Payments: Moving from commodity to commerce catalyst

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Introduction

Payments have historically been thought of as a 'cost of doing business' among retailers – a necessary activity that ultimately chews up margins and adversely impacts the bottom line. By that virtue, retail payment strategies have traditionally centered on reducing the cost of acceptance. While cost mitigation remains an important task of any payments team within a retailer, we have observed a payments mindset shift beginning to occur in recent years.

Retailers are increasingly viewing payments as a component of the customer experience and a lever that can be pulled to drive topline growth. In fact, according to a Q2 2019 custom survey of US merchants with over 1,000 employees, 451 Research found that 77% said payments have become a highly strategic area of focus for their business that spurs significant competitive differentiation. In this report, we discuss the ways in which payments are becoming an important catalyst for business growth and expansion.

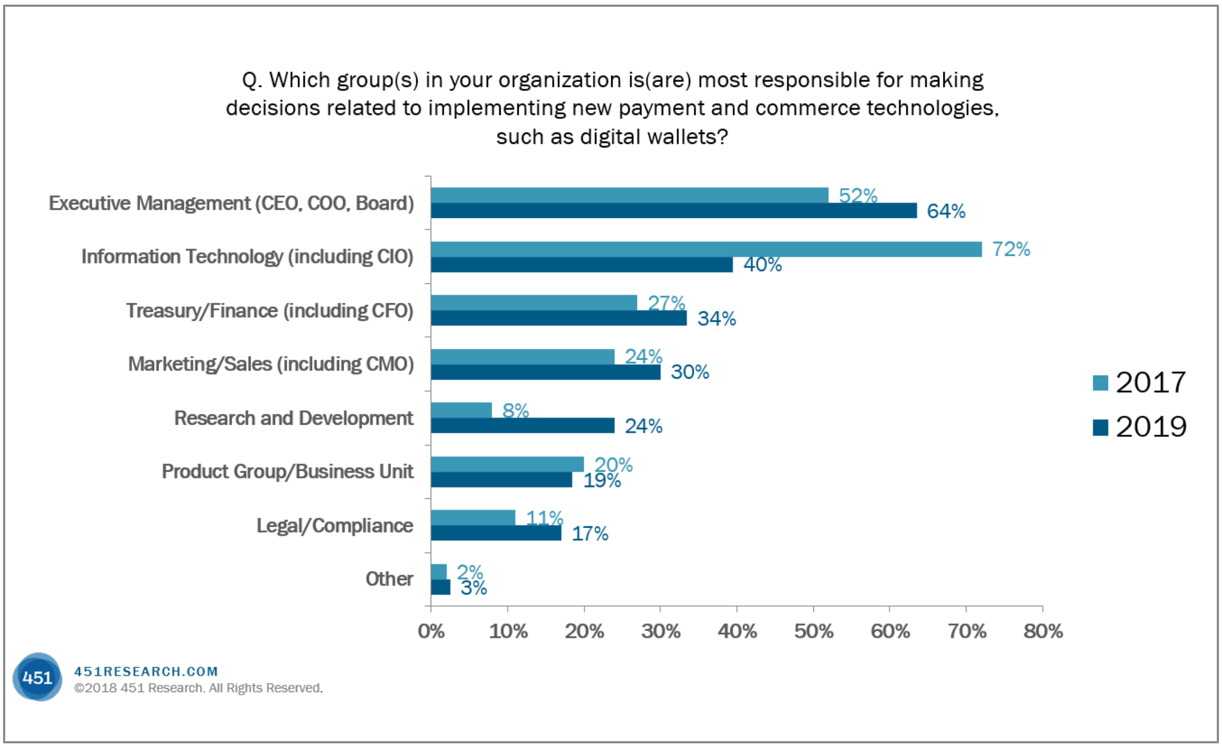
The 451 Take

Retailers' 'ask' of the payments industry has evolved from 'Help me accept and process a payment' to 'Help me grow my business.' This stems from an increasing realization that payments can be much more than a cost center, and if approached strategically can drive topline growth and expansion. The new asks of the payments industry today focus on business outcomes such as approval rate increases and reductions in false-positive declines and customer churn. To address these requests, astute payment providers are making investments in transaction optimization capabilities and machine learning to deliver better payment experiences that ultimately result in business growth for their retail customers.

Payments are no longer just a function of treasury and IT

Retailers' increasing emphasis on the strategic potential of payments is evident in the wide array of key decision-makers that now influence the implementation of new payment and commerce technologies (see Figure 1). While a decade ago payments were largely a function of treasury and IT, today we see stakeholders from across the organization influencing payment technology decisions, highlighting the growing importance of payments across the business. This shift is evident even in recent years when comparing custom merchant surveys we fielded in 2017 and 2019, where we observed a dramatic decline in the power of IT and notable rises in the influence of groups like executive management, marketing/sales and R&D.

Figure 1: Many groups now influence payment and commerce technology decisions



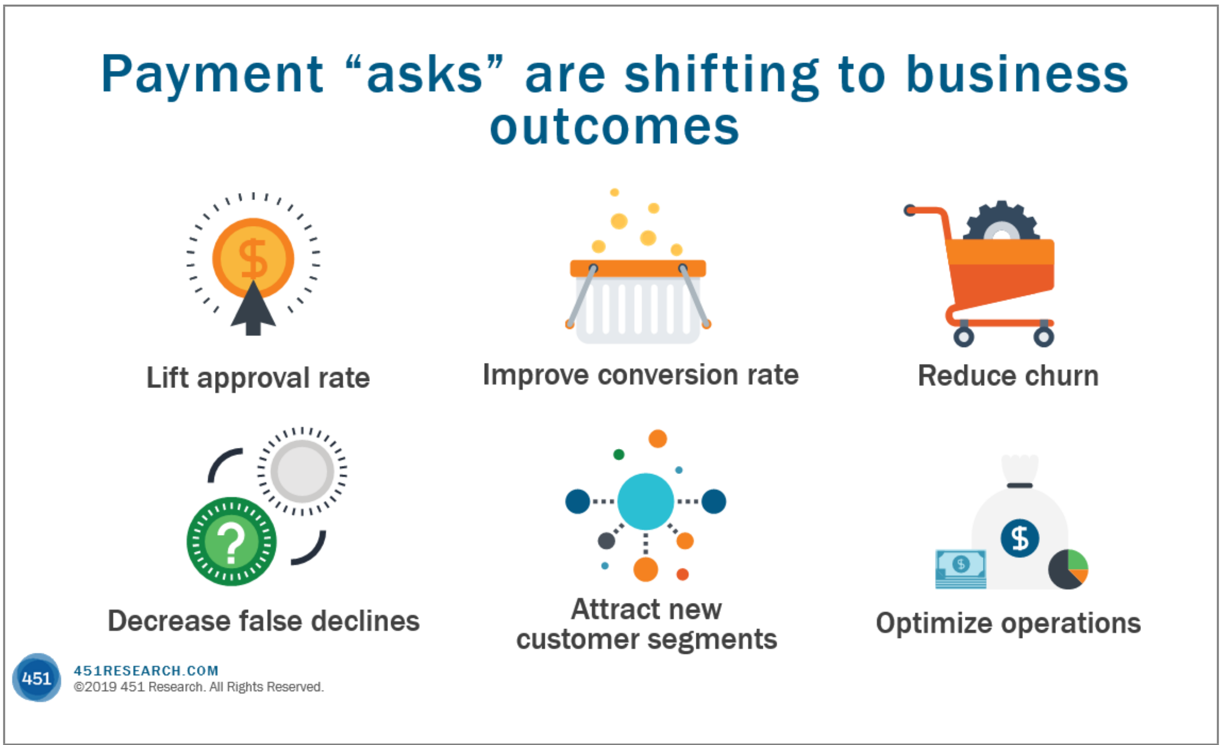
Source: 451 Research Custom US Merchant Survey, 2017 & 2019

To tackle objectives beyond cost mitigation, we are witnessing more retailers place their payments group outside of their treasury/finance organization. This is especially the case with digital-native merchants. Booking.com, for instance, places its payments team within the product group because it considers payments a core component of the digital experience it delivers to customers. Spotify, on the other hand, has its payments group sit within the business team, with its core objective being to focus on growth and optimization.

Payments should drive business outcomes

Many of the conversations we have with retailers today focus on the role of payments in driving business outcomes. Retailers are increasingly looking to payments as an area within their business they can optimize to propel revenue growth and are seeking partners that can help them deliver. As shown in Figure 2, these asks span a variety of areas but all have a common end objective – revenue growth.

Figure 2: Retailers want partners that can help drive business outcomes



Source: 451 Research, 2019

Below, we describe the ways in which payments can drive the business outcomes retailers are seeking:

- **Lift approval rate.** Even a sub 1 percentage point lift in transaction approval rates can have an outsized impact on revenue for retailers. Considering the industry-wide approval rate for digital commerce transactions sits at roughly 85%, there is significant room for improvement. Approaches like dynamic 3DS, intelligent payment routing and account updater services all play important roles in spurring approval rate increases.
- **Improve conversion rate.** Payments arise at the most pivotal moment of the shopping journey – when a shopper is about to transition to a buyer – meaning there is little room for friction. Unfortunately, many of the key issues causing cart abandonment stem from bad experiences on the checkout page. Digital wallet acceptance, mobile optimization, autofill and streamlined checkout forms are just a sampling of tactics that will help move more shoppers through the funnel.
- **Reduce churn.** Subscription businesses risk losing a double-digit percentage of their customer base each month due to payment-related issues that lead to drop-off. This primarily stems from customers' payment cards getting reissued due to expiry or fraud and cards getting declined due to insufficient funds. Account updater services and smart retry logic (e.g., retrying a failed transaction after payday on the 15th of the month) both play significant roles in helping subscription businesses preserve their customer relationships.
- **Decrease false declines.** Wrongly declining a transaction due to suspicion of fraud can have near- and long-term revenue consequences. Our consumer research shows that more than half of customers that abandon a cart due to friction at checkout (such as a false decline) say they are less likely to return to that merchant in the future. A variety of fraud-prevention technologies such as behavioral biometrics, machine learning, device fingerprinting and EMV 3D-Secure show promise to help merchants enhance their ability to more accurately detect bad actors.
- **Attract new customer segments.** Payments are an essential ingredient for international expansion. While Visa and Mastercard acceptance may ensure coverage of most of the US market, local payment method acceptance is mandatory internationally. Consider that in the Netherlands, for example, bank transfer method iDEAL accounts for 60% of e-commerce volume. Aligning with

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partners that have connections with local payment methods and acquiring relationships is key to attracting new customers abroad.

- **Optimize operations.** While payments are garnering greater attention among retailers, at the end of the day their main objective is to sell products or services. Payment partners that can alleviate the burden of payments (e.g., regulatory compliance, onboarding new payment methods, chargeback management) for retailers ultimately allow them to refocus on their core business and allocate their internal resources more efficiently.

Processors are responding with optimization toolkits

Payment processors are responding to retailers' requests for revenue growth with a more formally organized set of capabilities (e.g., retry logic, account updater, dynamic 3DS) focused on transaction optimization. Many of the optimization toolkits we've evaluated are helping increase authorization rates 3 to 7 percentage points, although we've seen some merchants experience lifts north of 10 percentage points. Some of the more robust capabilities in the market today that we've identified include:

- Adyen's RevenueAccelerate
- First Data's Authorization Optimization
- Stripe (intelligent revenue optimization)
- Worldpay's AuthMax

A key requirement for transaction optimization is harnessing data to identify trends that lead to erroneously declined payments. Considering there are more than 70,000 card issuers globally and each merchant vertical, customer segment and geographical market has its own nuances, identifying patterns in data is an absolute requirement to correct issues that are throttling approvals. As such, any payments processor worth its salt today is making investments in both supervised and unsupervised machine learning capabilities to spur continuous optimization. 451 Research's Voice of the Enterprise: AI & Machine Learning 2018 H2 survey shows that this will be an area moving up retailers' payments partner evaluation criteria lists, with payment processing emerging as a top two use case that retailers intend to deploy machine learning for over the next two years.