cited top-three opportunity for them, superseding reducing fraud loss and risk of a breach. These retailers see an opportunity to target unbanked shoppers, layaway customers, recipients of government assistance, etc. On the other hand, only 8% of Winners ranked this as a top opportunity.

Who Gets The Last Word?

Given that the top opportunity is customer-focused, it would be understandable if readers of this report were to assume that Store Operations and/or Marketing leaders are primarily driving the agenda – but that turns out *not to be the case*. For the largest retailers, the Line of Business leaders that are most influential are Finance and IT leaders (Figure 11).

Figure 11: Risk Avoidance



Source: RSR Research, April 2015

This result is indicative of two factors that can (and probably do) act as a brake mechanism on payment innovation. For Finance, it's all about minimizing the negative financial consequences of any operational initiative. In the case of IT, the issues relate to integration of new capabilities to the existing technology portfolio, and change management. In other words, when it comes to change in the stores, both Finance and IT are the keepers of the status quo – and risk avoidance (not innovation) is the driving concern.

What is equally surprising is that IT has the last word even for very small retailers, those who presumably are largely dependent on outside providers to do anything with technology.

What It Means

When taking these findings together, an underlying message comes through: while retailers of all stripes desire to improve the customer experience, risk avoidance seems to be guiding them toward caution. As we'll see in the **Organizational Inhibitors** section of this report, that is indeed the case.

That in turn explains why retailers are looking for more guidance particularly from their traditional payment processing partners. New payment technologies are still emerging, payment security requirements continue to evolve, and retailers are stuck – waiting for the dust to settle. But consumers are forging ahead, expecting retailers to keep up with them.

Organizational Inhibitors

A World In Flux

We saw in the **Overview** section of this study, in Figure 3, that Winners' top drivers of change in payments are "protecting customer payment data" and "minimizing the risk of data breaches." These issues tend to trump a desire to create more options for consumers; as we said in the last section of this report, risk avoidance seems to be guiding retailers toward caution.

So what specifically are the inhibitors to progress? For starters, Winners and laggards agree that budgets are tough (Figure 12). This is hardly surprising, both given the "store multiplier factor" (even a small per-checkout-station cost mushrooms into a huge capital outlay when multiplied by the number of checkout stations throughout the enterprise), and given the uncertainty about the future of payments that currently prevails in the industry. But the differences between over- and under-performers come into sharper focus with the next-up top inhibitors.

Figure 12: "Too Quickly"



Source: RSR Research, April 2015

Winners are concerned primarily with the fluid state of payment technologies themselves. To put this in context, two years ago contactless payment methods using near field communications (NFC) were considered non-starters (for example, the retailer payment consortium MCX decided not to support NFC). But that was before Apple announced NFC support on the iPhone 6. In the United States, a battle of words between banks and retail trade organizations continues to rage over chip-and-signature cards, because the rest of the world is standardized on chip-and-pin cards. Is tokenization the wave of the future vis-à-vis data security, or enhanced encryption methods for sensitive data? All of these are challenging technical issues that still need resolution.

Laggards, on the other hand, worry about payment security requirements changing too quickly. It's a subtle but significant difference between the two performance groups. Security requirements are imposed by the outside world (banks, payment networks, standards councils, and even governments), while sifting through technology choices implies investigation and experimentation with the alternatives. In short, Winners take a more active stance, while laggards take a passive one. That may help explain why Winners also identify a shortage of IT resources as a key inhibitor - they simply don't have the people they need to chase down every alternative.

Looking In Different Directions For Answers

RSR frequently notes in our reports that a key difference between Retail Winners and their lesser-performing peers is that Winners maintain a relentless focus on consumers, while laggards tend to look over their shoulders to see what the competition is up to. While accepting the fact that uncertainty clouds the future of payments for everyone, retailers in each performance group stay true to form. Winners are looking to see what technologies are most favored by consumers, while laggards are looking for industry alignment to a set of data security and privacy standards (Figure 13).

Figure 13: Looking For Direction



Source: RSR Research, April 2015

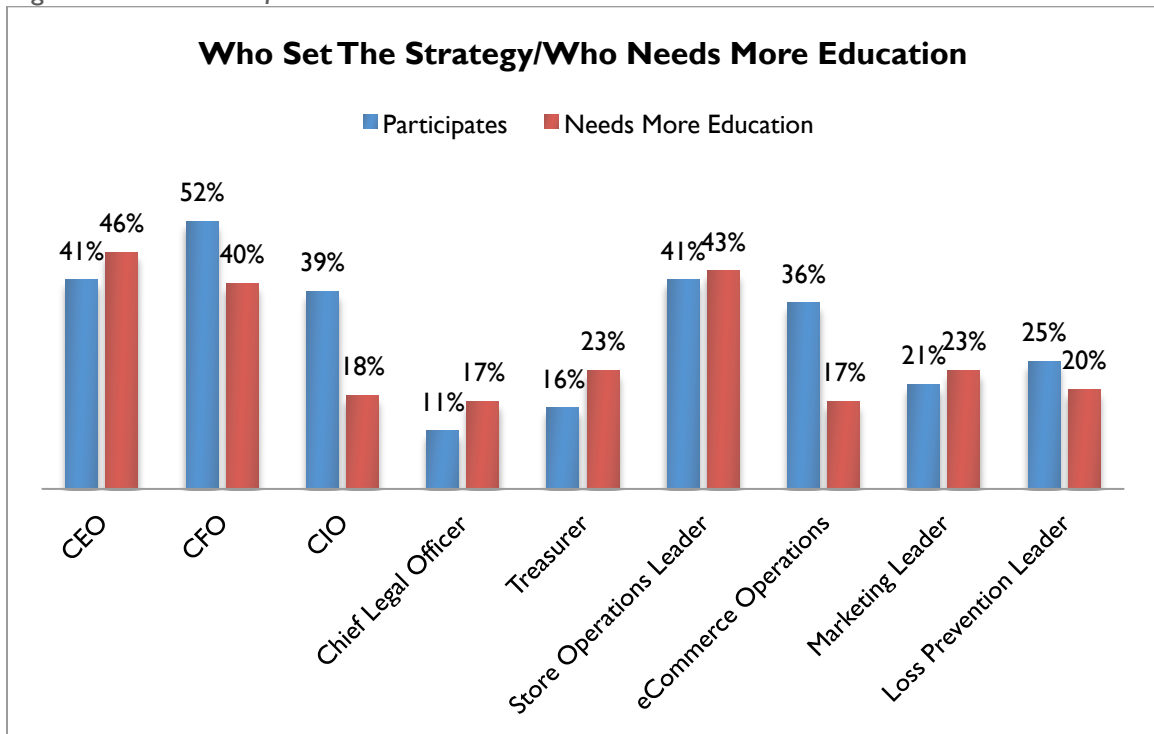
When looking at responses based on company size, an interesting difference is revealed. The largest companies (more than \$1B) are the most focused on which payment technologies get adopted by consumers, while smaller retailers (less than \$50M) are most focused on a proven ROI. Mid-tiered retailers, on the other hand, are focused on the “security” issue – nearly one-half indicate that they are waiting for industry alignment around accepted standards and wish that there is greater leadership awareness of the risks and payment security requirements.

The common theme for retailers across all performance groups and size is that they are in a holding pattern, either looking to consumers themselves or to the greater retail industry to point them in a direction. Looking back, specifically to the introduction of credit and debit cards, it’s hard not to see the fundamental change that has occurred. In the past, retailers were presented a “take it or leave it” proposition – they could choose to either accept or reject a payment type, but in all cases the technology was settled. Now, new payment technologies are still emerging, driven not as much by the issuing banks and payment networks as by the dual pressures of mass consumer adoption and security.

Technology Leading The Business?

We saw in the **Opportunities** section of this report that the CFO and CIO are the most influential business leaders when it comes to new payment adoption. So it’s no surprise that for many companies, the CFO and CIO (along with the CEO) are active participants in the dialogue about payments. The other key participant often is the head of Store Operations and to a slightly lesser extent, the head of E-Commerce (Figure 14).

Figure 14: Cast Of Characters



Source: RSR Research, April 2015

But according to our response group, the executives who most need more education about the advantages and risks of next generation payment capabilities are the CEO, CFO, and Store

Operations leaders. But once again, there's a Winners vs. laggards story here: Winners by far want more guidance from the CFO (59% compared to 40% for the overall response group), while laggards are looking to the CEO (63% vs. 46% overall). The CFO in particular is responsible in the company for financial risk mitigation, and Winners want that base to be well-covered.

Laggards are looking for the go/no-go signal from the top. But one could argue that the CEO is the one executive least likely to have had any time to delve into the nuance and complexity of next generation payments. As we saw earlier, this finding speaks to a level of passivity on the part of laggards.

Conversely, the Line of Business (LOB) leaders who are least in need of more education are the two that are most likely to be technically savvy: the CIO and the E-Commerce leader. The challenge for these two is that they are not as aligned to legacy operations as other key influencers. This means that when it comes to payments, technology tends to drive the business and not the other way around. And as every retail CIO knows, that's a hard sell.

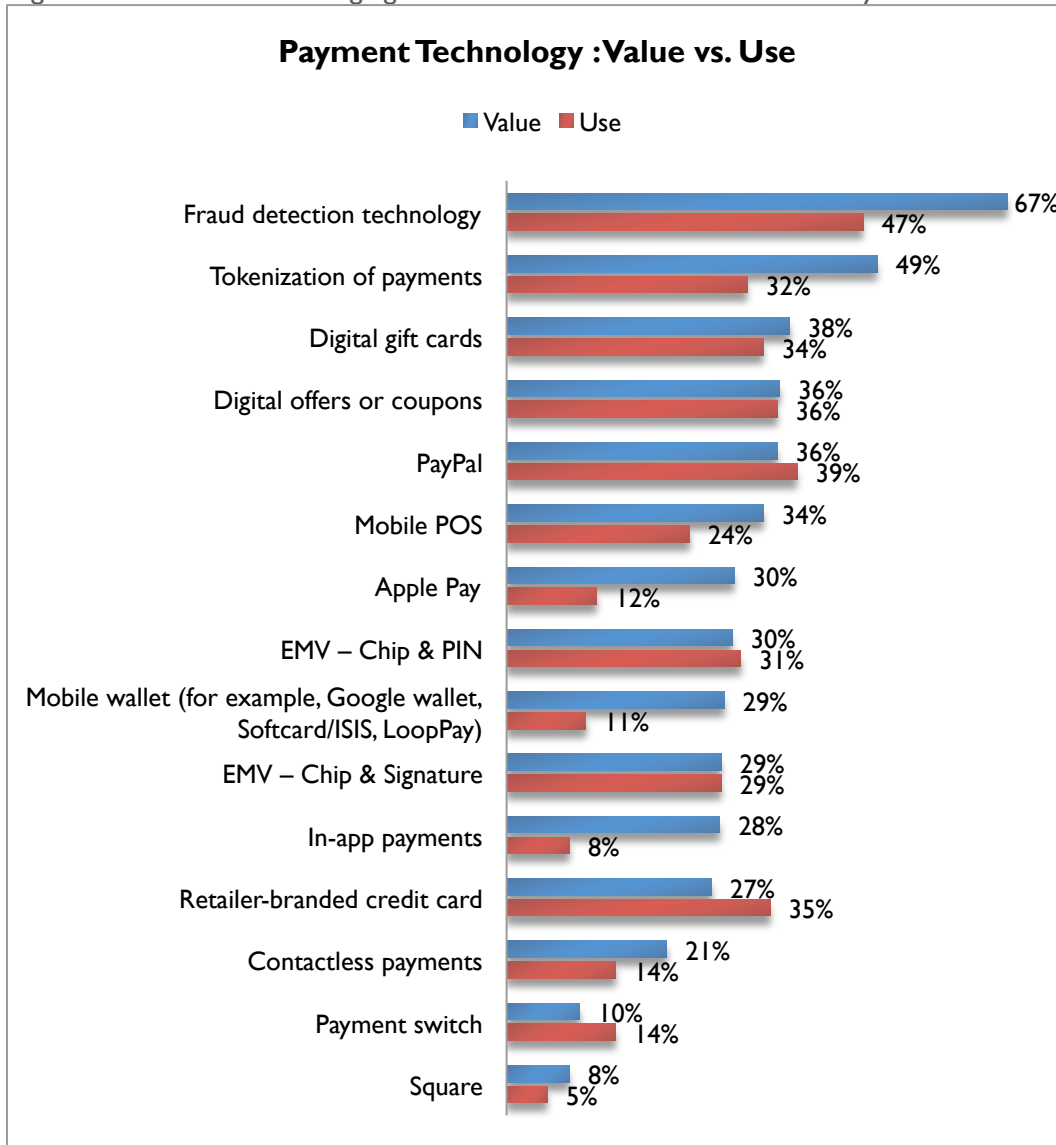
Hard sell or not, we'll see in the **Technology Enablers** section that budgets are beginning to thaw and retailers are slowly, cautiously, moving ahead. Our big concern is that they may be moving too slowly. While the ramp-up for consumer adoption of any technology may take a long time, once it begins, it happens at lightning speed. For example, while mobile phone adoption began in the mid-1980s and the web-enabled cellphone was first introduced in about 1996, rapid consumer adoption began in 2009 (the result of the iPhone introduction in 2007 and the Android in 2009). The time for new consumer capabilities to incubate is getting dramatically shorter, but consumer adoption happens just as fast. So retailers can't afford to wait too long – consumers are far too unforgiving.

Technology Enablers

Beyond Fraud, Privacy, And Security

Consistent with their business challenges, when it comes to Technology Enablers retailers place the most value on fraud detection and payment tokenization (Figure 15). However, underneath those two priorities, there is a lot of middle ground in the area of customer engagement, including digital gift cards and offers, mobile POS, Apple Pay, and other mobile wallets.

Figure 15: Customer Engagement Lives On Beneath Security's Shadow



Source: RSR Research, April 2015

While retailers in general report these technologies are currently well matched in terms of value vs. usage, the gaps we do see are very interesting. Clearly there is more work to be done in fraud and tokenization investments, but retailers' interest in Apple Pay significantly exceeds their current rollouts. The same can be said for mobile wallets and in-app payments.

Ironically, especially given the interest in Apple Pay, retailers' interest in contactless payments is significantly less – only 21% of overall respondents rated it as having a lot of value vs. 30% for Apple Pay. Hopefully they realize that Apple Pay is just one way to roll out that very technology.

Several differences emerge beneath these top line results:

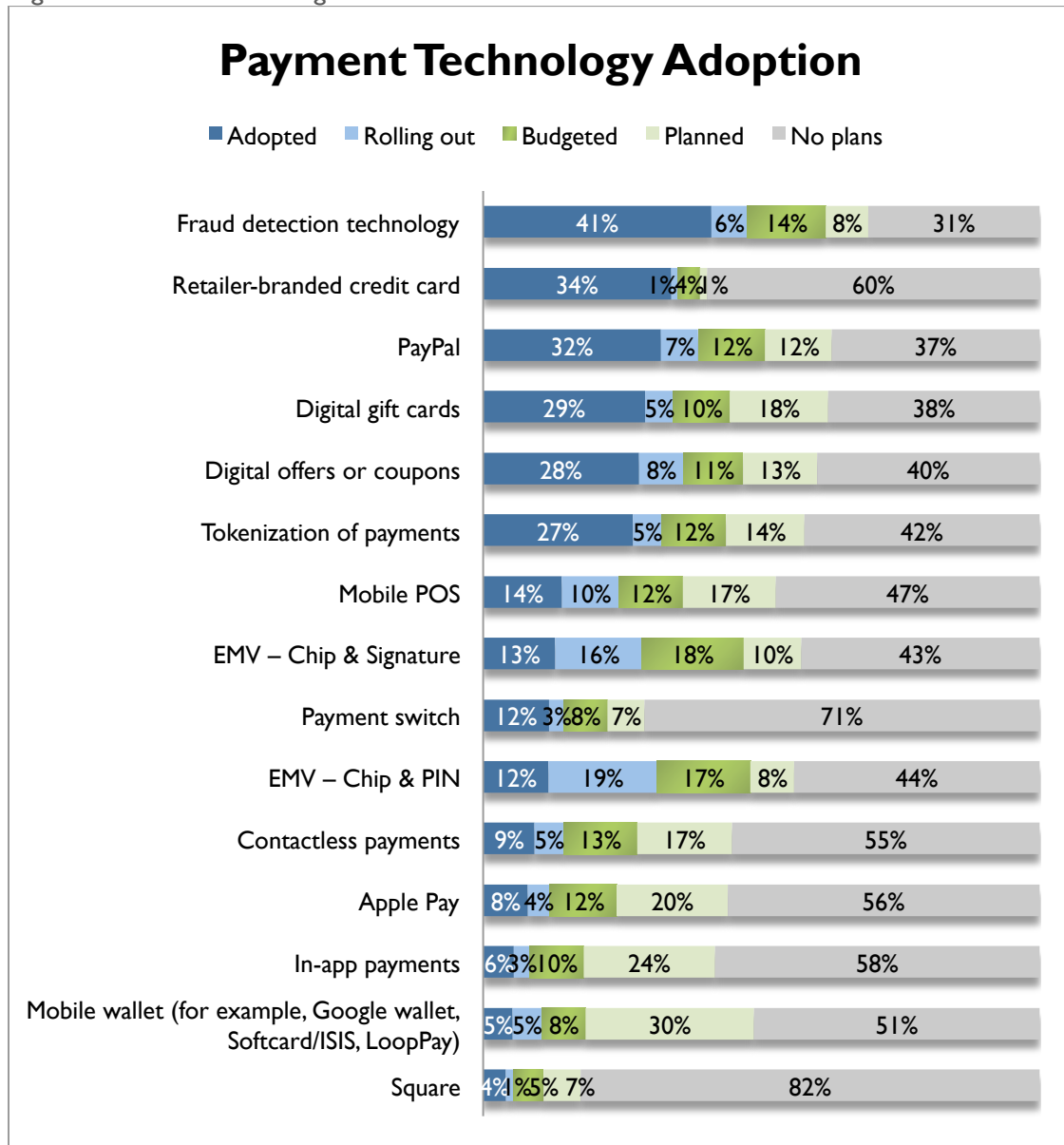
- Retail Winners place a great deal more emphasis on the value of tokenization of payments: 67% rate it "a lot of value" vs. 46% of laggards. Laggards instead look to fraud detection as their most valued technology enabler, with 79% giving it a lot of value vs. 67% of Winners.
- Laggards place a lot more value than their peers on two distinct tech enablers, payment switches and retailer-branded credit cards. As we'll see below, almost no one is investing in these technologies for the future, but 43% of laggards see a lot of value in retailer-branded credit cards vs. only 5% of Winners. The same holds true for payment switches, something we anticipated to be a "slam-dunk" investment, particularly for large retailers. Only 5% of Winners saw a lot of value there, compared to 17% of laggards.
- Tokenization and mobile POS are given very high marks by large retailers (over \$1 billion in revenue): 80% say tokenization has a lot of value, compared to just 22% of small retailers (under \$50 million). And 63% of large retailers see a lot of value in mobile POS vs. just 14% of small retailers.
- Fashion retailers are driving a lot of the perceived value in digital gift cards and Apple Pay: 64% of fashion retailers say that digital gift cards have a lot of value vs. 38% overall. And an astonishing 54% of fashion retailers say that Apple Pay has a lot of value vs. only 30% overall.

Still A Lot of Green In The Greenfield

Across all of the topics that RSR studies, payments shows one of the lowest overall rates of adoption among technology enablers. It is not that this is a low-tech part of the business. Rather, as we look at envelope-pushing innovations, there just hasn't been much movement. This was especially true of our benchmark in 2013: budgeted or planned investments numbered in the single digits.

In 2015, things are loosening up. Yes, for US respondents in particular, EMV mandates are driving some of the spend, though for many retailers this is proceeding at a much slower pace than we had hoped to see (Figure 16, below). But security concerns at the level of business strategy have not translated into massive investments that drown out everything else. Technologies such as digital gift cards, digital coupons or offers, mobile POS, and even mobile wallets are starting to thaw, in part as some convergence and relative maturity appears to have come to these technologies, and in part because, as we found in the operational challenges, retailers cannot afford to wait – consumers are ready to use these payment methods, and retailers need to be where their shoppers go.

Figure 16: Frozen Budgets Start To Thaw



Source: RSR Research, April 2015

There are, as usual, some stark differences beneath these top-line results:

- Laggards are very interested in mobile wallets and in-app payments: 57% report budgeted or planned projects for mobile wallets, and 46% report the same for in-app payments, while only 38% and 34% of peers, respectively, report committing funds or resources. This has the feel of more of laggards' silver bullet syndrome. They have somehow zeroed in on these two particular technology investments. However, renewed focus on mobile may also be driving this interest, rather than an overall payments strategy.
- Looking at results by retailer size, the largest retailers are driving most of the investment plans. They report having budget or plans at rates that exceed the smallest retailers'

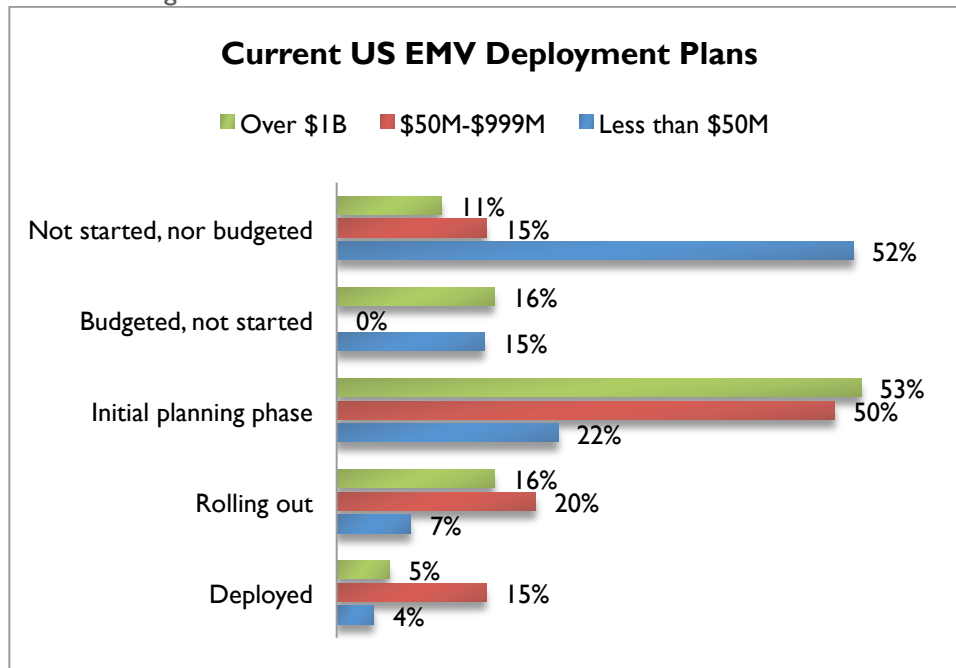
plans by nearly 2-to-1 for in-app payments (50% vs. 24%), mobile wallets (48% vs. 38%), mobile POS (44% vs. 18%), contactless payments (43% vs. 21%), and Apple Pay (42% vs. 26%). Small retailers anticipate making greater strides than their large competitors in only one area: digital coupons (38% of small retailers vs. 19% of large).

- Looking at retail verticals, two major differences stand out: Fashion retailers appear about to jump with both feet into Apple Pay – 52% report budgeted or planned projects for Apple Pay vs. 32% overall. And grocers plan on leading the way in mobile wallet investments, with 50% reporting budgeted or planned projects there vs. 38% overall.

A Special Note On EMV In The US

As we write this report, it is early in 2015. There is little sense of urgency around EMV among US-based retailers. Many card-issuing banks don't even plan on issuing chip-enabled cards until the liability shift deadline of October. Some of the largest retailers, seemingly as a visible response to publicized breaches, have already rolled out the signature capture / PIN pad devices that are EMV enabled, but there are still many, many mag-stripe-only payment devices in the field (Figure 17).

Figure 17: Coming . . . Soon?



Source: RSR Research, April 2015

The Hard Truth About Payment Security

Thieves are clever. And with the global reach enabled by the Internet, they seemingly never sleep in their quest for easy money. While retailers may speak of security, privacy, and fraud almost like a mantra, the reality is that it is a moving target. Security is not a project. It is a way of life. It is the project that never ends. And so retailers, as they have proven through their technology priorities, are learning to live in this dual world of continued vigilance alongside innovations that demand fast, sharp actions that rapidly become part of the background noise of running a business.

The good news is security has not sucked up all of the available money for investments in payments. The bad news is retailers still express a large degree of uncertainty about the capabilities needed.

Retailers have not frozen their investments to the degree they had in 2013 – there are cracks in the ice – but it is still not the torrent of investment that must still come. Look to specific verticals, and the largest retailers in those verticals who have the budget and the technology resources for innovation investments, to advance specific capabilities, like mobile wallets or Apple Pay. But the future of payments – the more radical changes in the way that consumers pay – is still yet to come.

BOOTstrap Recommendations

Payment processing is the last “moment of truth” in consumers’ path to purchase. No matter how engaging the selling process up to the point where a customer wants to exchange money for goods and services, all that good will can be lost if the payment itself is mishandled. But there’s a longer life beyond checkout, for digital payments in particular. As the use of digital payments (particularly debit and credit cards) has proliferated for both “card present” (i.e. store payments) and “card not present” (e-Commerce) transactions, so has the sophistication and sheer audacity of data thieves. The humiliation and financial harm to large and credible brands caused by data breaches has caught both retailers’ and the public’s attention. This has put the security of digital payment transactions as a top-of-mind concern for retailers, more so than innovation in new technologies such as contactless payments, mobile wallets, and similar solutions.

There’s another aspect to the next generation of payments that is unlike any prior wave of innovation. While in the past the form factor was dictated by financial institutions, today that discussion is being driven by consumer adoption of technology. Consumers themselves are likely to decide which form factor is declared the winner.

With these realities, it would be understandable if retailers were to decide to let someone else go first. But RSR believes that retailers can’t afford to wait for “final” answers to emerge about either security or form factor before working on innovation – those answers will never come. With that in mind, we offer the following recommendations:

Secure The Basic Infrastructure

Regardless of the eventual winning form factors at the edge of the payment process, the infrastructure that handles payment authorization has to be built with **fraud prevention**, **PCI compliance**, and **customer data privacy** in mind. That is the best strategy for minimizing the risk of data breach. But security is a moving target, and so investing in **fraud detection technology** is also critical. Retailers who worry more about the cost of addressing these challenges than the cost of *not* addressing them are missing the point.

Don’t Wait For Consumers To Settle On A Winner

While the ramp-up for consumer adoption of any technology may take a long time, once it begins, it happens at lightning speed. Because of that dynamic, retailers cannot wait for clear winners to emerge when it comes to payment innovations, particularly mobile payments and digital wallets. Experiment to develop institutional knowledge of potential impact and how best to respond, so that once consumers do settle on form factors, the enterprise is ready.

Watch The New Players

Consumer darlings like Apple and PayPal are unburdened by a long legacy of payment processing (in stores, particularly) and so they can implement disruptive innovations and force the payments industry and retailers to respond. Pay attention to what they are doing – it may have value to your brand!

Work With The Incumbents

While new players may be garnering a lot of attention, the companies that have ruled the roost for 50 years aren’t going away. Payment networks in particular have a lot to offer when it comes to payment security and customer privacy, as well as next generation payment form factors. Use

them as a resource – it's in their best interest as well as the retailers' to keep up with both consumer adoption of new form factors and new fraud prevention and detection challenges. While for retailers, payment processing represents “the last mile” of the customer path-to-purchase, it's the *only* focus for payments processors.

US Retailers: Expect A Shift

The 2015 EMV mandate in the U.S. will shift the risks associated with electronic payments from “card present” to “card not present” transactions. Store-based retailers need to pay attention to what e-Commerce pure players are doing to protect against that kind of fraud.

Develop An Integration Roadmap

As every retailer knows, a legacy infrastructure won't go away just because it doesn't “play” well with new technologies. Integration of new technologies (particularly at the point where the consumer offers the payment) to the existing infrastructure is a fact of life, and has to be addressed proactively.

Get Those Responsible For The Customer Experience More Involved

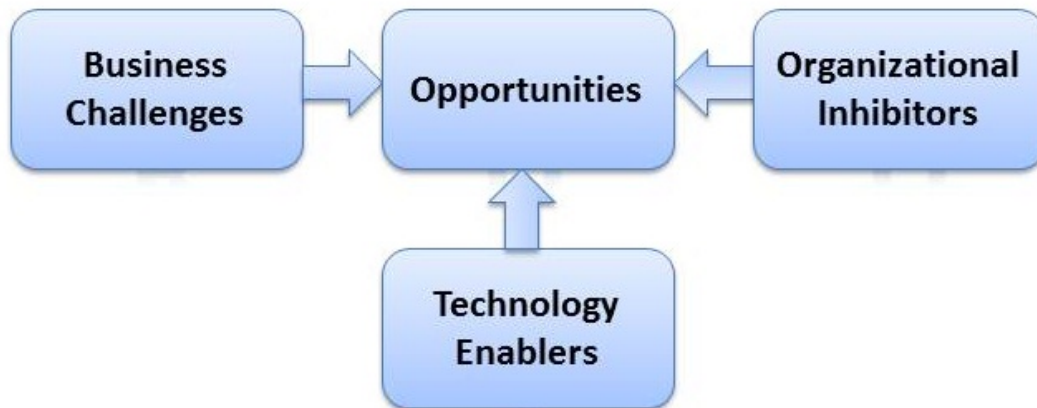
We saw in this report that those executives most likely to be tech-savvy, the CIO and the head of e-Commerce, tend to be the most influential when it comes to new payment type adoption. Store Operations and Marketing – two groups involved in designing and executing on the Brand Promise to consumers – must be more involved. It comes down to a need to design the customer experience across the breadth of the shopping experience. The way payments are processed is an important part of that experience. It cannot be left to technicians to decide what gets implemented and what doesn't. The CFO must also take a more active role, since he or she is responsible for risk mitigation. A data breach creates impacts far broader than just the transaction involved – it impacts the value of the Brand.

Appendix A: The BOOT Methodology[®]

The BOOT Methodology[®] is designed to reveal and prioritize the following:

- **Business Challenges** – Retailers of all shapes and sizes face significant **external** challenges. These issues provide a business context for the subject being discussed and drive decision-making across the enterprise.
- **Opportunities** – Every challenge brings with it a set of opportunities, or ways to change and overcome that challenge. **The ways retailers turn business challenges into opportunities often define the difference between Winners and “also-rans.”** Within the BOOT, we can also identify opportunities missed – and describe leading edge models we believe drive success.
- **Organizational Inhibitors** – Even as enterprises find opportunities to overcome their external challenges, they may find **internal** organizational inhibitors that keep them from executing on their vision. Opportunities can be found to overcome these inhibitors as well. Winning Retailers understand their organizational inhibitors and find creative, effective ways to overcome them.
- **Technology Enablers** – If a company can overcome its organizational inhibitors it can use technology as an enabler to take advantage of the opportunities it identifies. Retail Winners are most adept at judiciously and effectively using these enablers, often far earlier than their peers.

A graphical depiction of the BOOT Methodology[®] follows:



Appendix B: About Our Sponsors

CyberSource®

To achieve your business goals, you may be looking to increase revenues, expand globally, create new customer experiences, or reduce cost and complexity as your business grows. In every scenario, payments and payment management play a key role. CyberSource payment management solutions enable you to transact across multiple sales channels, manage fraud risk, and streamline payment security, worldwide—all via one connection to our global platform. We can help you innovate and grow your business as well as optimize your operations. CyberSource is a wholly-owned subsidiary of Visa Inc. Over 400,000 businesses worldwide use CyberSource and Authorize.Net brand solutions to process online payments, streamline fraud management, and simplify payment security. For more information, please visit www.cybersource.com.

Appendix C: About RSR Research



Retail Systems Research (“RSR”) is the only research company run by retailers for the retail industry. RSR provides insight into business and technology challenges facing the extended retail industry, providing thought leadership and advice on navigating these challenges for specific companies and the industry at large. We do this by:

- **Identifying information** that helps retailers and their trading partners to build more efficient and profitable businesses;
- **Identifying industry issues** that solutions providers must address to be relevant in the extended retail industry;
- **Providing insight and analysis** about a broad spectrum of issues and trends in the Extended Retail Industry.

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