Developing Your Payments Sixth Sense

Psychologists have recently acknowledged that something commonly referred to as "the sixth sense" really does exist. Some attribute these strong hunches or "feelings" about what might happen in the future to people being uniquely in synch with the Earth's magnetic force field which sharpens their focus in ways that those of us who aren't, just can't. Others say that it comes from being able to communicate telepathically with the spiritual world and being forewarned by those spirits about future events. Others, with perhaps a more practical bent, simply believe that some people are better able to internalize and process vast amounts of information in a way that helps them refine their "gut feelings" into a plan that anticipates the future more precisely.

The problem – and therefore the opportunity that is before the payments ecosystem – is how to leverage the power of connected devices, data and the cloud to eliminate the friction associated with buying things in a physical store.

Regardless of who or what you believe, it seems that having a "sixth sense" can come in handy, since if it's reliable, it can actually help prepare you for what's to come. And, that's the goal of this piece … to share the six forces that I think could inform your "sixth sense" about where the future of retail payments is headed so that you can more adequately prepare for what's ahead as you put a bow on your 2014 plans.

This sixth sense and six forces start, however, with realizing one enormous paradigm shift about the future of payments. Ready? The future of retail payments isn't about payments at all. It's about shaping, driving and enabling a ***commerce*** experience – one that will reinvent the way in which merchants and services providers and consumers interact.

2014 Newsflash | The Future of Payments Isn't About Payments

The innovation and the ecosystem that define retail payments as we know it today – the ability for a consumer to produce a plastic card with a mag stripe or a chip in it in any store and use it to pay for their purchases in a matter of seconds – works just great today. Consumers like it because they trust it to be reliable and safe – they know how to use it and it works more than 99.999% of the time. Merchants like it because they have invested lots of money in people and hardware and systems to support it – they and their sales associates know how to use it and it works more than 99.999% of the time. The action of ***making and receiving payment*** at a store isn't really broken today.

The problem – and therefore the opportunity that is before the payments ecosystem – is how to leverage the power of connected devices, data and the cloud to eliminate the friction associated with ***buying things*** in a physical store. In a world without smartphones and the cloud and data, interactions related to the buying experience between merchants and consumers couldn't happen in real time, couldn't reflect consumer preferences and, therefore, couldn't influence their choices or payment methods as the buying journey was underway. Consumers, as a consequence, have missed out on promotions and other sources of value related to the things that they are buying or might want to buy. Merchants have missed out too on not being able to offer valuable offers and promotions to consumers who were or could become their most valuable customers.

Now, with connected devices in the hands of consumers throughout every part of the buying experience the relationship between merchants and consumers can be reinvented – in real time.

The implications for the ecosystem are enormous. Payment, the process of "checking out" as we know it and define it today, gets moved to the background, an important enabler to closing the commerce loop but not what's driving it. Payment also isn't likely to drive the business model moving forward either. Today's payment ecosystem is monetized based on the payment transaction itself, tomorrow's business model is likely to be monetized based on the value that this commerce experience makes possible for merchants and consumers. But this refocus on commerce and not payment will, in fact, drive just about everything else in the payments ecosystem, including its winners and losers.

It's also what has given rise to the six forces that will inform your sixth sense in the year to come about the future of an ecosystem that is poised for great change.

Force Number One | T**he act of paying – and therefore payments - becomes invisible**
Now, anything that a clever entrepreneur has identified as an offline point of friction, can now not only have an online solution, but one that enables payment.

The mash up of connected devices, the cloud and data now enables every offline action to have an online component via apps that consumers download access via these connected devices. It has also inspired a whole host of entrepreneurs to reinvent – and monetize - those offline activities. The ability to move what were once activities completely tied to desktops or PCs has unleashed massive innovation – often focused on helping those with excessive supply to find consumers or businesses with demand for those services or products in real time. For example, finding a taxi or a black car, renting out a spare bedroom, booking a hotel room last minute, finding someone to run errands, ordering ahead to avoid standing in line, ordering ahead to secure scarce quantities of available inventory, not having to produce a payment card to pay for meals in a restaurant, not having to produce any payment credentials at all at checkout in stores, or simply skipping the lines all together and checking out by walking out of the store are all examples of the types of things that are now possible because connected devices and apps tied to payment have eliminated the friction associated with matching those with supply with those who have the demand and exchanging payment for those services.

The ability to move what were once activities completely tied to desktops or PCs has unleashed massive innovation – often focused on helping those with excessive supply to find consumers or businesses with demand for those services or products in real time.

There are important implications to the payments ecosystem. Once a consumer downloads an app, they "set and forget" their payment method. After that, the act of paying, for the most part, becomes completely invisible to the consumer. What consumers focus on instead, is the entire shopping and buying experience made possible when they download those apps and use connected devices to access

those apps. And, depending on where you are in the ecosystem, this development is viewed as either a massive opportunity or a massive threat.

Pushing payment to the background pushes the providers of that payment method to the background too and commoditizes those that process the transaction. And, if you're one of those players, that's pretty scary. It's why the digital wallet has become a topic of conversation in just about every board room in payments: every player wants to be "the" wallet that consumers download and use to organize all of their payments, loyalty credentials and offers so that their brand remains front and center. No one, particularly the players that represent the incumbents today, want to get lost in cyberspace, end up subordinate to someone else's brand and be viewed and priced as a commodity service.

My sense is that, ultimately, just like in the physical world – consumers will choose just one "wallet" – one container which aggregates all of the things that are relevant to their buying experience …. promotions, offers, loyalty and rewards, payments methods, etc. Consumers may fill those containers (or have them automatically filled) with many "apps" from merchants or other services providers that may also have payment methods attached to those apps – but consumers won't want to manage multiple wallets. Managing a few now, isn't a hassle, but once everyone has an app, consumers will consolidate. It is also my belief that, with very few exceptions, it is unlikely that the "container" that they choose is issuer-branded, even if that issuer allows multiple payment methods to be attached to it. "Wallets" must enable multiple methods of payment, since that is how consumers shop and pay today, but aggregating multiple payment methods under one issuer brand is a drastic departure from how consumers view the relationship they have with their issuer today. Adopting an open "issuer wallet" may require too much of a behavioral shift for consumers to easily make such a drastic change and, at least now, there's no apparent reason why they'd want to do it.

Consumers may fill their "wallet" with many "apps" from merchants or other services providers that may also have payment methods attached to those apps – but consumers won't want to manage multiple wallets.

"Wallets" must also deliver something much more meaningful than simply substituting for a plastic payment card. It must eliminate the friction associated with buying and/or create new value at the merchants they frequent . Wallets simply designed to enable payment and nothing more will fail to gain traction – in my opinion, that's one of the reasons that NFC has failed to gain traction just about everywhere in the world outside of narrow use cases such as transit. So, payments incumbents – networks and issuers – must think deeply about how and where they will play in a world where the act of payment takes a back seat to the buying experience, perhaps starting with making sure that their products are, in fact, those products consumers want to "set and forget" in this new commerce paradigm ruled by connected devices, the cloud, data and apps.

Force Number Two | The future of payments lives in the cloud

If the future of payments isn't about the act of paying but buying and the act of paying is invisible to the consumer, then the future of enabling those payments is about the cloud and not hardware.

When the world was just about making a payment and giving merchants the ability to accept those payments, the focus was on the hardware that could enable a physical card payment in a store. This hardware was "purpose built" for payment acceptance and the activities that supported it - payment authentication and processing. This hardware was complicated to upgrade or change for a variety of reasons, including the expense and difficulty of connecting to multiple processing platforms to enable various types of payments. For example, any service provider that wanted to enable a large merchant with their solution, had to connect with multiple payments processing platforms which was difficult, time consuming and expensive – and repeat that process for every single merchant.

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Today, the world is moving to an environment that is much simpler but much more robust. The cloud and connected devices and apps has, in a sense, democratized payments and commerce and given every merchant, regardless of its size, the opportunity to both accept card payments but also run their entire store operations from loyalty to inventory management to accounting to customer database management – and all in one nice neat integrated solution that is drastically cheaper than traditional solutions.

Think about what that means. Anyone, including merchants, can now develop and deploy more easily, any kind of proprietary solution that can enable a commerce experience that suits their needs and helps merchants sell more things. And, "purpose-built" devices aren't driving that shift, software platforms and the cloud are.

These platforms make it possible for third party developers with a vision to reinvent the consumer and merchant experience to do that and more easily connect to payment infrastructure. These platforms eliminate the friction associated with connecting merchants, payments processors and developers, freeing entrepreneurs to focus their time and resources on helping create solutions that help to reinvent the value exchange between merchants and consumers.

"Point of sale," therefore, no longer means a fixed place in a store with a device on a counter. In a world characterized by connected devices and the cloud, it has become an anachronistic term. Point of sale is now defined as wherever and whenever merchants and consumers with connected devices happen to be, powered by solutions that leverage cloud-based operating systems that connect those consumers and those merchants. Consumers with their smartphones and tablets and apps can communicate with merchants anywhere , and at any time ***in real time***, enabling a variety of commerce solutions that are

device agnostic, flexible, scalable and adaptable And the more that consumers acquire and use those connected devices, the more there will be entrepreneurs that develop applications for them to access, which will only drive the demand on the part of merchants to move away from their legacy devices to those that embrace the cloud.

The evidence of this can be found in the many failed attempts to ignite commerce using NFC around the world. This solution relied on "purpose built" devices that communicated with handsets with chips and secure elements in them. The use case was to replicate the payment experience at a fixed point of sale in a store via a purpose built device adapted to accept an NFC-enabled handset. Merchants, not seeing the business case for replacing one purpose built device for another only to enable a payment rejected the proposition. As a result, mobile NFC is lagging almost everywhere in the world.

For example, ISIS, the large multi-hundred million dollar carrier-lead initiative built around NFC, has failed to gain any traction outside of transit, and even that is small. Google has moved away from NFC to a cloud-version of NFC. Sure, there are a few countries, such as Canada and Poland, where conditions were ripe for NFC, and new schemes in some countries that enable NFC via a bank app, but so far they seem to be the exceptions and not the rule. Yet, new technologies such as Apple Beacon, which uses Bluetooth Low Energy devices to connect merchants running Apple's latest operating system with consumers that do the same, have unleashed the creative juices of a network of developers that are building apps that leverage Beacon technology to further enhance the merchant/consumer relationship inside the store. And, in developing economies, it is likely that commerce innovations will skip hardware altogether and simply become mobile enabled digital money schemes that don't rely on hardware in physical locations to enable payment and commerce.

The implications of this shift in thinking, which is most cases is related to the merchant's lack of interest in investing in new point of sale devices also further calls into question whether EMV at the physical point of sale, a card-based solution that requires the installation of purpose-built devices by merchants and the issuance of cards with chips by issuers, is solving for a problem that the payments ecosystem has going forward.

The implications of this shift in thinking, which is most cases is related to the merchant's lack of interest in investing in new point of sale devices, also further calls into question whether EMV at the physical point of sale, a card-based solution that requires the installation of purpose-built devices by merchants and the issuance of cards with chips by issuers, is solving for a problem that the payments ecosystem has going forward. EMV is a physical card-based solution that emerged in Europe as a result of infrastructure deficiencies. If the future of payments and commerce is in the cloud, transactions that are enabled by the cloud can be secured thru a variety of superior solutions, including tokenization, a method that the payment networks have come together to establish standards around and promote. It seems logical that the faster that transactions move to the cloud , the less likely it is that merchants will want to invest to support EMV at the physical point of sale. They will, instead, evaluate options that provide them with

the degrees of freedom and flexibility and security that leveraging these cloud-based solutions will offer them.

Force Number Three | Financial services, retail and payments are being creatively destroyed
The creative destruction of retail and financial services is in full swing – third party digital wallet providers and alternative providers are emerging as tomorrow's sector leaders.

This new world of digital and connected devices makes it easier than ever for new players to enter many well established industries, disrupt them and create entirely new ways of doing business. Nowhere is this more visible than in retail, payments, and financial services where a whole new crop of player is emerging and taking share from incumbents. These new players aren't tied to the legacy systems or inefficient practices of incumbents that make it more expensive and longer for them to get to market. Mobile devices and the cloud also make it possible for the delivery of retail, payment and financial services to be reinvented at a lower cost and made available to large segments of the population– and provided that consumers and businesses find value in them, for adoption to be accelerated. As a result, the incumbent players that dominate today's retail, FI and payments landscape find themselves increasingly marginalized, and in some cases, competing with players who aren't governed by the same rules and regulations, and/or haven't grown large enough to catch the eye of industry regulators.

The digital wallet story is both interesting and instructive. The players that dominate the offline payments world today – the networks and large issuers – have all but ceded ground to those that started life online when shopping on the internet was tedious and slow, and when, it wasn't at all clear that shopping online would ever become any more than a small sliver of overall retail sales.

There are two areas in payments and financial services in which this is quite evident: digital wallets and in core retail financial services: banking and credit.

The digital wallet story is both interesting and instructive. The players that dominate the offline payments world today – the networks and large issuers – have all but ceded ground to those that started life online when shopping on the internet was tedious and slow, and when, it wasn't at all clear that shopping online would ever become any more than a small sliver of overall retail sales. Some fifteen or so years ago when these players entered the market, they solved a big problem that consumers had at that time – the ability to actually safely pay for the things they wanted to buy online using their preferred method of payment, often with a seller they didn't know. At that time, access to these sellers was done largely via desktops (then laptops sometime later) and sellers were aggregated into marketplaces, notably eBay and Amazon.

Payments incumbents took a different path. Simplifying the process of shopping online wasn't anything they were particularly interested in since the great majority of retail spend was (and still is) concentrated in physical stores where plastic cards dominated and were easy to use. As it became more and more evident that smart mobile devices could enable a number of activities, including payment,

these players invested in hardware-based solutions – NFC – and a vision that essentially digitized the existing shopping experience in a physical store. But instead of using a plastic card to check out, the hypothesis was that a phone with a chip in it would enable payment. Networks and issuers rallied around NFC solutions and the physical acceptance that they had with merchants that would allow them to convert the hundreds of millions of plastic card-carrying consumers into mobile NFC wallet account holders.

In the meantime, the emerging online players were amassing digital accounts so that consumers could conveniently shop online across a variety of merchants using a single digital account. As more consumers adopted more smart mobile devices (phones and tablets) more of them began using those devices to shop online just like they did when they were on their desktops and PCs. And since the technology that powered these solutions didn't require having a piece of hardware in a store to enable commerce, these innovators pursued a vision that leveraged these digital accounts – now in the hundreds of millions – to buy anything, including goods and services in the physical world by communicating to merchant point of sale systems via the cloud. These players had positioned themselves to leverage the digital accounts tied to payment to close the loop on transacting. In the process, they had successfully blurred the lines between transacting in the on and offline worlds via these digital accounts in a way that didn't require the investment in new hardware point of sale systems.

The contrast in outcomes is stark.

Players that started life as internet players have collectively accumulated hundreds of millions of accounts that can now be leveraged for a physical merchant's benefit via apps enabled by two connected devices that can communicate with each other via the cloud. Incumbents, by contrast, have spent the last ten years trying to convince merchants to enable hardware-dependent mobile commerce solutions. Emerging players have a digitized customer base and a more flexible and robust solution to offer to merchants, and merchants are responding because they are interested in supporting a solution that can more quickly leverage an existing pool of consumer digital accounts enabled for commerce. The longer it takes for incumbents to offer a solution to merchants and consumers that provides similar value, the more at risk issuers and networks become of becoming subordinate to these third party solutions. Further, emerging players can also try to incent consumers to adopt non-network and issuer-branded payment alternatives in order to reduce the cost of acceptance to merchants and their processing costs at the same time it dis-intermediates existing networks and issuers.

On the alternative financial services front, the story is a bit different but the outcome is similar. The perfect storm of regulation, connected devices and the cloud is reshaping the financial services sector as we know it.

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The imposition of price caps on debit interchange as a result of legislation in the US and competition authority decisions in

the European Union and elsewhere, the regulation of financial services fees and processes as a result of the Card Act in the US, consumer protection regulation in other countries, and the financial crisis that has shaken consumer and FI confidence has resulted in banks sharply curtailing or even eliminating lending to small businesses and consumers. At the same time, anywhere interchange fee caps have been imposed, banks have raised fees on checking account services to offset lost interchange-fee revenues.

As a result, at least in the US where I am most familiar, consumers have either been forced to or have decided to leave their traditional financial institutions and seek other options - the basic need for lending and repositories for funds remains. A whole new crop of alternative providers has emerged to capitalize on the void that banks can't or don't want to fill anymore. These players, internet and/or mobile banks, lenders and even merchants - can deliver services in a way that avoids many of regulatory issues that pose expensive and onerous constraints on their incumbent counterparts.

So, today, whether it's lending to consumers or small businesses, investing in new ventures or providing alternatives to traditional checking account products, there is an app for that, so to speak, and some pretty big companies behind them. For example, the world's biggest merchant, Wal-Mart, has partnered with Serve to create an alternative debit product that functions like a checking account in every way, including issuing checks to consumers. Green Dot, the prepaid services issuer, bought a bank in 2012 and has launched a mobile banking service called Go Bank. The peer-to-peer lending provider, Lending Club has lent $2.6B to consumers since it started in 2006 with an average loan amount of $13k. Capital Access Network, a merchant lender, has loaned about $15B since it started about a decade or so ago, with an average loan amount of $40k. Several providers of small dollar, short term funds such as LendUp, have also emerged, many of them bridging funds from pay day to pay day and targeted to single mothers who have no other options.

Many entrepreneurs have gone on record in the US saying that the current regulatory environment is one that would completely crush their chances of success or prevent them from even entering the market since they simply could not afford to allocate the time and money to developing innovation and complying with layers of government regulation.

But, as much innovation as this "perfect storm" has spawned, there's a cautionary tale to be told.

Many entrepreneurs have gone on record in the US saying that the current regulatory environment is one that would completely crush their chances of success or stop them dead in their tracks from even entering the market since they simply could not afford to allocate the time and money to developing innovation and complying with layers of government regulation. In the European Union, a lot of payment innovation has come to a grinding halt as a result of the combined impact of regulation and the financial crisis. And, when investors anywhere in the world decide how to allocate their capital, they steer clear of industries in which there is or could be in the future severe regulatory constraints that impede the venture's ability to fund innovation – that is unfortunately payments and financial services. The same mindset holds true for incumbents as well, who have seen their ability to fund innovation severely impacted by the rising costs

of compliance and the number of resources they have to allocate to compliance. The risk for both incumbents and new entrants is that innovation could be chilled or even killed to the detriment of merchants, consumers and the entire ecosystem. Over-regulating the supply of services prevents those with demand for those services - demand that doesn't disappear as a result of the regulatory actions taken - from receiving value from that innovation.

But, financial services and payments aren't the only two ecosystems being reshaped by the mash up of connected devices, the cloud and data – and regulation. Essentially, any opportunity to match excess supply with demand in real time can be done via an app, a connected device, the cloud and access to data is now easy and efficient. The ability to attach payment to these opportunities is the monetization "secret sauce" and why existing industries are able to be disrupted more frequently than ever before.

In order for issuers to have an incentive to issue cards and for merchants to have an incentive to compensate issuers for giving consumers a convenient way to pay for purchases, the ecosystem will have to consider new ways to monetize the exchange of value among all parties.

For instance, livery services in the US are being reshaped as apps and the cloud make dispatchers and traditional taxi services irrelevant. That has raised the ire of the taxi industry that has complained bitterly to the regulator. Now, battling regulation is almost the entire focus of the CEO of Uber, the leading provider in this space in the US. The cloud and connected devices have also disrupted the physical movie rental business, basically shuttering two of the largest providers of that service. And, apps plus the cloud enable hotels to capture last minute bookings by pushing out availability in real time the day that they have inventory available, eliminating the need for travel agents to be involved.

Force Number Four | Out with the old business model, in with the new
The way in which money flows across the payments ecosystem will look dramatically different a few years from now than it looks today.

The Durbin Amendment and the impact to debit products in the US is instructional.

Debit interchange in the US has been reduced by half as a result of the Durbin Amendment and Fed Final Rule in 2011 and may move much lower if the Federal Reserve Board loses its appeal of a recent decision by judge in the US who ruled that the Fed's rules ignored Congress and were too favorable to the banks and networks. Merchants have made the case, successfully, that paying for acceptance is not something they value anymore. The reduction in debit interchange fees set by the networks and paid to the issuer as an incentive to issue cards bearing the networks logo has impacted issuers by reducing their ability to offer services and benefits, most notably rewards, to consumers carrying those cards. In order for issuers to have an incentive to issue cards and for merchants to have an incentive to compensate issuers for giving consumers a convenient way to pay for purchases, the ecosystem will have to consider new ways to monetize the exchange of value among all parties. And, all of this will have

to be structured in such a way so as not to disenfranchise the consumer who has come to both value the utility of the payment card, as well as the convenience and benefits they get from using them.

There are a couple of possibilities.

Merchants may not value acceptance but they do value incremental sales. Schemes like those made famous by US-based innovator, LevelUp and that monetize the loyalty benefit realized by a particular merchant are starting to garner interest and traction. Instead of interchange, merchants pay a hefty percent of the value of the incentive offered to consumers who visit the store frequently. A typical scenario looks like this. Once a consumer spends $50 with a single merchant, they receive a $5 credit when they return again to that merchant and make another purchase. Only when that $5 credit is redeemed does that merchant pay 40% on that $5 promotion. They have paid nothing up to that point in interchange fees – processing costs are paid by LevelUp In this model, LevelUp absorbs the interchange fee and other acquiring costs so all the merchant sees is a fee for a loyalty program that, they hope, will drive traffic and incremental customers and sales.

Merchants have complained over the years that the current interchange model funds issuer rewards schemes that don't benefit them directly. Models tied to loyalty and incremental sales and a direct merchant and consumer benefit mitigate these merchant concerns.

This scheme is made possible because consumers download a LevelUp app onto their mobile devices which gives merchants the data and the customer record necessary to track and attribute those incentives to the right customers. Ironically, it is the payment method linked to the LevelUp app that creates the proof point needed for the merchant to know who is buying and how much they are spending. Merchants are intrigued by this model because whatever they fund in the way of an incentive comes right back to them and is only paid out when that incremental sale is made. Merchants have complained over the years that the current interchange model funds issuer rewards schemes that don't benefit them directly. Models tied to loyalty and incremental sales and a direct merchant and consumer benefit mitigate these merchant concerns. And, there are lots of those players that are enabling these schemes in the market today and more that are emerging. ShopRunner offers an Amazon-Prime like model for consumers and a digital account linked to a ShopRunner acceptance mark at those retailers, that drives traffic to those retailers. Merchants pay "commissions" based on sales driven to them by ShopRunner.

These models are interesting for another reason: they can potentially dis-intermediate the traditional issuer and the network, unless they are the ones enabling the incentive schemes. It may be the case that consumers attach an issuer or network branded payment method to the app initially, but over time, these consumers can be more easily switched to other payment methods that run over alternative rails like ACH and carry the brand of that third party as they become more familiar with these third parties and trust them to keep their data safe. A model like this is likely to support the US-based Merchant Customer Exchange (MCX) and other non-network branded commerce platforms as well.

This incentive-based model also disrupts another ecosystem – the advertising ecosystem. Traditional ads will be displaced by offers or promotions or other incentives communicated in real time by merchants or third parties via the apps that consumers have downloaded that power these schemes. Unlike ads, these promotions can result in an action that can be quantified and monetized. Over time, traditional advertising will be judged as less effective, less popular and less relevant. It is likely that those who emerge to dominate the commerce ecosystem moving forward are those third parties who blur the advertising and loyalty ecosystems by enabling incentive-based schemes that prove their ability to drive incremental sales to merchants.

There are two other business model possibilities that may emerge over the next several years.

One possibility is that those that can, will become three party systems, which are exempt from interchange regulations. Candidates for this shift are those with access to consumer and merchant endpoints and with large consumer bases. Three party systems can charge merchant high merchant discounts which merchants will pay if they want to serve those customers. And since merchants are in the business of making sales, it is unlikely that they would refuse to accept payment from customers presenting payment products issued by those schemes.

But whatever belief you hold about the future of business models in payments, any of the scenarios described will fundamentally alter the role of the players in the ecosystem one way or the other. Unfortunately for issuers, they will likely fare the worst since the interchange fees that fund their activities are most at risk now and into the future.

Possibility two is to basically kick the can down the road, to borrow a phrase from the 2012 US Presidential election. It is a fact that in the US, consumers with mobile devices don't typically attach debit cards to their registered accounts but use credit accounts instead. They do this because they feel that doing so mitigates their downside risk should their phone be lost or stolen. Merchants, therefore, pay higher interchange (credit plus card not present rates) on those transactions. And since in the US, initiating legislation on credit interchange will take years to work its way thru the legal and congressional process, it's entirely possible that issuers and networks encourage consumers to use credit products to conduct mobile commerce by creating incentives to do so.

But whatever belief you hold about the future of business models in payments, any of the scenarios described will fundamentally alter the role of the players in the ecosystem one way or the other. Unfortunately for issuers, they could likely fare the worst since the interchange fees that fund their activities are most at risk now and into the future. As long as the four-party system stands, networks will continue to make money on volume – they set interchange rates and establish rates that acquirers pay to them irrespective of what is allocated to the issuer. However, in order to stave off the threat of three party systems, networks have an interest in reinventing the business model in collaboration with issuers since without them, there is no one to issue their branded cards and no consumers to use them to drive volume over their networks.

At the same time, networks must heed the headwinds created by merchants to keep the cost of acceptance as low as possible, at a point in time where 50 or so merchants in the US as part of the MCX scheme, who represent 500 million shoppers each week, are designing their own scheme to shut the networks out entirely.

Force Number Five | Consumers will decide the winners and losers

Connected devices and the cloud may reinvent the retail experience and business models may totally change how money changes hands across the ecosystem, but it's the consumer who will decide the winners and losers.

The essential truth in payments is that ignition requires enough consumers and merchants to buy in to whatever new or existing payments/commerce scheme comes along. And, both merchants and consumers have the power to make or break innovation. As we've seen, the resistance of merchants to NFC deployments or interchange fees or decisions related to what innovations will be integrated with their existing point of sale systems has had an impact on the pace at which innovation moves thru the ecosystem.

The critical player in the mobile commerce ecosystem is the consumer. And, giving consumers the "killer app" that makes them want to use a mobile device and apps with payment methods attached to them in some way is the Holy Grail that everyone across the ecosystem is pursuing.

But, ultimately, merchants are influenced by their customers. And, if they think that enough consumers are on board with "the" new mobile commerce innovation, they'll rush to accommodate it. It's why they've said "yes" to apps that allow them to deliver offers and other incentives to drive foot traffic into their stores and sales to their bottom line and "yes" with even more fervor to apps that come with lots of digital accounts for them to leverage.

So, that means that the critical player in the mobile commerce ecosystem is the consumer. And, giving consumers the "killer app" that makes them want to use a mobile device and apps with payment methods attached to them in some way is the Holy Grail that everyone across the ecosystem is pursuing.

And that's a challenge because consumers' habits, especially those connected to payment and financial services, are hard to change.

A recent study by the Federal Reserve Bank reported that about 9 out of every 10 times consumers use the same underlying payment method for the things they buy. This is based on their personal calculus pegged to the type of merchant, type of product, dollar amount of product and type of shopper – age, gender and socioeconomic status. It is also based on what payments products are available to them; it's not often easy for consumers to switch between payments methods – it's either too much of a hassle or too expensive or simply not an option given their current financial situation and the appetite of issuers to extend services to them.

Therefore, for consumers to move to both be persuaded to adopt mobile commerce and then even possibly an alternative method of payment will require that they be given a reason to switch – an incentive based on the new sources of value that they could receive by doing so. What seems clear is that loyalty and rewards are no longer the way to get consumers to make a change.

So, what will? Well, for one, incentives that don't just offer points and rewards. Consumers, shaped by the financial crisis and now enabled by devices that allow them to receive and redeem offers in real time, don't care about earning rewards and banking them for future use. Further, most consumers don't spend enough to accumulate enough rewards to make any meaningful redemption desirable. When points were all that was available, they took them. Now there are other options which make points and rewards nearly irrelevant for most consumers.

What consumers do value is immediate gratification – savings delivered in real time and redeemed in real time. Consumers also value information about prices and special offers and being incented to achieve preferred customer status so that more valuable offers and value can be delivered to them. And, they increasingly value what others have to say about the products they might want to buy. The "wisdom of the crowds" theory holds great sway over what consumers buy and even how much they are willing to spend. And with connected devices always at the ready, they can receive and take action on that information anytime.

Consumers also value experiences and not everything has to be delivered in the form of a savings or a sale. Things that eliminate the friction associated with the buying experience are of great value.

Consumers also value experiences. Not everything has to be delivered in the form of a savings or a sale: things that eliminate the friction associated with the buying experience are of great value. For example, being able to jump the lunch line by ordering ahead online and picking up in store, building a digital shopping list based on prior purchases that can then be sent to the merchant and fulfilled the same day, being prompted to reorder an item that is running low, being offered an item that complements something that was bought a week or so earlier, or being able to shop via QR code on television and have the items shipped same day are just a few examples of experiences that consumers value but aren't triggered in the first instance by an offer to save money. In fact, whoever can architect that preference using a portfolio of experiences and offers and discounts will be the one that reaps stronger relationships with consumers since the relationship will go well beyond just being the cheapest provider of goods and services.

Think about what has ignited the most successful mobile commerce application of the last several years – Starbucks – as well as the emerging payments players that have risen over the last decade to challenge the incumbent players. Amazon established itself as the world's biggest online marketplace with lower prices, but what ignited it was the ability to use "one-click" to make payments when it was really cumbersome to shop on line (even more so than today). PayPal was the "killer app" that helped accelerate the growth of eBay since it offered a way for sellers and buyers who didn't know each other

to transact securely and efficiently. The Starbucks app helps consumers who love their Starbucks card to access it digitally and never be embarrassed because there isn't enough funds on the card to buy coffee. The Dunkin' Donuts app makes it easy to buy coffee via the mobile phone and to send a digital cup of coffee to a friend. Loyalty and preference was established in all cases because the experience was convenient and easy and efficient – and the habit of returning to those merchants became second nature. And, that's what will ultimately motivate merchants to invest in changing their POS environments to accommodate and monetize those new habits.

Force Number Six | Change won't be as fast as you think or as slow as it's been

Everyone wants to know how long it will take for more than 50% of consumer spend in the developed world to happen via mobile devices and the answer is whatever you've heard, multiply by 2.

It's a fact that most everyone in the developed world has a smart mobile phone or will very soon and that they are used for just about everything in life. Young people, in particular, would rather lose their keys or wallet than their mobile phone. But, moving the needle away from plastic to mobile is a function of two things: how quickly solutions are available and how long it will take before enough people with enough spending power adopt them.

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Today, all over the world, there's a big disconnect between the young people who will try anything new and how much spending power they control. They may love technology and may be early adopters of schemes tied to mobile phones and commerce but it will be at least a couple of decades before the young people who love these connected devices have enough spending power to move the needle away from commerce via plastic cards and to mobile devices. And, their parents who do, aren't entirely comfortable yet with the notion of consolidating everything that they do, including payment in stores, on their mobile phones.

Second, the world is just now starting to get some momentum around mobile commerce. In spite of news and hype to the contrary, outside of a few isolated use cases, such as Starbucks in the US, and the much older but over-hyped mobile payments system in Japan, mobile commerce involving the physical point of sale hasn't ignited anywhere in spite of the efforts and investments of many to make it happen. Even Kenya's M-Pesa, the only truly successful mobile payments system in the world, isn't really used much yet to pay at the physical point of sale. (Of course, everywhere people are using mobile devices to buy online in the same way they used their desktops to do that. And having a mobile device has made it easier to buy online since people can use their mobile devices easily to do that all the time.)

For the last decade, the predominance of the mobile commerce activities everywhere in the developed world assumed an NFC-enabled mobile future. But merchants and banks didn't want to be tethered to a scheme that wed them to the mobile operators, secure elements and TSMs and networks. So, progress languished as merchants resisted upgrading their systems to accommodate a scheme that they didn't

want or believe was to their benefit. Innovators didn't develop value added apps to spark consumer interest so consumers didn't make a point to buy NFC-enabled phones or download NFC enabled apps – there were few places to use them and no real value associated with doing so. And banks in many parts of the world have slowed down efforts by mobile network operators to start mobile payment systems. Even in places like Japan and Korea, two of the early adopters of mobile technologies, mobile commerce languished outside of specific use cases like transit and convenience stores in transit stations. In countries like France, where NFC pilots were subsidized by the networks, no forward progress has been made since the early trials. Further, the economic and financial crisis that has gripped Europe since 2008 has stalled any interest on the part of merchants in that region to invest in new terminals to enable NFC or anything other point of sale innovation.

Analyst forecasts helped to fuel those flames and it has only been very recently that the impact of these overly optimistic forecasts has been realized. As a result, progress over the last decade has been slow.

Now, here are two things that might change that.

Ubiquity isn't a requirement for consumers to embrace commerce solutions enabled by connected devices. In fact, the greatest innovation of the next 10 years might be a small leather container that holds a smart phone, an ID card and/or driver's license, a credit and debit card – and a $20 bill since those will be the things that people will carry around with them to enable transacting in the years to come.

The first is the shift away from hardware-based schemes to software and the cloud, renewing interest on the part of merchants to invest in mobile commerce initiatives. Cloud-based schemes afford merchants and others across the ecosystem degrees of freedom to innovate that hardware-based mobile commerce schemes can't. We're already seeing evidence of merchants embracing apps and commerce-related schemes and moving more quickly than they have in years past.

Second, it's also possible that a truly "killer app" comes along that's so simple, so compelling and so universally appealing that consumers adopt it relatively quickly. Starbucks and its mobile app is great evidence of this. Today, in less than 3 years, volume via the app accounts for 20% of its sales. To put this in perspective, it has taken 17 years for eCommerce to achieve just 5% of overall retail sales in the US. A commerce related app with the same kind of utility and appeal offered by a player in control of hundreds of millions of digital accounts, could rapidly ignite merchant interest to support it. And, that killer app wouldn't have to be ubiquitous in order for consumers to be interested, it would just need to be available in enough of the stores that consumers liked to be useful.

In fact, connected devices, apps and commerce put a whole new spin on the topic of ubiquity. Ubiquity isn't a requirement for consumers to embrace commerce solutions enabled by connected devices. In fact, the greatest innovation of the next 10 years might be a small leather container that holds a smart

phone, an ID card and/or driver's license, a credit and debit card – and a $20 bill since those will be the things that people will carry around with them to enable transacting in the years to come.

Looking Ahead

Hopefully, these six forces as described have helped to provide a perspective on how payments will be transformed over the next several years, fueled by connected devices, the cloud and data. 2014 promises to be a year in which a number of new developments worldwide will surface that reinvent the relationship between consumers and merchants and radically transform the ecosystem that supports it. Those developments will serve as a catalyst for the future of this vibrant industry will perform. Hopefully, this piece, and its six forces, provides you with a useful sixth sense for how to refine your strategic plans and capitalize on the developments in the exciting year ahead.