



Retail Intelligence: Value Added Payment Services are No Longer Enough

This article examines how payment providers, such as merchant acquirers, and processors with strong merchant services businesses, are moving beyond payments-oriented value-added services (VAS) as means to escape the commoditization and eroded margins of core processing services. Nearly every link in the payments value chain is under pressure. Increasing competition, growing security concerns, and climbing consumer expectations for convenience and customization all press on merchants and their payments providers. A scan across markets, however, reveals acquirers offering largely identical VAS, with little to distinguish them in the eyes of merchants. These VAS can alleviate the downward spiral of core processing services, but in a homogeneous competitive environment, their potential is limited. A holistic approach to merchant services, known as Retail Intelligence, is required.

During the last ten years some acquirers have actually embraced the commoditization of their business by relentlessly pursuing cost-efficiency and economies of scale. This model only favors a handful of incumbents, leaving smaller acquirers and emerging payment service providers (PSPs) the option of focusing on better service, product innovation and extracting value from the data surrounding transactions--collectively known as (payment-oriented) VAS. This approach has lead to a flurry of merchant-facing payment services such as: e-billing, cash management reporting, loyalty solutions, data analytics, and omnichannel acceptance.

A decade of pursuing VAS now makes them ubiquitous. Originally developed as a means to escape payments service commoditization, VAS are now, ironically, a commodity themselves. This is

Figure 1

Breaking Out from the Payments Service Silo

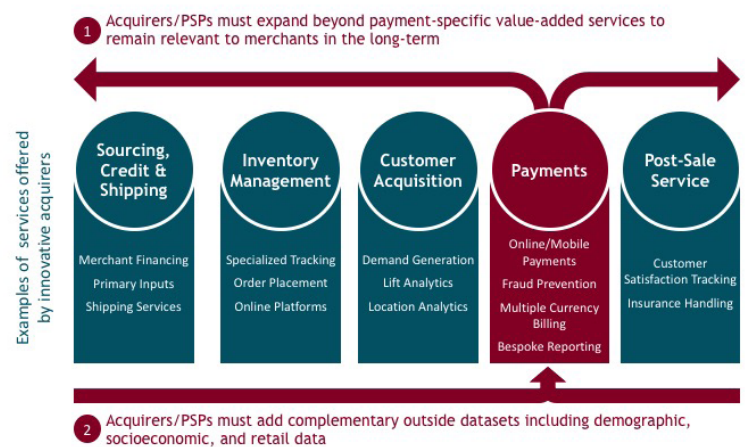


Figure 2

Examples of the Beginning of Retail Intelligence





exemplified in the Single European Payments Area (SEPA) where early movers developed cross-border solutions and multi-currency platforms, only to find the landscape full of similar solutions within a couple of years. A similar scenario is unfolding in South East Asia.

To escape commoditization, the merchant-acquirer relationship needs to extend beyond the payments vertical to include services to multiple parts of the merchant value chain. This concept is known as Retail Intelligence. A key characteristic of Retail Intelligence is that it is also a two-way information exchange that draws data from multiple sources both within a merchant's business and from the surrounding environment. Furthermore, Retail Intelligence performs an "information absorption" function, taking in payments transaction data and passing it to other areas of the merchant's operational value chain where they are needed.

Aside from a few examples (e.g. merchant credit) most payment-oriented VAS feedback loops tend to be bilateral and focus on either improving the payments experience per se, or mining transaction data to find ways to improve sales. The use of VAS as conduits for improving other parts of a merchant's value chain, and client-facing parts of their business, are generally limited. In this regard, Retail Intelligence is a more dynamic differentiator and driver of growth.

Opposed Supply and Demand

Merchants want and need Retail Intelligence to support their increasingly sophisticated operations--and sophisticated operations are no longer the exclusive realm of large merchants. The average time for a small Taiwanese retailer that goes online to sell internationally is under a year, compared to two years in 2008; and cross-border transactions now account for 20 percent of all sales for many of Hong Kong's independent clothes labels. Despite these

fast changes, few acquirers are innovating aggressively enough. Merchants instead see many acquirers continue to focus their business practices on accumulating transaction volume. This is partially due to new payment platforms failing to replace legacy solutions, thereby creating a glut in the overall processing bandwidth.

What merchants seek are partners--acquirers or not--who can offer Retail Intelligence

Furthermore, new solutions are deliberately designed with excess capacity in mind to ensure fast performance for the merchant, issuer, and end-user developer communities. These are costly investments in infrastructure that require huge transaction volumes to reap economies of scale. The combined result of all this excess capacity is a fierce wrangle for transaction volumes, that directs efforts toward merchant acquisition rather than service innovation.

As the payments component of acquirers' services continues to commoditize, there is a reactionary trend to focus on pricing and efficiency as distinguishing features. This is a dangerous way to face growth challenges. Efficiency gains obey a law of diminishing returns on investment, and keeping merchants by leveraging decreased pricing will only erode margins.

What merchants seek are partners—acquirers or not—who can offer Retail Intelligence—services beyond just payment processing, that help improve cost structure and facilitate market presence. Many merchants are exploring the possibility of working with specialized payments technology providers outside of their acquirers, or assessing disruptors with new business models. Some larger



merchants are even developing in-house capabilities. The impact these strategic choices have on merchants' success means careful decision-making is paramount. Acquirers that are not solving these needs together with, or on behalf of their merchants, will suffer.

Forward-thinking acquirers are responding by expanding into services such as inventory management, merchandise sourcing support, direct marketing, and post-sale service. They are in the vanguard of Retail Intelligence. Acquirers offering only payments-related VAS, risk falling behind their competitors, losing customers, and ultimately facing obsolescence. The good news is that Retail Intelligence can both protect acquirers against market forces and improve their businesses.

Three Examples of Retail Intelligence

Although Retail Intelligence is much more than payment-oriented VAS, it remains in the latter's shadow. What many acquirers tout as best-in-breed VAS are simply very good loyalty or fraud control solutions, that make excellent use of data analytics. In other cases, VAS translates to little more than offering mobile payment gateways and multiple currency settling capabilities. In today's merchant services landscape all these examples are simply table stake attributes.

1. Going beyond loyalty platform solutions

Point accrual tracking, program rule set-up, and point expiration tracking, are usually part of an acquirer's core services, and are leveraged as VAS when the data they generate is used to improve program or liability management, and help design promotions and campaign reviews. Each of these services is under rapid assault from coalition programs, database consulting firms, and dedicated third party loyalty service providers.

Figure 3

Competitors Encroach on Loyalty Services

Types of Competitors and their Target Loyalty Program Components

Processing	Fulfillment
Card Networks Payment Processors	Emerging Integrators Online Stores working with Issuers
Analytics	Communications
Processors Consulting Firms Database Specialists	Direct Marketing Suppliers

Forerunners in the loyalty field are defending themselves by developing Retail Intelligence related to fulfillment and loyalty campaign communication services. These activities require direct interaction with consumers and are tangential to loyalty processing. Because these services are not traditional competencies of acquirers, they are turning to partnerships or acquisitions with fulfillment integrators and direct marketing companies in order to fill service gaps.

A European acquirer was frustrated with the low use of its loyalty data analytics services despite significant upgrades. Research revealed that many of its merchant customers did not have a dedicated communications team or supplier in place. Data insights could not be acted upon, and merchants hesitated against investing in better analytics. In a "help-me-help-you" effort that characterizes Retail Intelligence, the acquirer partnered with a direct marketing company so that merchants who did not have a robust marketing team could actually use the data analytics created by the acquirer. The move proved so successful that the acquirer assumed a majority share in the marketing company.



A Latin American bank and merchant acquirer made a sales proposition to its travel merchants that hinged on the bank promoting them as reward partners among its card holders, and directing targeted travel offers to them. In theory this was an excellent way to leverage both merchant and issuer data, but a lack of experience with fulfillment led to scathing remarks by clients and a spike in churn among travel merchants.

The situation was reversed by partnering with an online travel agency that became the white-label fulfiller for all travel rewards. The agency also secured better deals for travel rewards, placed staff in the bank's call center, and handled cross-sales for travel related products such as insurance and pre-paid cards. Within two years the Retail Intelligence solution became an income generator, when it was offered to non-competing banks and acquirers in the region.

2. Extending the role of anti-fraud solutions

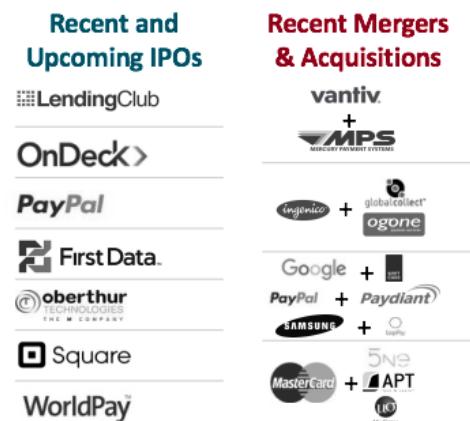
Payment-oriented VAS have made great strides with algorithms and reporting tools that prevent fraud from taking place, and their effectiveness is now opening the road for Retail Intelligence services. Fraud control is much like an escalating arms-race with each side developing ever more sophisticated tools, yet little attention has been given to helping merchants repair or preserve their relationship with customers who are victims of identity theft or fraud.

Credit card issuers were the first to explore partnerships with companies that help victims rebuild their credit records and identities; something card holders are usually billed for. One American merchant acquirer is flipping the practice on its head and harnessing the data it harbours within its fraud control solution to identify victims to whom merchants can reach out to and reissue credit. This alleviates the traditional reliance on credit bureaus, redirects the victim's throttled spend to the merchant's card, and builds brand loyalty.

What distinguishes the acquirer's move toward Retail Intelligence is how the acquirer is coordinating with, and training the merchant's customer service desk. This high-touch solution has promising initial results, with consumer spend on repaired cards being 23 percent higher than on unaffected cards.

Retail Intelligence is emerging as acquirers strive to help merchants during the employee screening and demission process. A North American acquirer is investing in a back-ground check company so it may provide merchant aggregators in the "on-demand" services category, an additional tool with which to screen their micro-merchants. Crime-rings in Latin America systematically infiltrate banks and merchants, but mismanaged evidence and errors in the dimission process often void the legal ability to pursue fraudsters. This has led to some acquirers in the region creating personnel black-lists they share with merchants, so that they can avoid hiring known (buy unconvicted) criminals. Acquirers are also training merchants' legal and human resources teams to ensure they follow the right protocols when handling evidence and employee fraud.

Figure 4
A New Market Landscape will Facilitate Retail Intelligence Solutions





3. Enabling merchants to leverage demand generation and lift

The traditional VAS approach to small merchant solutions is to reduce onboarding time, leverage mobile and tablet technology in the POS space, improve exception management, and make adding online sales painless. These solutions certainly help increase demand and create lift for merchants, but they do not prepare the merchant for growth. If an acquirer has access to a merchant's transaction data, and is using the data to create lift, it is also in a privileged position to offer credit or offer sourcing solutions.

At least two global merchant acquirers are already offering merchant credit services in the United States and have plans to grow internationally, but some of the boldest Retail Intelligence sourcing solutions come from small markets. In Rwanda, an acquirer is piloting

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collective sourcing on behalf of mobile phone retailers with support from the government. In Peru and Colombia, collective sourcing is hoped to encourage adoption of digital payments among mom-and-pop stores, particularly in semi-rural areas. A similar service is being explored with small restaurants in northern California.

How Retail Intelligence Will Evolve

1. Incumbent acquirers will focus on buying capabilities

The ability to provide merchants with insights allows acquirers of all sizes to not only preserve their position but also demonstrate

their value to merchants. In this regard, incumbent acquirers historically had an advantage over specialized or new generation challengers, because they already held the trust of merchants to access data and handle a complex and indispensable process. Retail Intelligence is gradually changing this dynamic. In 2008, less than 10 percent of large merchants switched merchant processors when they renewed contracts, but in 2013 the number of defections in Europe and North America reached nearly 14 percent, while the average contract term was reduced by 11 months.

What incumbent acquirers lack are the Retail Intelligence solution modules that keep their datasets from commoditization. An overarching challenge is to augment these datasets either in-house or through "buy or partner" strategies--with buying being the most likely. Over the next three years these pressures will result in an accelerated schedule of acquisitions as incumbent acquirers buy solution providers to remain competitive and create a defensive moat around the large accounts that maintain their transaction volume based business models.

2. Challengers will gain ground among SMEs

Keeping smaller merchants is even harder. Incumbent acquirers already struggle to satisfy them and are accustomed to churn rates as high as 45 percent in the SME category. The second most common complaint (after pricing) is the lack of relevancy or applicability of merchant acquirers' products and services to the needs of a small merchant. It is among smaller merchants that challengers are making the most inroads, and where Retail Intelligence services will be honed. Indeed, nearly a third of small merchants that leave global merchant acquirers, cite a new acquirer's better services and products as the reason. This is over twice the rate seen in 2008 and is likely to increase as more challengers enter the scene.



3. SaaS will relandscape and level the playing field

What enables new acquirers to efficiently mine the SME category is the expansion of SaaS--something that in and of itself fosters and encourages new merchant solutions. This will be a key characteristic of how Retail Intelligence services will be provided and reinforces the importance of Independent Software Vendors (ISVs) as merchant acquirer partners.

The trend toward SaaS and the reliance on ISVs is well established. Already one-fifth of new merchants are acquired through ISVs in North America. In the niche Not-for-Profit payments processing sector, the rate is almost 40 percent, and a similarly compelling case is occurring with online accounting solutions--a logical, but mostly unleveraged pairing.

The role of gateways as an important link between POS hardware solutions, e-commerce, and payment networks is encroached by this trend. Despite some payment focused software companies building their own gateways, the general trend favors consolidation under white-label gateway services. This is the most cost effective solution to upgrading existing solutions and investing in new ones.

Figure 5
Retail Intelligence Strategies Differ for Different Sized Acquirers

Key Migration Questions

Key Migration Questions	
Large Acquirers	<ul style="list-style-type: none">How many geographic and industry-specific requirements do we need to juggle?How can we retain control over our merchant offerings while integrating the necessary innovations, culture, and talent?Do we want to become a one-stop shop for our merchants?
Small or Specialized Acquirers	<ul style="list-style-type: none">What do our individual merchants or merchant categories most want and need?How broadly beyond payments can we efficiently expand?What services can we offer today that also provide a foundation for future innovations?

The current processing glut and commoditizing of VAS is not sustainable

Unlocking Retail Intelligence

The current processing glut and commoditizing of VAS is not sustainable. Only a handful of already large players will be able to leverage scale and operations, and even among them, there is mounting pressure to provide credible alternatives beyond VAS. Winners--both incumbents and challengers--will be those that realize that Retail Intelligence will take them outside of their comfort zone and oblige a reassessment of core parts of their business model. Five factors required to succeed with Retail Intelligence are:

1. Pick Your Fights

Acquirers that adopt Retail Intelligence will face a fundamental change of focus as they seek solutions for ever more parts of a merchant's client-facing business. Providing excellent solutions across the entirety of a merchant's value chain is nearly impossible and is unsustainable. Acquirers should select the parts of the value chain they are most interested in or best suited to succeed.

2. Get to the High-Ground

The need to develop merchant solutions is now measured in weeks and months as opposed to years. Players that are first to market hold the advantage, so it is more important to focus on a trial's success than to have the plan for scalability solved.

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3. Don't Rely on Size

Incumbent acquirers can no longer rely on larger war chests and bigger teams as a differentiator in bringing solutions to market. Challengers are easily able to find resources and partners. Valuations and IPOs in the fintech space area are at an all time high, and even crowd-sourcing has helped some challengers quickly reach scale. Large size is a potential burden because it hinders agility.

4. Lose Battles to Win the War

Traditionally, acquirers focused on a handful of new solutions over the course of a few years. The new competitive dynamics oblige acquirers to develop multiple solutions over very short time-spans. Solutions that do not demonstrate early uptake should be pruned, making it easier for resources to benefit more promising branches.

5. Negotiate Alliances

Time-to-market is essential and generally favors an acquisition model, although some acquirers may have niche expertise that favor building in-house solutions. A few acquirers--particularly in the cloud--are opting for a hybrid option, and are establishing preferred partnerships with API developers and ISVs to build and sell a core set of solutions. An alternative approach may be for acquirers and ISVs to have app-marketplaces that host multiple solutions.

Forward thinking merchant acquirers are already moving beyond payments-oriented VAS and are exploring Retail Intelligence. Going forward, agility, responsiveness, and innovation, will be more important than size and resources. Dexterity will be measured as much by an acquirer's ability to develop relevant solutions across a merchant's value chain, as by quickly finding the right partner or acquisition target. Merchant acquirers, be they incumbents or newcomers, whether large or small, that successfully move beyond payments-oriented VAS into Retail Intelligence will be the companies we talk about tomorrow.

We welcome your thoughts and opinions.

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