WHY LOYALTY PAYMENT CAN HELP DIGITAL WALLETS TO BREAK THROUGH

By Dominic Hofer, CEO Loylogic, June 2013

We live in an economy where personal consumption is over $11 trillion and plastic payments have surpassed all other payment options at the point-of-sale. Mobile payments, however, remain a nascent offering, representing only 0.01% of retail purchase volume. Despite a rise in consumer spending, consumers are remaining wary. The American consumer is selecting payment methods more deliberatively, both when and where to use credit, debit, or prepaid cards and choosing those programs that provide the greatest value.

In this environment, loyalty programs have an unprecedented opportunity to interact with members and reinforce the value of their chosen program in a meaningful way. Loyalty points redemption at the point-of-sale may just be the preferred mechanism for strengthening loyalty by giving members the value they desire, the redemption choice they seek, and the flexibility they need. And, at the same time, it provides for that strong use case that digital wallets need in order break through user adoption: consumer can pay with new money and merchants get access to new money.

The Consumer Landscape

The payments and loyalty industries today are more dynamic, in evolutionary and revolutionary terms, than they have been in the last half century. Without a doubt, the unprecedented proliferation of mobile and smartphones has led this transformation. Today, smartphone penetration is 58% of the US mobile subscriber base. It is, arguably, the most pervasive global technology ever invented, even exceeding that of electricity. As such, mobile has fundamentally changed how consumers search, engage, and consume.

We have witnessed a dizzying rush by new and established companies to capitalize on mobile and all that it affords. New engagement models have been developed with seemingly endless more to come. There are new payment and loyalty schemes being introduced regularly. For the merchant and consumer, this is both exciting and confusing.

Established Payment Ecosystem

In the payments space we have seen a propagation of online and mobile wallets, with wallet providers beginning to converge on an integrated model – allowing consumers to transact in both the online and physical worlds.

While we have already passed the inflection point in terms of smart phone adoption, how consumers use their mobile devices continues to change. A recent InMobi study found that 45% of consumers stated that their mobile device influenced their in-store purchase, with 40% actually using their mobile device during purchase. With an ecosystem ripe for mobile wallets, why has its adoption been so anemic? There are a number of factors at play that have slowed adoption. Primary among them:

1. **Consumer Need** – Consumers have not been given a compelling reason to adopt mobile wallets. While using a mobile wallet is easier than paying with cash, it isn’t easier, or faster, than paying with a plastic card at the point-of-sale.

2. **Consumer Conditioning** – Consumers have been conditioned to swipe their physical payment cards at the point-of-sale (POS) for a lifetime. Changing this ingrained behavior is probably the hardest psychological barrier to break.

3. **Handset Manufacturers** – While near field communication (NFC) is the technology of choice of the payment networks (Visa, MasterCard et al.) for mobile payments, handset manufacturers
have been reluctant to add NFC chips to their phones as it adds incremental cost to something for which there is little consumer-driven demand.

(4) **Mobile Networks** – The telcos, which control the distribution of mobile phones, have been reluctant to open up the embedded "secure element" in their NFC-enabled phones to NFC wallet providers, which would allow them to store, in encrypted form, payment credentials.

(5) **Merchant Point-of-sale Integration** – When NFC was initially rolled-out by the networks (Visa, MasterCard et al.), it was primarily targeted at quick service restaurants, thus leaving 98% of merchant locations without NFC terminals. Bar codes, the other technology of choice for many wallet providers, require merchants to have 2D barcode/QR code readers, which many lack.

Given the POS changes required by many mobile wallet providers, and the costs involved, merchants have been reluctant to join the mobile payments bandwagon. Up until recently, there has been little merchant incentive or business case for replacing existing POS terminals with NFC-enabled ones. That changed when the major payment networks announced new chargeback liability shift rules that promote the issuance and use of contact chip/EMV payment cards. These rules, which take effect in October 2015, are an effort to drive EMV and NFC payments, as the terminals that are used for EMV payments are also compatible with NFC-enabled mobile devices. The lack of compatibility with current POS infrastructure and the anticipated slow pace of deploying new POS terminals, even under a best-case scenario, likely means that a solution that works within the existing infrastructure will be the interim, if not long term, solution.

Consumers, like merchants, are resistant to change. When asked how interested they would be in using their mobile device for in-store payments, a whopping 69% of consumers were not interested in substituting mobile payment for their physical credit or debit cards in-store. While the overall receptivity of mobile payments appears on the surface to be fairly narrow, the body of research shows that those who are open to in-store mobile payments tend to be the usual suspects i.e. male, younger (18-34), higher income, smartphone owner, online and mobile banking users.

While merchant acceptance of mobile payments will likely soon change, given the network rule changes, consumers have yet to be given a compelling value proposition. It is clear that mobile wallet providers, will need to expand the ecosystem beyond payments in order to capture the consumer’s imagination.
Setting the Stage

"Is tapping a phone on a terminal any easier than swiping a credit card? I don't think so -- it's not solving a real consumer problem ... It needs to remove complexity from your life ... the technology needs to ... let you focus on the things you most want -- loyalty points or rewards ..."

David Marcus, President, PayPal

Source: Loylogic

So, what will be the essential ingredients of a successful mobile wallet? Merely being innovative won’t win the day. Table stakes of wallets will be functionality that helps consumers:

- Pay with monetary or virtual currency (e.g., POS, P2P)
- Get relevant deals, cash discounts or earn points for coming back
- Get access to events, transportation or open your office, home or car
- Store cards and IDs or perform tasks such as searching reviews, comparing prices

Loylogic recognizes that trust, a smooth and practical consumer experience and differentiation are essential, and often missing, components of wallet offerings. While some wallet providers may be perceived as being innovative, they also tend to have lower consumer trust (e.g., Facebook). Thus, solutions relying on existing payment infrastructures will have an edge. Compelling design with an intuitive and convenient user experience is critical. Partnering with third parties to augment gaps, like virtual currencies (a.k.a. points and miles), is essential as payments merge with loyalty and rewards in the mobile wallet.

The fact that consumers are increasingly engaged with their mobile devices in-store and at the point-of-sale bodes well, long term, for significant consumer adoption of mobile wallets, as its use eventually becomes a natural extension of their behavior.
Just as general purpose payment cards changed our sense of money, mobile will fundamentally reconceive our sense of payment cards. One can argue the speed of this transformation - five years, ten years or more - but few will bet against its trajectory.

### Loyalty Currencies’ Landscape Today

![Image of loyalty program statistics]

**Sources:** Colloquy, The Economist, Loylogic desk research

While consumers are inundated with payment choices, their selections pale in comparison with the options consumers face when it comes to loyalty programs. In fact, there are between 2.1 and 2.65 billion loyalty program memberships today in the United States alone. Colloquy’s 2013 loyalty census estimates that while loyalty program membership continues to go up unabated, active participation has decreased to 44%. While a decrease in active participation maybe somewhat expected given the proliferation of programs, the fact that participation is this low is somewhat surprising. This underutilization tells us that many programs have unclear value propositions and that they are failing at a fundamental level.

Loylogic estimates that there are $154 billion in consumer reward points that are outstanding on member balances in North America. Typical reasons are:

- Accumulating points for a big event, like a trip
- Low mileage balance – not meeting point thresholds for redemption
- High mileage balance – have more points than can be redeemed under current traditional redemption offerings
- Inability to redeem points – blackout dates, redemption availability
- Lack of compelling redemption options – redemption selections not being relevant to members
When Loylogic asked frequent travelers from over 400 different programs about their respective programs, consumers indicated that the ability to use their points and miles (anywhere and anytime) was the single most important redemption factor.\textsuperscript{9} In fact, 62% of frequent travelers in Loylogic’s 2013 Frequent Traveler Survey wanted to use their points or miles at the point-of-sale. The flexibility was so important, they were even willing to accept a lower value for them.\textsuperscript{10} Point-of-sale redemption, for many loyalty program members, is value personified.

\textbf{The Future Starts Today: The Best of Both Worlds}

Program operators have had an eye on point-of-sale redemption for a long time as a way of creating differentiation for their programs and helping members further realize the full value of their loyalty program. With the proliferation of mobile loyalty and payment options, many operators have talked about POS redemption, with varying degrees of conviction. However, no vendors are doing it in a compelling and scalable way. With PointsPay, loyalty programs can now do today, what was not possible before.
Loylogic’s PointsPay – Solving for What Consumers Want

PointsPay was the world’s first mobile-based wallet for redeeming loyalty points and miles at the point-of-sale. It is an innovative, new Loylogic mobile-based offering that responds to consumer preferences by providing loyalty program members with the opportunity to redeem their points (or any virtual currency) at over 30 million POS locations worldwide or online. It offers a payment solution that enhances the ability of loyalty programs to maintain product innovation and engage members in a meaningful way. PointsPay operates on an open platform that integrates with ALL loyalty programs, without exception. And its advanced system provides transparent transactions using the existing payment infrastructure and POS networks – without requiring any cumbersome merchant integration. Members can shop globally, immediately, and without barriers.

While Loylogic emphatically embraces mobile and mobile payments, we recognize that each global market has different nuances, economics, regulatory regimes and levels of market maturity. Appreciating that the U.S. market is early in its transition to mobile payments, that general purpose payment cards represent close to 70% of retail POS dollar volume, and that in-store mobile payments were only about $500 million in 2012 (the Starbucks wallet represented the majority of payments); Loylogic opted for a hybrid model in deploying the PointsPay solution worldwide. Via a wallet app, PointsPay users can select their loyalty currency and charge re-loadable PointsPay cards that can be used to pay at any merchant accepting major card networks. In doing so, it leveraged the best that mobile has to offer as well as the best of the traditional payments infrastructure.

PointsPay allows loyalty program members to transfer points into a cash value. Program participants do this online or by installing an app on their phone that allows them to check their program point balances and convert it into a currency of their choice (over 100 to choose from including U.S. dollars).

Points are transferred onto a virtual card that appears on the phone and onto a plastic Visa or MasterCard card that is issued to program participants - allowing for both e-commerce and POS transactions. The points transfer is immediate.

Loyalty program participants get a truly liquid currency allowing them to transact in real-time, with full security. Unused points can be transferred back to member accounts, with no loss of point value.

PointsPay is available for all industries in consumer loyalty (including travel, financial services, telecom, gaming or retail) as well as for any type of performance improvement programs. Important is that, program operators fully stay in control of their program cost (CPP – Cost per Point). In addition, PointsPay can be customized to any specific program member segment. Finally, digital wallet providers that are looking to add a global points redemption option can easily integrate PointsPay into their existing or planned wallets.

PointsPay is a truly unique and tested customer engagement program with compelling benefits for the program operators:
• Unlimited rewards for hard-earned points
• Innovation and program differentiation
• New mobile marketing channel
• Boost member engagement and satisfaction
• Opportunity to decrease reward cost
• Control points as well as cash flows
• Steer revenue recognition (FASB Topic 605/IRFRIC-13)

Payments and loyalty landscapes are changing at an unprecedented pace, and loyalty programs that don't differentiate in a meaningful way or take a 'wait and see' stance regarding POS redemption, risk others doing it first and solidifying those customer relationships that rightfully belong to them. Loylogic powers some of the largest, fastest-growing and most innovative loyalty programs in the world. While Loylogic will be integrating more components of the payments ecosystem as the market evolves (e.g., NFC), PointsPay's POS redemption solution is available in the market today, as a fully functioning, in use, loyalty program value driver.

About Loylogic
Loylogic builds turnkey e-commerce and e-payment solutions for the largest, fastest-growing and most innovative loyalty programs in the world. Visit us at www.loylogic.com or http://www.pointspay.com/.

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