2012 | THE YEAR IN PAYMENTS

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A Look Back At The News And The Noise That Defined Payments

2012: The Year in Payments | A Look Back At The News And The Noise In Payments

By Market Platform Dynamic's CEO Karen Webster

2012 will go in the payments history books as the year that was … well… by and large mobile. Payments innovation fueled by the IP-enablement of devices used by consumers and merchants to interact drove payments innovation into high gear. Players large and small flooded the market with new applications, new business models, and new approaches to transforming the shopping experience.

As a result, there was no shortage of news, blogs and commentary related to what was happening in payments and the new ideas being introduced to the consuming public. In fact, just about every day, there were, on average, 30 news announcements chronicling “the latest” — from names that are familiar and from many that are not. I thought it would be fun to look back at some of the major developments that happened in payments and separate what was really news from the noise that, at times, drowned out the important developments that will set the stage in 2013 and beyond for how consumers and merchants will interact at the point of sale – whatever and wherever that may be.

Why So Much News in 2012?
Before diving into the juicy stuff, let’s make sure we are all on the same page with respect to why 2012 was so active.

I think you’d agree that the lightning fast pace of innovation in payments is a relatively recent phenomenon. 2012 notwithstanding, the last really big developments in payments was the launch of PayPal in around 2000 and maybe the introduction of GPR prepaid around the same time. Before that, the biggest news in the 1990s was that debit cards finally took off in the mid 1990s after sitting around in the U.S. for almost two decades. And the 1980s were notable for Discover successfully launching itself in 1985 to become the fourth payment network. Three or four biggies (I’m hedging on a couple of them) in the space of roughly three decades doesn’t exactly set the world land speed record for innovation in payments.

The reason for that is relatively easy to explain. Innovation in payments is a long journey from idea to ignition and adoption given the complexities associated with igniting innovation in payments. We know payments to be a complex ecosystem, with many stakeholders who must be incented (and enabled technically) to work together to adopt new products or enhancements. As a result, change moves through the ecosystem very slowly. And the two stakeholders who must ultimately adopt new payments innovations – merchants and consumers – have to be convinced that moving away from what they know and feel comfortable with – is worth the effort. eCommerce, for example, made big news in 1994, when Amazon launched the first massive online shopping portal, but it has taken more than 17 years for online commerce to reach roughly five percent of retail sales. It has taken that long for the technical infrastructure, device availability, merchant acceptance, and consumer interest to evolve. Getting to ignition – when there is a critical mass of consumers and merchants – just takes time.

Things started to change, however, starting in about 2006 when the following four market dynamics began to accelerate the pace of innovation and thus reshape the course of payments forever. (And if you read what MPD Founder David Evans and myself were writing around that time, you would know that we were highlighting the fact that payments was going through an inflection point and poised for massive innovation.):

1. ***The adoption and diffusion of the smart mobile phone.*** Sure, to those of us in our early adopters technology bubble, smart phones are old news. But, for most people, even just as recently as four or five years ago, IP-enabled devices were owned by a very small percentage of the population. But the adoption and diffusion of smart mobile devices have empowered hundreds of millions of people all over the world – and the third parties who wanted to reach them – with the ability to access the Internet, leverage location-based services, push messages to consumers, and download and use commerce-enabled apps. Today, in the U.S. and in many European and Asian countries, smartphones account for over 50 percent of all mobile phones in market. In fact, in the U.S. today, two out of every three phones purchased is a smart phone. Developing markets are highly mobile-enabled too, and as prices of smartphones fall, it is only natural to assume that smartphone penetration – and the utility that these devices enable – will increase in those markets, as well.

2. ***The advent of cloud computing***. Part of the reason that change in payments has been historically slow, was the difficulty (and expense) associated with tapping into existing payments infrastructure. Payments processing platforms are fragmented across merchants, payments types, and POS software making the introduction of new payment methods at the merchant point of sale tedious, expensive and time consuming for them and the innovators behind those new developments. Cloud computing changed all of that and gave rise to players and computing technologies that made it possible to access these legacy platforms via APIs that reduced the time and expense associated with introducing innovation. The notion of cloud computing is what has fueled perhaps the industry's biggest paradigm shift – online to offline commerce – which enables transactions to happen "in the cloud" and fulfillment in the physical store.

3. ***Big data mashups.*** Big data is a term of art that describes the power of data mashups that, in the case of payments, means taking transaction data, combining it (in real-time) with location-based data and other behavioral data to deliver targeted offers, devise targeted campaigns and otherwise personalize the communications arc between merchants, consumers, banks, payments networks and other value added service providers. The latest wave of "big data" requires companies to accumulate data from sources close to the consumer and then integrate that information into product life cycles to influence more precisely consumer buying behavior.

4. ***The IPO of MasterCard and Visa.*** Before the Visa and MasterCard's initial public offerings in 2006 and 2007 respectively, the association business model made it quite apparent that the banks were their primary customer/stakeholder. Now, as publicly traded entities, these networks have pressure from shareholders and Wall Street to deliver returns. Issuers remain an important stakeholder, certainly, but the lens through which the networks make decisions and design strategy now looks

well beyond just what's good for the banks. Network players are investing in and acquiring a wide range of players to expand their core platform functionality and even enable direct to consumer capabilities. For example, MasterCard's prepaid "rails" enable them to issue prepaid cards directly to consumers and Visa's rewards engine enable the delivery of Visa-branded rewards to consumers directly which in turn, allows them to capture consumer data, including name and email address. In the old association days, both of these initiatives would be unlikely pursuits for fear of being viewed as disintermediating and/or otherwise competing with the banks.

A fifth, but more recent development, is the amount of investment capital pouring into the payments sector. In 2011, more than $550 million dollars (which was double from that in 2010) was invested in mobile payments ventures from VC firms – exclusive of the many acquisitions and strategic investments made by PayPal, Visa, MasterCard, Google, or others in new ventures. As of the end of Q3 in 2012, that number was shattered and then some. It was reported by PriceWaterhouseCoopers that nearly $750 million had been invested in startups by venture firms, making the billion dollar investment threshold, when all of the tallies are ticked and tied at the end of 2012 seem like an easy target to beat.

So, Who Made News in 2012?
Given this backdrop, there was no shortage of news by newsmakers who can be organized into five distinct categories:

- ***Incumbents***, those players that form the basis of the traditional payments ecosystem including the payments networks (e.g. MasterCard, Visa, AmEx, Discover), issuers (e.g. Bank of America, JPMorgan Chase, Wells Fargo, HSBC, Barclays) and processors (e.g. First Data, TSYS, Elavon, Fiserv).

- ***Established Innovators***, those technology and software companies, primarily, that have emerged as a result of the four dynamics described earlier and that have gone on to get great traction in the market place. Examples include PayPal (the granddaddy of them all at the ripe old age of 13), Square, and Google; niche players such as Monitise, Green Dot and Groupon; merchants such as Walmart; and of course, Apple, that with iTunes has created the largest digital wallet on the planet with its 435+ million iTunes accounts.

- ***Mobile Operators***, that for the most part partner with others to bring payments innovation to the fore. In the U.S., three mobile operators formed a joint venture, ISIS, which is an NFC-powered mobile payments scheme. Worldwide, operators like Vodafone, Everything Everywhere, Digicell, SafariComm, and literally dozens of others have set their sights on mobile payments, mostly using NFC technology to do so. In the U.K. Weve was created by the mobile trinity of EE, O2 and Vodafone UK to enable mobile payments, and in South Korea, mobile network operator KT launched MoCa, a cloud-based mobile wallet that is supported by sixty banks and retailers.

- ***Startups*** come in a variety of shapes and sizes, literally. Most have zeroed in on a mobile app of some kind designed to facilitate payment at the merchant point of sale or enable the commerce experience in some other way, such as delivering mobile coupons, enabling mobile check-ins and deals, creating loyalty schemes, registering accounts online for offline redemption, and turning mobile devices into POS acceptance devices for small and/or casual sellers.

- ***Mashups*** are a category reserved for the alliances, partnerships and joint ventures among incumbents, primarily and another category of "newsmaker" that accelerates their innovation ambitions in a particular niche or geography. Visa has been quite active in this space and has acquired players such as Fundamo, PlaySpan and CyberSource to expand payment capabilities at both the consumer and infrastructure levels. MasterCard has done similar things with its investments in iZettle, Telefonica and mFoundry.

What's interesting is that for as diverse as this slate of newsmakers is, their announcements in 2012 varied little. Mobile apps and, in particular, mobile wallets, new business models and offers were the news du jour. Everyone in the payments/commerce space views the wallet as the silver bullet to own the consumer, their data and their relationship so the wallet wars erupted in 2012. New business models were also in vogue in 2012 as innovators tapped into the merchant's age-old disdain for interchange fees and reconstituted business models pegged to pay for performance models instead of transaction fees. And, offers became the industry's staple – whether linked to statements, pushed via mobile or delivered online and redeemed in store – in the quintessential online to offline commerce play.

The Really Big News Makers of 2012

So given all of the newsmakers, which of them made news worth talking about? Well, in that category, I have to say thank goodness for PYMNTS.com! Here are a few of the more noteworthy newsmakers that in some way served to ignite payments innovation and will be worth watching in 2013 as they leverage the moves made this year.

Square

Square wasn't the first player to introduce the "dongle" device that turned mobile phones into point of sale acceptance devices (Intuit with Go Payment was almost a year before), but it certainly popularized the concept when it launched in 2009. But to view Square as just a dongle provider is to underestimate both its innovation and its potential.

Square's greatest innovation then and now was the business model that made it possible for small merchants to get a merchant account instantly, and acquire clients outside of the traditional acquiring ecosystem – and to do that while riding the existing payment rails. Its brilliance was enabling new merchants to accept existing mag stripe cards instantly. In 2012, however, it made public its often-stated and original ambition – to actually launch a consumer and merchant network. Its Pay With Square consumer mobile wallet app enabled checkout in store via facial recognition and a registered card account with a merchant POS system that turned IP-enabled tablets into cash registers. In August of 2012, Square and Starbucks joined forces[1] to enable all Starbucks customers to Pay With Square, leveraging what is the largest active (and most successful) mobile payments incubator in the world – Starbucks – with its eight million (and growing) mobile app users and the potential to leverage Starbucks consumers who don't have a Starbucks mobile app (about 80 percent of them) to adopt the Square wallet. That would, in turn, help Starbucks attract new merchants in the vicinity of Starbucks locations who could woo consumers with Square wallets to shop there conveniently. This scheme went live in November.

Square, overall, has raised $341 million in VC funding, including an undisclosed investment made in it by Visa in April 2011 and the $25 million that Starbucks invested when its deal was announced in August. In 2012, Square also made an acquisition of the 80/20 Group in order to expand its design platform and improve its user interface to create a more user friendly Square in the hopes that an improved user interface will increase its use. Square's challenge for 2013 will be acquiring a critical mass of merchants and consumers to really ignite its platform. With only 75 thousand merchants on its platform, it really needs to ignite its merchant network. The Starbucks relationship is an important cog in that wheel – I guess we'll see how that plays out over the next 12 months.

PayPal

PayPal has long been a payments innovator, creating the first-ever digital wallet some 13 years ago and accumulating more than 130 million active users worldwide in the process. Through a series of acquisitions over the last several years, its mobile commerce prowess has moved well beyond payments to activities that enhance the entire commerce journey – inventory and price checking, local offers, online/offline checkout, and now "empty hands" checkout at the physical point of sale using a phone number and PIN typed into a POS terminal. Like every other player in the payments space with ambitions to move to the physical point of sale, doing so is a long, slow process. At the beginning of August, after having been at it for about two years, PayPal had successfully integrated[2] with 16 (out of 8 Million) merchants in the U.S.

Its partnership with Discover[3] in late August 2012 changed all of that – and certainly has the potential to accelerate its physical POS acceptance. It was a pretty sweet move for both Discover and PayPal. That announcement gave PayPal access to seven million of those eight million merchants and the potential to leverage Discover's 40+ million-cardholder base to stimulate adoption of the PayPal brand at physical merchants. With that announcement, PayPal also said that it would do something that may seem a bit archaic in order to get consumer traction at the physical point of sale – issue plastic PayPal cards that can be accepted today at all places that accept the Discover card and is one way to get consumers comfortable with the PayPal brand at the physical checkout. Riding the Discover network rails, also enables PayPal to flip its accounts over time to ACH, away from credit cards, creating better economics for PayPal, while still enabling Discover to be paid on the transaction.

2013 will be the year that we see the Discover partnership rollout in physical retailers. How consumers respond, whether that strategy enables PayPal to acquire more consumer accounts, and whether consumers can be persuaded to move away from how they currently pay at the point of sale towards Discover. 2013 has to be the year in which PayPal launches a full court press around consumer acquisition and usage, now that merchant distribution is, in theory, enabled via Discover.

From a technology standpoint, PayPal has gone on the record saying that NFC is not for (PayPal) commerce[4], and its variety of trials in many countries around the world – including Australia, France, Turkey, the UK and Singapore, with one exception (Sweden) – reinforce that view. For PayPal, mobile commerce is all in the cloud and its volume via the mobile device is expected to surpass $8 billion in 2012. PayPal saw a 100 percent increase in global mobile payment volume on Cyber Monday 2012 compared to the same day in 2011.

A final point and one worth making is PayPal's "omni-channel" wallet. PayPal is today the only player that now offers consumers and merchants a single way to pay across all major channels. This is something that surprisingly, the payment networks themselves have not been delivered in spite of their long tenure in the payments space. This could give PayPal a slight advantage as commerce channels blur, as the online to offline commerce experience enables consumers to transact online even while in store and consumers place a high value on a consistent (and frictionless) commerce experience everywhere they shop. It will be interesting to watch PayPal in 2013 as other large players, including the incumbent networks, all strive to populate digital wallets and create an omnichannel experience as well.

Apple

It's fair to say that Apple's mobile commerce plans are a mystery – given its penchant for secrecy – but it's the one player that everyone in the payments ecosystem fears. As I've written before – they could be the sector's Black Swan[5], Apple has the largest digital wallet on the planet with 435 million registered iTunes users. But, in reality, it has a lot more than that – it has the trust and dedicated following of its users. A recent survey of consumers reported that if Apple were to open a bank, it would, somewhat shockingly, have customers lining up at the front door waiting to make deposits and would be trusted more than the consumer's existing bank. Apple has its sights on payments, but has played its tactical plans close to the vest. They dashed just about every NFC zealot's hopes when the iPhone 5 didn't include a chip, even though they hold a bunch of NFC patents. It's also a stretch to think that Apple will release phones with NFC chips in them used for payment[6], since there is no real business case for them to do that now; since there aren't many places for consumers to use them. It's far more likely that its payments play will leverage a cloud-based scheme, its IP-enabled devices and its iTunes accounts to reinvent commerce. Its Passbook feature, which was part of iOS 6 that launched in September of 2012, maybe showed us a little leg with respect to what payments and commerce "the Apple way" looks like. Passbook aggregates all bar-coded tickets, coupons, loyalty offers and closed loop gift cards, and uses geo-location technology to push the appropriate app to the front of the mobile device when a consumer is within striking distance of that merchant. Its Pass API encourages developers to Passbook enable its apps which helps keep both consumers and merchants sticky. Although the number of Passbook enabled apps is small (a month after Passbook launched there were only 14 apps that fit in Passbook), it's proven to be pretty powerful for those who have tried it. For example, American Airlines has seen a net add of one million downloads of its American Airlines application since it Passbook-enabled its app and it says it serves roughly 20,000 "passes" every day with 1.5 million active users. It sure doesn't seem like much of a stretch for Apple to evolve the Passbook concept into something that is commerce-enabled and completely disassociated from NFC. We'll certainly see and likely know more in 2013.

It's worth noting though that even if Apple does nothing at all to enable payment or commerce directly, it has already benefited enormously from mobile commerce: so many of the innovations in the space leverage its devices – iPhones and tablets – to enable those apps. Since Apple makes its money on the sales of those high margin devices, they are happy campers any way the mobile commerce game is played. More devices and device sales means more interest from developers who value (and monetize) access to consumers via those devices. And since Apple's iOS isn't fragmented like Android's, developers seem to launch with apps there first so that they have access to a critical mass of customers from the jump. More apps makes consumers sticky – and thus the virtuous circle of mobile commerce continues and the advantage accrues to Apple.

Walmart

Walmart has long been an innovator in retail and financial services. 2012 was a year of experimentation for the gargantuan global retailer using social channels (layaway services offered via Facebook), mobile devices for enabling self-checkout in stores via the iPhone, enabling online shopping on Walmart.com via good old fashioned cash brought to stores to settle the transaction and QR codes via a clever mobile truck experiment in New York over the summer and via a new general purpose reloadable card, Bluebird, launched in partnership with American Express[7] in the fall.

All of these methods enable tailored payments products to specific demographic groups, and most offer Walmart channels through which to promote specific offers and even its own payment products, including its private label product. In spite of what is likely a low penetration of its customer base of iPhones, my guess is that Walmart chose the iPhone for its self-checkout trial because it was able to reach the largest number of people at one time via the iOS platform. Android is likely a more popular product with its consumer base, but it is fragmented across too many consumer handsets and OS versions to capture enough critical mass at the outset. As for the Bluebird pilot, the card was launched in October by American Express and Walmart, aimed at middle- and lower-income Americans who are looking to avoid fees charged by banks. Most interesting here is that it is designed to target a Walmart customer that is or could be banked, but is looking for a low-cost, convenient and secure alternative. Bluebird is promoted as less of a prepaid card and more of a checking and debit alternative without a monthly maintenance fee, annual fee or activation fee.

Mobile and Social Commerce Discovery

2012 was the year that the use of mobile devices to influence buying behavior pre-transaction and, therefore, drive incremental sales to merchants came to life. And, it really isn't the purview of any one innovator. In 2012, it was reported that 52 percent of consumers used their mobile phones to check prices in store and 19 percent of those who did so actually purchased products online in the store from a competing retailer, fueling a new concept that we now call showrooming. Perhaps a merchant's worst fear, showrooming is what happens when consumers use the physical store to demo products and otherwise "kick the tires" but then buy those products online once a better price is found. Retailers, in response, are resorting to a number of clever schemes designed to keep consumers loyal to the physical storefront, including the automatic push of (in some cases, manufacturer-funded) offers and other value-added benefits thru the availability of opt-in WiFi connections and other incentive promotions.

Perhaps more interesting, this same study reported that more than one-third of consumers leave the store buying nothing – which is a far greater risk to sales than showrooming, even though its gets the lion's share of the blame and media hype. The path to purchase is just getting longer and more methodical, a casualty of our fragile economy. According to Forrester, now 82 percent of consumers research a product before buying it and nearly two-thirds pay more attention to prices and value then they did even a year ago. Consumers are fluent in online media and consult a variety of sources to help with their buying decisions. As a result, 80 percent of shopping decisions are made before entering a store. A 2013 initiative for merchants, therefore, is how to use mobile devices, online channels and a mix of smart offers and other tools to entice consumers into buying from them while in the store, rather than leaving empty-handed.

As I mentioned, social networks have also become an important influencer of buying behavior, with more than 47 percent of consumers saying that they've consulted their social network before making a purchase, more than 60 percent of consumers reporting that they "friend" brands on Facebook to find out about new products, and more than half of those consumers saying that they purchased items from that brand when offers are made available to them via posts to their news feed. That said, Facebook commerce[8], a concept that made big news a few years back, has all but failed to ignite, stimulated by consumer fears of transacting on Facebook, somewhat clunky user experiences on the platform itself and the cognitive dissonance that consumers have about shopping on Facebook – a place they come to catch up with friends, not shop. F-commerce, as it is known, appears now to be slowly, and I mean slowly, gaining interest as Facebook itself decides to dip its toe into commerce via social gifting. It launched its gift application late in the year, which leverages its Karma acquisition and triggers the purchase of gift cards when users are reminded of a friend's birthday. That has given rise to several other social gifting applications including Wrapp which reports sending giftcards at a rate of one million a week. Wrapp has partnered with Givex to add new merchant partners and is testing a gifting concept PayPal in Sweden.

Mobile Banking

Mobile banking exploded in 2012 as smartphone penetration accelerated. Consumers, by and large, feel very comfortable using their phones to access their financial information, even initiate the transfer of money between accounts (their own or others) and monitor transactions. Nearly 13 percent of consumers in the U.S., and nine percent of consumers in Europe and 15 percent in Asia are active mobile banking users. Mobile P2P is the tangible mobile banking byproduct and many players are innovating in this space including large banks (e.g. Barclay's Pingit, Swish in Sweden and ClearExchange in the U.S.) and established innovators (e.g. Facebook and PayPal).

In addition to its popularity in the developed markets, mobile banking in the developing markets has the greatest potential to add value, and bring financial inclusion to financial services that are otherwise illusive. As will be discussed later, the predominant providers are the Telco's, with the biggest barrier to scaling these schemes, the economics of delivering these services given the financial constraints of its customer base.

M-Pesa, the mobile banking success story launched in Kenya in April 2007, expanded its presence into 35 countries in 2012, including India and South Africa. It will be interesting to see how these schemes ignite in 2013 since similar efforts to export M-Pesa have failed to generate adoption, in part, given a lack of financial literacy and regulatory support in the countries that have tried it and in part, the challenging economics of these schemes. There are literally hundreds of schemes launched by mobile operators in developing markets, few of which have gotten much traction so far. The more interesting implication perhaps, is the impact of these schemes to the traditional money transmittal companies. Technology, and more specifically, the mobile phone, has made it easier for new competitors to enter a space that was once the purview of a small number of larger players. PayPal, for example, could be a much more formidable money transfer competitor in large sender markets where inter-and intra-country money transfer happens, markets such as the U.S., U.K., Germany, France and where PayPal has a base of accounts. Its recent partnership with MoneyGram also helps them enable cash in and out at the physical point of sale and initiate money transfer via PayPal accounts and the MoneyGram network. Then there's the Facebook experiment in Russia with its P2P trial that initiates transfers between Facebook accounts. 2013 will likely see even more instances of larger alternative players who may seek to expand their worldwide product and service footprints to include the larger sender and receiver markets worldwide who seek access to financial tools and financial inclusion.

Mobile Point Of Sale (MPOS)

2012 was the year that mobile phones and tablets as point of sale (MPOS) acceptance devices literally exploded. MPOS may have started life back in 2008 as a way to enable casual sellers and small merchants to accept cards, but it has quickly moved up the merchant supply chain. In 2012, we saw MPOS move upmarket into tier-one retail settings and across enterprise markets such as hospitals and universities in an effort to move commerce closer to the customer. Clearly, MPOS is reinventing the entire commerce experience for all types of merchants and the consumers who interact with them.

MPOS players can be divided into two camps: the literally dozens of players who supply devices to merchants and the universe of players who "power" those players and provide them with the MPOS hardware, software and enabling platform functionality needed to meet the needs of their customers. The capabilities of those who "power" the suppliers range greatly, and as a result, the MPOS offerings in market today exhibit a wide range of functions from the more basic payment card acceptance and processing on the one end (eg. Groupon Payments) to enabling a merchant/consumer network on the other (e.g. PayPal Here and Square). Solutions that do nothing more than offer payment acceptance are being quickly commoditized and 2013 will be year in which more robust MPOS solutions emerge, with some targeted to specific industry requirements. This area is so important that PYMNTS.com has created a monthly "MPOS Tracker[9]" to both organize and update the ecosystem as it evolves.

The 2012 Noisemakers

Here's my short list of the players and ideas that got a lot of air time at conferences and real estate in payments publications but are unlikely to move the needle in payments anytime soon, if ever.

ISIS

In 2012, it is safe to say that ISIS was barren. ISIS, as most of you know, started life as an alternative merchant-centric payment network, shifted course nearly 17 months ago to accept traditional payment methods and has been stagnating, without any significant merchant or consumer ever since. Its U.S. launch was postponed several times and a very anemic launch in Salt Lake City with a transit authority happened on October 22, 2012. A few, even less remarkable deployments were announced later, including a partnership with a vending machine company so that all of those NFC-enabled ISIS wallets can now get vending machine goodies on demand. ISIS may see a few more implementations here and there, but unless something dramatically different happens with ISIS in 2013, it is likely to remain as barren as its investors checkbooks are becoming. Its choice of NFC technology, lack of merchant acceptance, unfamiliar consumer brand, uncompelling value proposition for consumers and merchants, and late pivot away from its network ambition just puts it too far behind the curve to be successful at this juncture. Its investors have seemingly taken notice, as well, and have begun investing in other initiatives to hedge their mobile payments bets.

NFC

Nothing happened in 2012 that would move me off of the position that I and my MPD colleagues have maintained for the last 6 years: NFC is a non-starter for payments in most places given the lack of a persuasive business model for merchants and value proposition for consumers. NFC was conceived by the mobile operators as a way to become relevant in the mobile payments space and capture revenue and customer control. The risk, then, as it is now, is that a more powerful, plausible and cloud-based solution will emerge in the time that it will take all of the NFC stars to align and get ignition (handsets with chips, terminals that can accept them, consumer adoption of phones with chips, interest in using it at the point of sale, business models that get all parties on board).

Indeed, that seems to be the direction things are heading. All of the major mobile payments schemes that are getting traction in the market today are bar or QR code enabled – PayPal, Apple, Square, LevelUp, Starbucks. NFC trials in other parts of the world, such as France, have met with lackluster results. Even Turkey, which has its ambition of becoming the first ever “cashless” country, is thinking about alternatives to NFC given the high cost of merchant terminalization, the cost to consumers of acquiring NFC phones, and the timeline associated with having enough consumers with NFC phones capable of transacting at merchants with NFC terminals. The exception seems to be Poland, where contactless payments, cards and phones are making inroads given a lack of existing payments infrastructure and, thus, the ability to leapfrog both to enable consumers and merchants to move away from cash to electronic payments via contactless methods.

One-off Wallet Solutions

As stated before, just about everyone in payments has a wallet “for sale” in the mobile payments space. But, the cold hard reality of digital wallets is that just because innovators can make them, doesn’t mean that consumers will rush to adopt them. Digital wallets, just so that we are all on the same page, are digital “containers” that aggregate lots of things that are now in the physical wallet – payment cards, loyalty cards, coupons, passes, checks, even identification. That means that, in theory, a digital wallet would aggregate single use mobile payment apps, like the Starbucks app, the Level Up app, the Uber app, etc., along with existing issuer-specific payment cards.

Clearly, having a smart mobile device makes it easier for consumers to download and even use multiple digital payment apps than accumulating multiple single use plastic cards in a physical wallet. At some point though, just like they do today, consumers will consolidate around a short list of single use mobile payments apps and will want to organize them into one digital container. There is no reason to think consumers will want multiple digital wallets any more than they want multiple leather wallets. And, so this is the essence of the digital "wallet wars" in the space today. PayPal and Apple are clearly relevant working hard to be "the digital wallet," Square is too, as are the payment networks, but it seems unlikely that issuers, and the plethora of third parties that are developing and promoting wallets (not to be confused with apps) will be successful in this space. 2013 might still be a year or two too early for the massive wallet consolidation and/or attrition to happen, but it will.

"New" Rewards Schemes That Aren't All That New

Rewards programs have been a staple of payments for decades. But this entire area is one that needs massive disruption, due in part to the consumer's desire for immediate gratification versus the "earn and burn" environment of points-based programs. With a few exceptions and given the dramatic number of points that go unredeemed each year (~60 percent of all rewards points go unredeemed), it's also not clear how effective these programs have been at keeping customers loyal to the cards that support them.

Sensing this, issuers and networks have pivoted to other things, and in 2012 that was primarily offers and deals. This shift to an offers/deals mentality was stimulated in part by the desire to compete with the many daily deals services in the market and a more price sensitive consumer. Players such as Four Square, Shopkick, RetailMeNot and others partnered with networks and issuers to mash up their respective consumer bases, merchant relationships and location-based capabilities to serve offers to their subscribers but were met, by and large, with lackluster response. Some offers players, such as Bloomspot and EverSave were acquired by payments players in 2012 to be presumably rolled into other payments-related offers and/or mined for their consumer mailing lists – one of the only real assets that daily deal companies possess. MasterCard pivoted away from the deals-oriented MasterCard Marketplace to launch its Offers API as a way to aggregate offers and deals from others for the benefit of its cardholders.

But, offers, it seems, really wasn't the payments' rewards panacea either. Most just aren't relevant or compelling anymore so haven't driven incremental the volume to merchants that was envisioned. All they saw was a decline in their margins, due in part to a increase in their cost of serving their existing customers (who loved buying their deals) and a "one and done" consumer that was loyal to the deal and not to any particular merchant or payment brand. As a result, the offers pipeline dried up as merchants pulled back, the deals got worse (merchant quality declined and/or prices weren't cut as deeply), consumer interest plummeted and deal providers closed down (roughly 40 percent of the daily deal sites that existed three years ago don't exist today and even the big guys like Living Social and Groupon have seen their valuations take a beating and GiltCity has pared way back). The surviving sites that have carved out a product niche, curated interesting products and built a base of loyal customers, such as Zulily, OneKingsLane, Gilt, Fab and Fancy, now simply benefit the issuers whose cards consumers register to those sites.

The 2012 loyalty program du jour became the card-linked offer with many an innovator emerging to offer a rebate or discount of some kind tied to a card swipe in store. While tons easier than other schemes to implement at the physical point of sale, the consumer opportunity to associate the "immediate" gratification associated with these programs seemed lost since most of the benefit came weeks later when the statement was received by the consumer or accessed online. Hopefully, we'll see some shift in this segment in 2013 as the lead dogs in this space use big data and the mobile device to help influence buying behavior by triggering a promotion based on location, favorite store, previously purchased items and/or items that complement previously purchased items to drive foot traffic into those locations. At that point, linking the benefit to the statement becomes an accounting record since the benefit associated with that offer is both visible and actionable.

Hopefully, 2013 will be a year in which we start to see real innovation happen in this space that adds real value to consumers and merchants and doesn't discount or cheapen the brand associated with delivering that loyalty proposition. In this space, we've got nowhere to go but up.

Where We'll Learn More In 2013

There were a few newsmakers whose initiatives started to emerge in market late in the year. While 2012 was, for them, more of a starting point, 2013 will be a year where their efforts will either fizzle or be the start of a fabulous future.

Payment Networks and Wallets

Visa and MasterCard made news in 2012 when each released its own version of a digital wallet. Both say that they are "card brand agnostic" meaning that each will aggregate cards from all issuers and networks. But, their challenge is getting ignition since they don't control either the merchant or the consumer endpoint.

In 2012, though, these two networks seemed to take two very different forks in the digital wallet world. MasterCard was focused on getting merchant acceptance at the physical point of sale and to get merchants and developers to agree to be part of its wallet. Visa decided to focus on getting consumers to populate its digital wallet, getting over 50 issuers to agree to market its wallet to its consumers. Visa says, for now at least, that it will focus on online utility versus physical acceptance.

So, 2013 will be the year that we will see how each of these networks continue to solve the chicken-and-egg issue of consumer and merchant adoption and to see how these wallets ignite and where.

Google

Google is at a critical juncture in mobile payments. It has access to powerful assets that enable it to be an important player in this space – the Android operating system, access to a developer network, control of a handset manufacturer (Motorola), and more recently, its acquisition of prepaid card processor, TxVia. It's extraordinarily hard to believe that Google will let the mobile payments/commerce opportunity pass them by but payments success has eluded them so far: Google Checkout was shuttered after five years in the market, and little merchant and consumer traction and its initial payments strategy of NFC-enabled payments seems to have given way to Wallet 2.0[10] which is a cloud based approach that looks surprisingly just like PayPal's, plastic card and all.

To succeed in mobile payments, Google will surely need to move well beyond its NFC mobile wallet tether both here and abroad. The re-launch of its Wallet 2.0 initiative leverages some of its powerful assets, and now allows consumers to register any card in its wallet just like iTunes and PayPal does today (the TxVia acquisition was leveraged to enable this). But, merchant acceptance is still Google's number one issue – it has to persuade merchants to accept the Google Wallet acceptance mark at checkout, which is hard for two reasons. Reason number one is that it lacks a consumer base, just as most digital wallets do today. That's something that lots of money and clever incentive schemes could overcome. But, it's reason number two that might end up being the insolvable puzzle: merchants don't want Google to have their customer data. All of the nice plaudits and consoling words to the contrary, merchants are hard-wired to believe that Google is in the data business and the monetizing data business, because they are, and don't want their data being used to Google's benefit and potentially their detriment. Google's biggest hurdle is overcoming the consumer and merchant perception that Google's wallet is backdoor access to a new source of revenue – transaction data – which, let's face it, is precisely why Google has its sights on payments in the first place. Google has lots of interesting assets to deploy in the pursuit of a mobile commerce strategy, but it still feels as though it hasn't quite settled into a scheme that it can ignite.

Open Loop Prepaid

After more than a decade in the market, open loop prepaid is still a very small slice of the overall payments pie with challenging economics for program managers and issuers. In 2011, prepaid card use accounted for only three percent of general card purchase volume at U.S. merchants. Its typical target customer: unbanked and under-banked consumers. They lack financial literacy skills that create churn and turnover for issuers and make profits tough. However, the consumer base that is the target for these products is why there is so much activity in the space. It is estimated that there are 2.5 billion people worldwide without access to traditional financial services products. One in five households in the U.S. are reported by the FDIC to be underbanked.

2012 was the year that JPMorgan Chase., Wells Fargo, American Express, US Bancorp (branded by Suze Orman) and Regions Financial Corp. all entered the market with less expensive prepaid offerings than market leaders Green Dot and Net Spend. This activity was spurred in part as a reaction to the large numbers of consumers who found themselves disenfranchised as a result of the rise in checking account fees in the aftermath of the Durbin Amendment's cap on debit interchange. These new, less pricey cards cost on average less than $60 a year in usage and withdrawal fees, while the average yearly cost for Green Dot and Net Spend range between $190-$300. The more affordable costs are appealing to the more recent crop of underbanked consumers, Gen Y customers, as well as the more traditionally banked consumers who want to use the cards to manage their budgets. 2012 was also the year that Green Dot bought a bank and Net Spend signed a prepaid card distribution deal with Intuit, to bundle its prepaid cards with TurboTax and QuickBook products, and PayPal launched "PayPal My Cash Card." It was also the year that the market leader Green Dot took a drubbing in the stock market losing nearly 62 percent of its value after the Walmart/American Express announcement while NetSpend saw its value increase by about 42 percent.

By region, the top prepaid markets are North America, Latin America, Asia-Pac, and Europe. Prepaid cards in Europe are expected to make the most traction as consumers use them to shop online, as they use them as valuable budgeting tools and as destinations for remittance funds; however, prepaid cards still struggle to find their niche on the continent. The Latin American open loop prepaid card market – Brazil and Mexico in particular – are strong markets for growth. In Asia, prepaid cards have mostly developed as transport cards with features for micropayments in retail stores. The industry in Asia is driven by corporations and government use of prepaid and prepaid players, like Western Union, have launched creative programs, like its Gold Card product with Visa in the Philippines that enable split purse capabilities.

Overall, the strongest use case for prepaid is the distribution of government benefits and payroll as governments and businesses look to replace inefficient checks with more efficient electronic means. Other creative strategies are emerging which may ease the unbanked customer more easily into this new payments form factor. Mitek, the leader in remote check deposit activity, recently launched a mobile app for Android and iOS phones that allows a check to be photographed and deposited onto a prepaid product instantly. The payment method is still a prepaid plastic card, but this app avoids costly check cashing fees and is designed to make the user both comfortable with the technology and sticky to the card product.

One final point on prepaid. In the U.S. at least, prepaid products are in the crosshairs of the industry's new regulator, the CFPB that is concerned that prepaid product fees are too high and is putting pressure on issuers to reduce fees. This is an important consideration for issuers given the challenging economics of prepaid products, and is driving large players such as Green Dot to bundle other products like offers (Green Dot's acquisition of Loopt enables this) and leverage existing assets like distribution (Green Dot's distribution deal with Rush Card is one example) and processing capabilities to find other revenue sources beyond card load/reload and monthly maintenance fees.

Merchant Consumer Exchange (MCX)

A number of large merchants (Wal-Mart, Target, Home Depot, 7 Eleven, etc.) made news in August when it made public its plans to create its own payment network. Motivated by a desire to save interchange revenue and protect what they believe to be the ultimate risk of being locked into a Visa and Master Card network future, MCX-retailers have yet to announce a technology standard, business model, a CEO and/or make specific their go to market plans or timetable. I wrote a treatise on it earlier this month, which you can read here[11], but just like any other new payment scheme, there are massive chicken-and-egg issues to overcome (the failed ISIS experiment is a recent testament to that) and many stakeholders to incent, including incenting now competing merchants to "cooperate" with each other in setting operating rules and for consumers to adopt something new. Consumers don't care how much merchants pay to accept their payment method of choice – they are motivated by convenience. And, even when motivated by convenience, consumers' payment habits are hard to change. Skeptics believe that this is a scheme of another sort – one designed as a negotiating ploy to reduce the amount of the merchant discount paid by them to networks and issuers. If this is a serious scheme, it will be years, no decades, and hundreds of millions of dollars in the making, which could make interchange look like a bargain. 2013 will likely see the announcement of a CEO (a rumor circulating earlier in December identified a very high profile candidate – we'll see soon if the rumor had any basis in fact), and likely a trial somewhere, but it will be eons before anything material happens.

Alternative Consumer and Merchant Credit

2012 was the year that a number of interesting and exciting new credit alternatives for businesses and consumers entered the market, a welcome set of services in an ever-tightening credit market. LendUp made news over the summer when it launched its online consumer credit product that provides a "ladder up" to financial security by giving borrowers, mostly single moms, loans wrapped around financial education. Kabbage provides merchant financing from between $500 and $40,000 to online merchants who list their products on eBay, Amazon marketplace, Etsy, among others. These loans are based on a number of factors, including a seller's rating, time in business, transaction volume, social media activity, and credit score. And, CapTap, an online product of Capital Access Network, offers small businesses access to capital by loaning against its receivables. This online tool makes it fast, easy and painless for merchants to get access to funds. The U.S. Treasury also launched the Small Business Lending Fund Initiative to encourage lending in late December.

The 2013 Crystal Ball

If 2012 was the year of mobile, then 2013 will be the year of layers – as mobile introduces a new payments layer over those that exist now for consumers and merchants. It will be a very long while – a decade at least – before the majority of our transactions happen via the mobile in some way. So, in the interim, consumers and merchants will just add mobile to the litany of payment methods that they have and use today already – cash, check (given new life thanks to remote check deposit), and cards. 2013 will be a year in which we start to see how, why, where and when consumers and merchants layer mobile over what is currently in their leather wallets.

Most interesting, though is that with very, very few exceptions, the innovation that is taking place is being done on top of the existing card infrastructure. Existing credit and debit and prepaid products are the cornerstones of the new developments that will reshape how consumers and merchants interact. No one, outside of MCX, is inventing a new payment system (and I have serious doubts on whether they really will either). If you're an innovator, that makes it a lot easier to get something developed. Getting adoption is still difficult, but innovators aren't asking consumers to abandon what they use today, just to use it in a different context (e.g. mobile versus plastic card). If you're an issuer, your challenge is make sure that consumers don't swap out your card for someone else's. One rather cynical view of payments over the next decade is that it is really a zero sum game – consumers will use "plastic card A" via mobile the same way she does offline today. The opportunity for the traditional players who represent innovation's backbone becomes how to take share from issuers and even payment types.

The huge paradox of payments is that it is a system that is horrendously complicated and therefore very difficult to change anything that touches it. But it works really, really well, and is incredibly fast. A swipe at the point of sale works 99.99… percent of the time and it takes about a second to process, if that. That makes the most complex part of this industry changing anything that begins at the physical point of sale – and that is where the innovation is happening today and will continue for years to come – after all, it is where 95 percent of all transactions happen today. Changing anything in payments means getting a massively complicated ecosystem to all change at about the same time – the merchants, the consumers, the processors, the networks, the issuers, the telcos, and then all of the third parties like the loyalty providers, the security and authentication players … the list goes on.

So 2013 won't be the year that we crack completely any of these chicken-and-egg problems, but will likely see a whole bunch of people take a crack at doing so. Will 2013 be the year that the Black Swan floats into payments and changes that landscape forever? Who's to know? That's the whole point of the Black Swan: you don't see it coming! But I'd wager that is more likely to happen than the perfect storm of perfect alignment across all of the ecosystems and technologies and stakeholders to magically create mobile commerce ignition.

Albert Einstein said that the best way to predict the future is to invent it. And, the safest prediction for 2013 is that we will continue to see many an inspiring and motivated entrepreneur working hard to invent – or reinvent – the future of payments and commerce.

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[1] http://www.pymnts.com/commentary/square-s-deal-with-starbucks-connects-it-to-all-the-right-consumers
[2] http://www.pymnts.com/commentary/parlez-vous-paypal
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