Point of View

Winning Strategies for Financial Services Players in the Age of Mobile and Social Payments

Insights from Cisco IBSG Primary Research

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In previous papers, the Cisco® Internet Business Solutions Group (IBSG) addressed changes that the omnichannel reality is bringing to banking.[1] Nowhere are these changes more impactful than in the payments area.

The Payments Innovation Explosion

For an industry where the last major innovations—such as electronic payment networks and ATMs—happened several decades ago, the pace and magnitude of innovation in the payments arena is now exploding: hundreds of start-ups are redefining the value proposition of every aspect of the industry, creating new opportunities to include the underserved banking population and redefining the way marketing and loyalty are conducted in the retail industry.

Significant transformation often happens when several factors align. Innovation in payments is no exception, as we are seeing long-term trends in the new ways we exchange value, including:

- **Exploding mobile connectivity:** In particular, the penetration of smartphones and tablets is bringing a wealth of capabilities, from location-based services and remote payments to interactive marketing. The effects are even more dramatic in emerging nations, given strong penetration of mobile phones.[2] Globally, it is interesting to note that more people have cell phones than they do access to electricity.[3]
- **Changes in profitability sources:**
  - *Retailers:* Brick-and-mortar retailers already under pressure from online retailers are feeling the sting of mobile-enabled consumers bringing online retailers into the physical store. Consumers can now use their smartphones to scan the bar code of an item on the shelf, get access to the lowest price available online, and complete the order while standing in a retail store. In such a climate, retailers are increasingly interested in ways—at the intersection of payment and marketing—to attract and retain consumers.[4]
  - *Financial services institutions:* Similar to retailers, in that an important source of revenue is under threat, financial institutions have seen dramatic reductions in their

[1] "Winning Strategies for Omnichannel Banking: Cisco IBSG Global Research Reveals New Ways for Banks To Prosper in an Omnichannel World," Cisco IBSG, June 2012, http://www.cisco.com/web/about/ac79/docs/Cisco-IBSG-Omnichannel-Study.pdf

[2] "Mobile Phone Access Reaches Three Quarters of Planet's Population," The World Bank Group, July 17, 2012.

[3] "Chart of the Day: More People Have Mobile Phones than Electricity or Drinking Water," *Business Insider,* April 30, 2012, http://www.businessinsider.com/chart-of-the-day-putting-global-mobile-in-context-2012-4 - ixzz29Tg4COai

[4] "Orchestration Services Increase Revenues for Retailers: Cisco IBSG Research Reveals New 'Learner' Segment Is Receptive to Services that Bridge Knowledge Gap, Provide Greater Value from Purchases," Cisco IBSG, September 2012, http://www.cisco.com/web/about/ac79/docs/retail/Retail-Orchestration.pdf

payments-related revenues (overdraft and interest-rate levers), which are likely to become long-term regulatory trends. Financial institutions are also operating in very low-interest environments—where interest revenues are declining—and are struggling to find ways to defend and increase the profitability of their franchises.

- **Demographic/cultural changes:** People who have been immersed in technology their entire lives (for example, Generation Y) account for a growing percentage of the payments industry's customer base. They expect "always-on" seamless access to information, people, and services at the time and place of need, features that are widely available in a virtual world dominated by social networking and mobility.
- **Globalization:** As global economic growth continues to shift toward the emerging world, it will create a significant need for secure, widely available, and inexpensive means of payment and value exchange. Cash as the primary mode of payment cannot serve the needs of the growing digital economy, and digital payment alternatives such as M-PESA,[5] a mobile wallet from Safaricom Ltd. in Kenya, are bound to increase.

The Threat of Disintermediation

From a financial services institution's perspective, disintermediation is a major risk in the current wave of transformation. Disintermediation happens when the current industry offering (and revenue model) becomes obsolete by failing to adapt to new technology-enabled value propositions (think of Polaroid). This threat is coming from four major players:

1. **FinTech start-ups:** A few years back, when innovative FinTech[6] start-ups such as Mint.com began attending Finovate[7] events in the United States, the talk was about FinTech start-ups disintermediating banks by building their value proposition around maximizing the value to consumers, with banks competing on the back end for the delivery of commoditized products. This situation has changed significantly: Most FinTech start-ups today position their offering as either white-label products for banks to offer their customers or as outright acquisitions by a bank. PayPal, however, is the exception because it did disintermediate banks, and banks do not want to be "PayPaled" anymore. Additionally, the extent of PayPal's impact on the payments world is likely to expand considerably, with PayPal payments branching out to the physical world of commerce enabled by mobility.
2. **Telcos:** Telcos present a serious threat to financial institutions' payments business, with some taking a significant share of the banking business—dwarfing it in the case of Safaricom—through mobile payments. And, banks around the world are trying to figure out whether to collaborate or compete with telcos. Their decisions often are driven by the relative consolidation within the banking and telco industries, country regulations, and the willingness of telcos to share payments revenues with their financial services partners.

[5] http://www.safaricom.co.ke/
[6] FinTechs are technology companies such as PayPal and Mint that focus on financial services.
[7] Finovate (http://www.finovate.com) is an annual conference showcasing technological innovations in the financial services space.

3. **Retailers:** Retailers have long been fighting interchange fees imposed on them by payments providers to process electronic payments. In some cases, retailers tried to expand their franchises to include financial services. For example, Walmart's efforts (while unsuccessful) over the past decade to acquire a banking license generated much worry for incumbent financial services players. Going forward, retailers' prominence in the payments world is bound to increase. Recent examples are Walmart, Target, and Best Buy, which have joined forces to create their own version of a mobile wallet, the Merchant Customer Exchange (MCX), with the ability to link marketing and payments and, in doing so, gain significant leverage in their relationships with traditional payments providers. Combined, these retailers' total customer spend is US$1 trillion.

4. **Tech Companies:** These are companies with an extended consumer franchise, especially in mobility and social networking:

   – *Mobility:* With Android and Apple iOS leading the way in the United States, it is no surprise that Google Wallet and Apple Passbook are already positioned as key mobile wallet and payment platforms. Whether (or rather, when) a form of near field communication (NFC) takes off as a payment mechanism (further discussion of NFC is on page 10), mobile payments are here to stay. Google and Apple have a vested interest in—and potentially different ways of—monetizing their payment capabilities, enabling Google to close the ad/commerce loop and Apple to expand its marketplace.

   – *Social networking:* Facebook, Twitter, and LinkedIn all have significant consumer franchises, and in some cases have dabbled in payments, with examples such as Facebook Credits. Additionally, Facebook has money transmitter licenses in more than 15 U.S. states[8] and is now in a position to capture a much larger share of payments in real currencies. One can expect similar payment schemes to emerge on Twitter (for example, Twitpay for Twitter-based fund-raising) or LinkedIn, perhaps including business-to-business (B2B) payments or currency exchange capabilities due to the business nature of LinkedIn.

Although Facebook has lost more than half of its IPO value[9] because it failed to monetize its client base—and given the enormous potential of payments as a revenue source and enabler of Facebook Commerce (or "F-Commerce")—the question has less to do with, "Will Facebook get into payments?" and more to do with, "What will the banks' role be under this model?" In fact, the "want list" feature on Facebook is a clear example that the move toward F-Commerce is under way.[10]

[8] "Facebook Fast-Tracks Its Payments Business," *American Banker,* February 21, 2012, http://www.americanbanker.com/issues/177_35/facebook-credits-money-transmitter-license-bank-regulation-1046825-1.html

[9] "Facebook Loses Half of IPO Value," *Detroit Free Press,* August 18, 2012, http://www.freep.com/article/20120818/NEWS09/308180033/Facebook-loses-half-of-IPO-value

[10] "Facebook 'Want' Button Gets Tested with Retailers," *The Huffington Post,* October 8, 2012, http://www.huffingtonpost.com/2012/10/08/facebook-want-button_n_1949366.html

Impact of Payments Innovation on Financial Services Players

As this current wave of payments innovation unfolds, many traditional players are asking questions about the nature of this wave (including possible threats to and opportunities for their businesses), and subsequently are thinking about the spectrum of potential and relevant responses. This is particularly important, given that payments revenues often represent more than 25 percent of all retail banking revenues,[11] and that payments (as highlighted in the rest of this document) are a gateway to a larger set of banking products and services, including savings, loans, and investments.

To address these questions, in May 2012, Cisco IBSG surveyed an Internet panel of 1,061 U.S. broadband consumers on mobile- and social network-based payments. Specifically, the survey focused on the future of payments and, in particular, consumers' readiness[12] for mobile wallets such as Google Wallet and Visa payWave, and social payment models such as Facebook Credits.

A mobile wallet enables consumers to 1) use their mobile phones in the store to make purchases at the counter, and 2) use their mobile phones to make online purchases. Many forms of mobile wallet apps have emerged, such as Square Wallet (now used by Starbucks), Google Wallet, Apple Passbook, and Isis Mobile Wallet. Most of these support multiple payment instruments provided by different financial organizations and run on existing "payment rails." However, the risk of replacing these rails using closed loop payments over secure Internet connections has never been more real than it is today.

Social payment services such as Facebook Payments (F-Payments) enable users to buy digital products such as widgets or games; extensions of these services could include physical products from Amazon or Walmart via social networking sites. Such payments could be made using virtual currencies such as Facebook Credits or real currencies via a social wallet such as Facebook Wallet, which is similar to a mobile wallet except payment is linked to a social networking platform instead of a mobile device.

In addition to our findings, which are the foundation for this Point of View, relevant findings from a global omnichannel banking study[13] from Cisco IBSG are also discussed in this paper. The omnichannel study was conducted online, in the second and fourth quarters of 2012, with 5,300 mobile phone owners from the United States, Canada, the United Kingdom, Germany, France, China, Mexico, and Brazil.

A Story of Connectedness, Age, and Wealth

Our analysis from the survey revealed three segments that are most significant in determining a person's readiness for new payment models (listed in order of importance):

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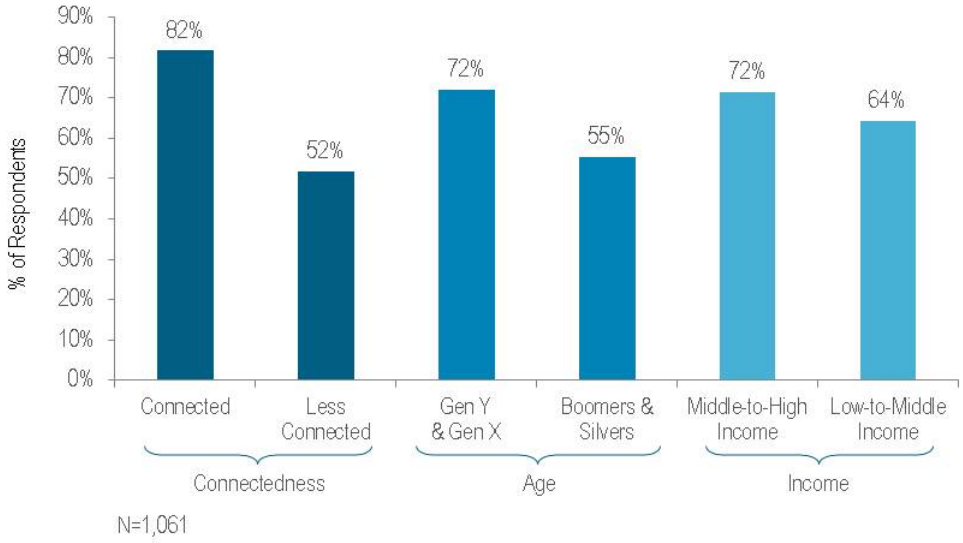
[11] "Retail Payments: Integration and Innovation," Working Paper Series, No. 1135, European Central Bank, December 2009, http://www.ecb.int/pub/pdf/scpwps/ecbwp1135.pdf

[12] As part of its analysis, Cisco IBSG defines "readiness" as interest in one or more of these unique features of mobile and social payment models: additional banking services from a mobile wallet provider; coupons through the mobile wallet; click-through from Facebook directly to online marketplaces; Facebook credits; Facebook banking services; and linking the mobile wallet to existing credit or debit accounts.

[13] "Winning Strategies for Omnichannel Banking: Cisco IBSG Global Research Reveals New Ways for Banks To Prosper in an Omnichannel World," Cisco IBSG, June 2012, http://www.cisco.com/web/about/ac79/docs/Cisco-IBSG-Omnichannel-Study.pdf

1. **Connectedness:** Consumers who own either a smartphone or a tablet are more likely to be receptive to new payment models than those who own neither.
2. **Age:** Gen Y,[14] and to some extent Gen X,[15] are more ready to adopt new forms of payment than are baby boomers[16] and Silvers.[17]
3. **Wealth:** Individuals having annual incomes of $60,000 or more (middle-to-high income) are more open to adopting new payment solutions than those with low-to-middle incomes.

Figure 1. Percentage of Respondents Who Are Ready for New Payment Models (by segment).



Source: Cisco IBSG, 2012

These three segments all point to growth in future demand for new payment models and thus are extremely relevant to banks:

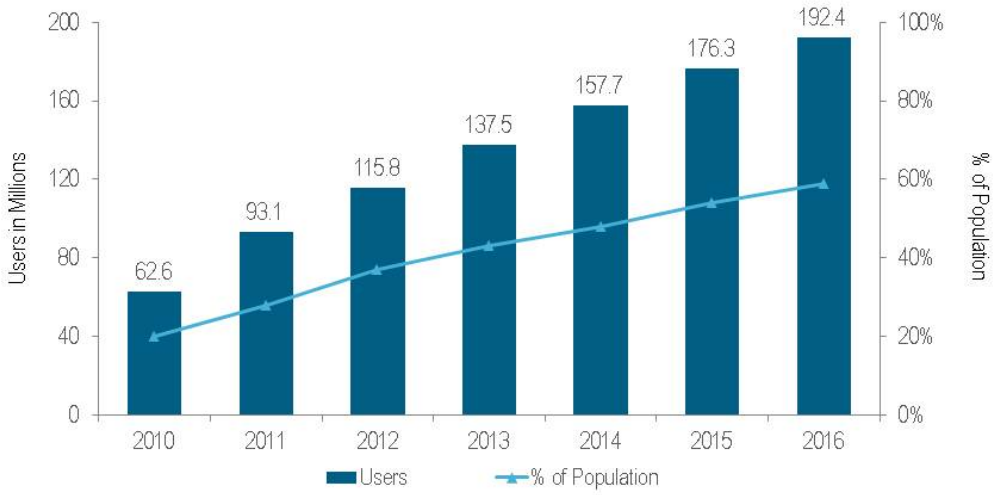
- First, mobile device penetration (especially that of smartphones) is expected to accelerate over the next several years as mobility becomes the norm (see Figure 2).
- Second, as Gen Y and Gen X (both early adopters of mobility) age, their net worth and purchasing power will tend to rise.
- Finally, wealthier clients are often banks' most profitable customers—increased interest in mobile payments on their part will equate to a more lucrative opportunity for banks.

These findings are corroborated by the Cisco IBSG global omnichannel banking study, which showed that these same factors are valuable in predicting consumers' appetite for new banking models. Our study further revealed that new payments providers will likely become precursors to new banking services providers: our analysis showed that if the non-

[14] Also known as the Millennial Generation, Generation Y is defined as those people born between 1977 and 2001.
[15] Generation X is defined as those people born between 1965 and 1982.
[16] Baby boomers are defined as those people born between 1946 and 1964.
[17] Silvers are defined as those people born before 1946.

bank provider of a mobile wallet or Facebook payment account began offering non-payments accounts such as savings, loans, or mortgages, consumers would likely adopt such services. This scenario is particularly true of the three segments defined above.

Figure 2. Smartphone Penetration in the United States.

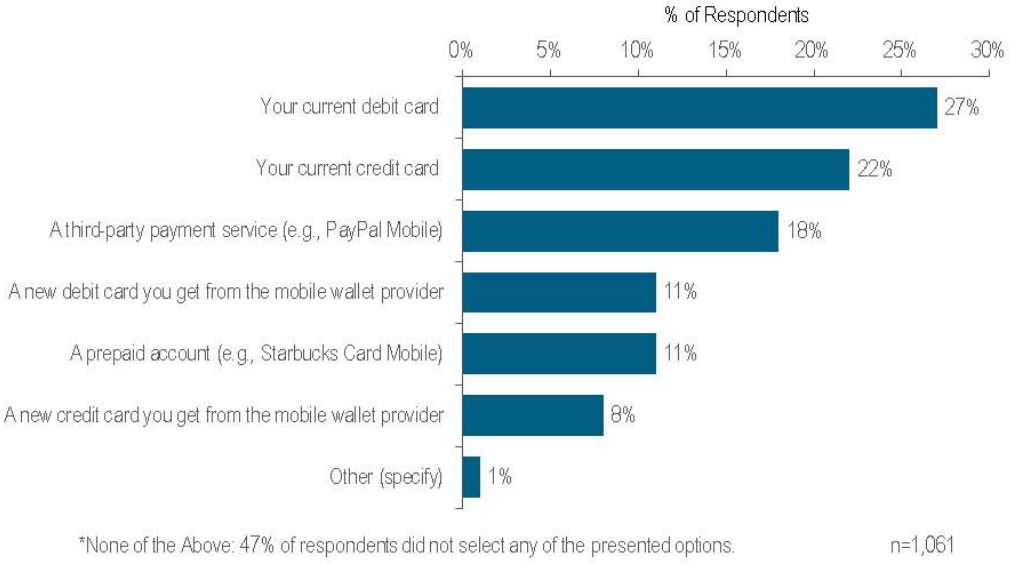


Source: "Smartphones Continue to Gain Share as U.S. Mobile Usage Plateaus: Majority of Mobile Users Will Have a Smartphone by 2013," eMarketer, April 2012

Traditional Players Ideally Are Positioned To Compete

Furthermore, our analysis showed that established players who decide to provide their customers with a mobile wallet offering will be in an advantageous position because consumers prefer to link their mobile wallet to existing accounts, such as debit, gift, or credit cards (see Figure 3).

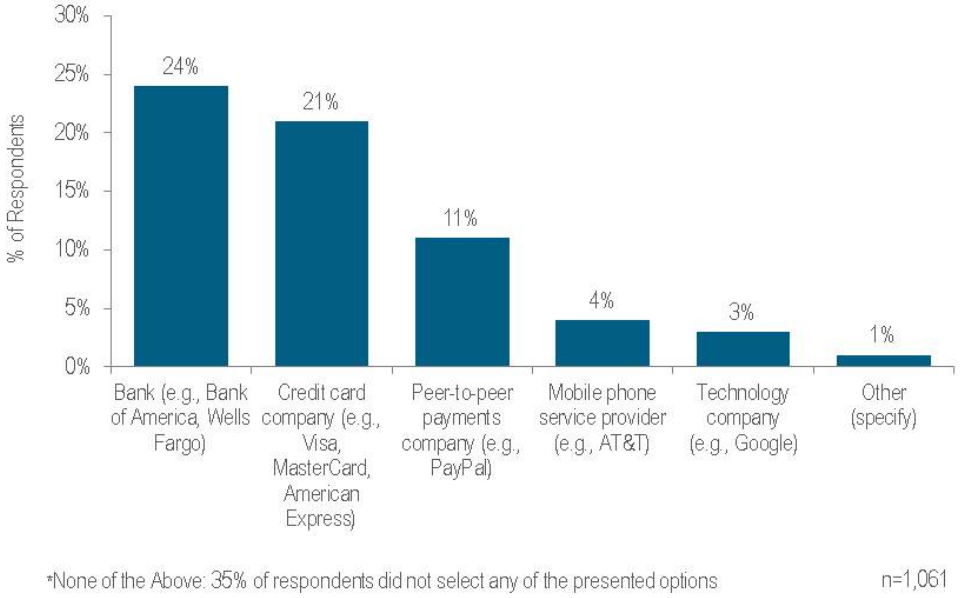
Figure 3. Percentage of Respondents Interested in Tying a Mobile Wallet to Select Payment Accounts.



Source: Cisco IBSG, 2012

Consumers also preferred traditional financial services players when asked about the type of company from which they would like to receive mobile wallet capabilities, as shown in Figure 4.

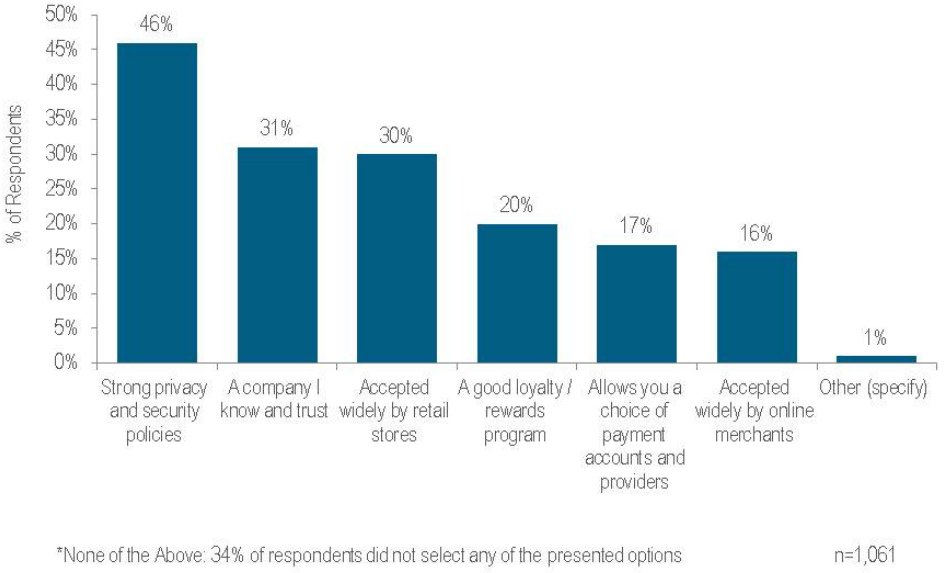
Figure 4. Percentage of Respondents Who Would Choose Select Organizations for a Mobile Wallet Service.



Source: Cisco IBSG, 2012

Consumers' preference for banks and credit card companies is also due to the fact that privacy and trust are the most important considerations when choosing a mobile wallet—areas where traditional financial services players have proven their value—and are followed closely by wide acceptance by retail stores (see Figure 5).

Figure 5. Factors Driving Consumer Choice in a Mobile Wallet Provider.



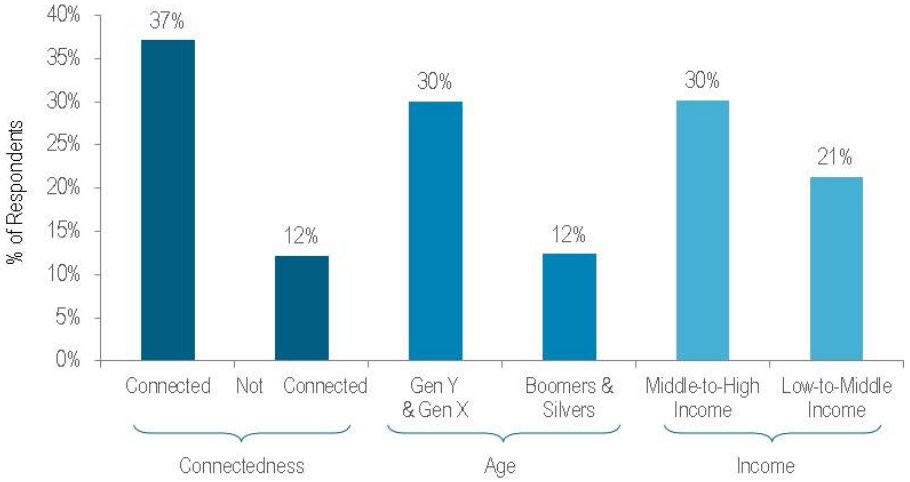
Source: Cisco IBSG, 2012

Traditional financial services providers are well positioned to offer mobile payment services, given the level of trust and brand reputation they have with consumers. In this respect, it is the incumbents' battle to lose if they do not actively participate in providing mobile wallet / payment capabilities. However, they are not immune to competition, especially from those players who offer mobile payments alternatives widely accepted among retailers and have attractive loyalty and rewards programs. The Walmart / MCX mobile wallet, for example, could be quite successful, especially if combined with interesting incentive programs.

The Case for Mobile Commerce

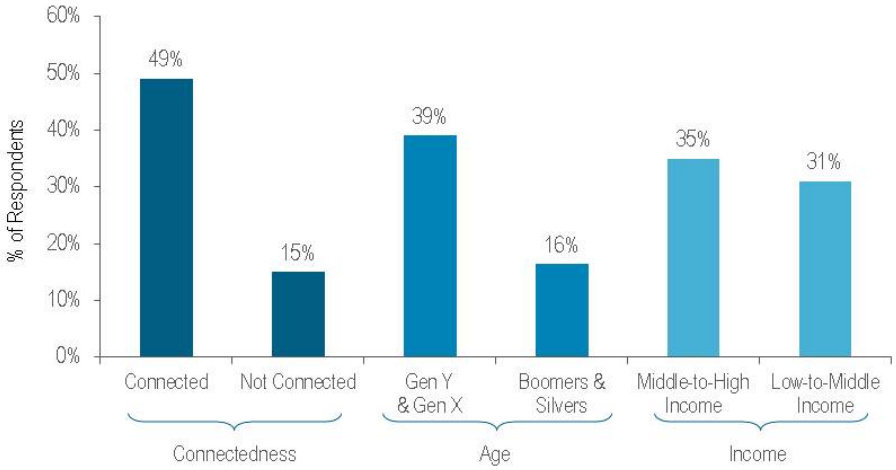
Mobile commerce is at the heart of the mobile wallet value proposition, manifesting in respondents' interest to use a mobile device for 1) making online purchases (see Figure 6) and 2) receiving retail offers such as coupons and rewards that can be seamlessly redeemed at the point of sale (POS), as shown in Figure 7.

Figure 6. Percentage of Respondents Who Expect To Conduct More Mobile Commerce by 2014.



Source: Cisco IBSG, 2012

Figure 7. Percentage of Respondents "Somewhat" or "Very" Likely to Accept Mobile Offers and Coupons from Favorite Retailers.

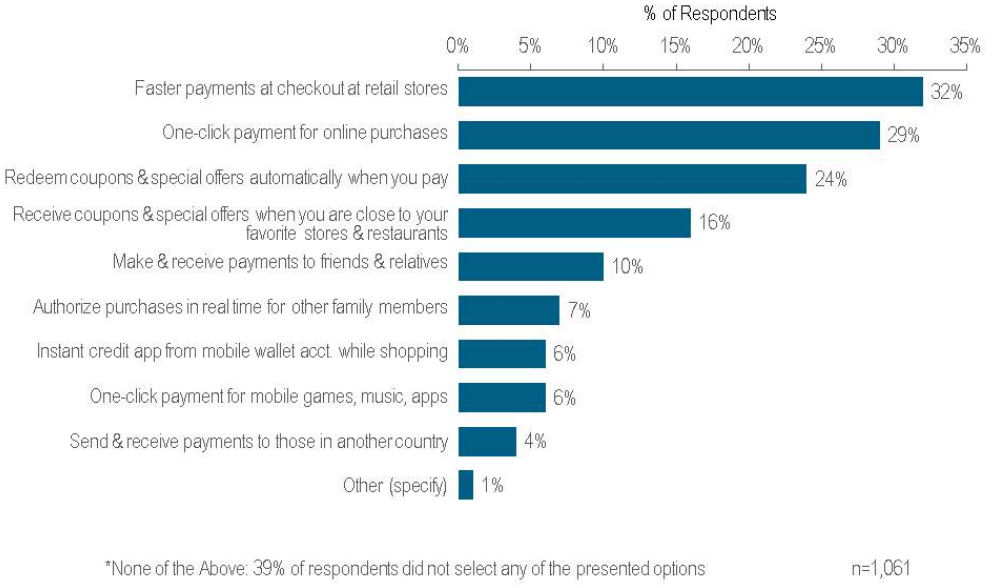


Source: Cisco IBSG, 2012

It is important to note that consumers highly value the ability to use their mobile wallet to facilitate online purchases with a single click versus entering more than 200 characters related to their credit card and address on a small mobile screen. One-click payment when shopping online via a mobile device is important at a time when the focus is on enabling payments in physical locations, and where NFC adoption—whether on the merchant or mobile side (the Apple iPhone 5 is not NFC-enabled)—is still lagging. Furthermore, one-click payment is especially important because mobile phones are expected to surpass desktops as the main access point to the Internet in the United States.[18]

Figure 8 shows the types of mobile features our study's respondents said they would find beneficial.

Figure 8. Top Benefits of a Mobile Wallet.



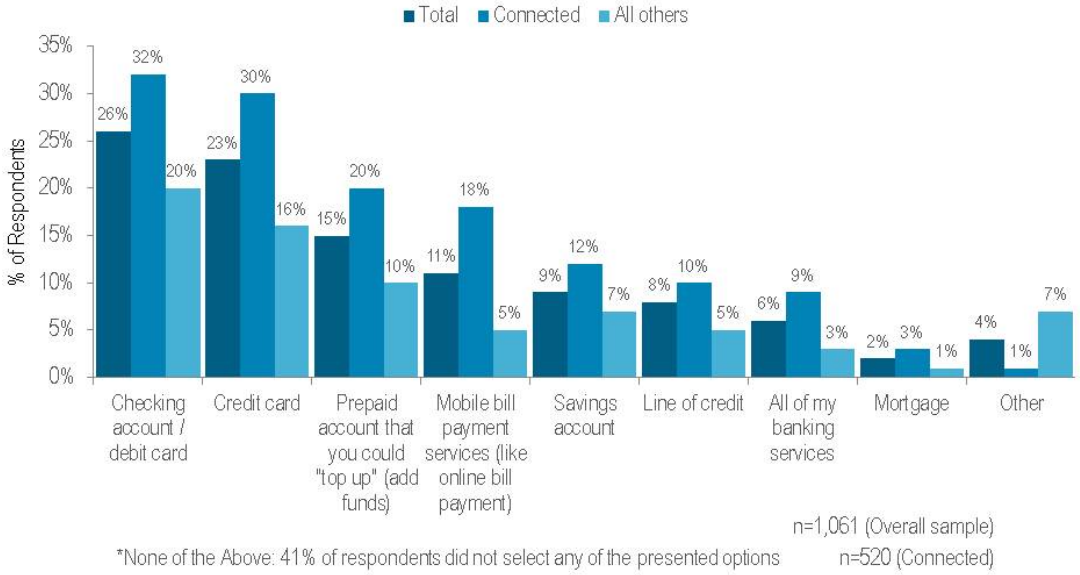
Source: Cisco IBSG, 2012

Mobile Wallet: A Gateway to Mainstream Financial Products

When it comes to mobile wallet ownership, the risk of disintermediation is not limited to payments. Our research shows that consumers who adopt a mobile wallet from a non-traditional financial institution are likely to accept other forms of financial services, starting with payment-related accounts, then moving to traditional banking products, including savings accounts and loans (see Figure 9.) This finding is further validated when considering strong demand for mobile-wallet-enabled financial services among the highly connected segment, which is growing rapidly.

[18] "Most Will Access Internet via Mobile Devices by 2015, IDC Says," *Computerworld,* September 12, 2011, http://www.computerworld.com/s/article/9219932/Most_will_access_Internet_via_mobile_devices_by_2015_IDC_says

Figure 9. Percentage of Respondents Interested in Select Services from a Non-Bank Mobile Wallet Provider.



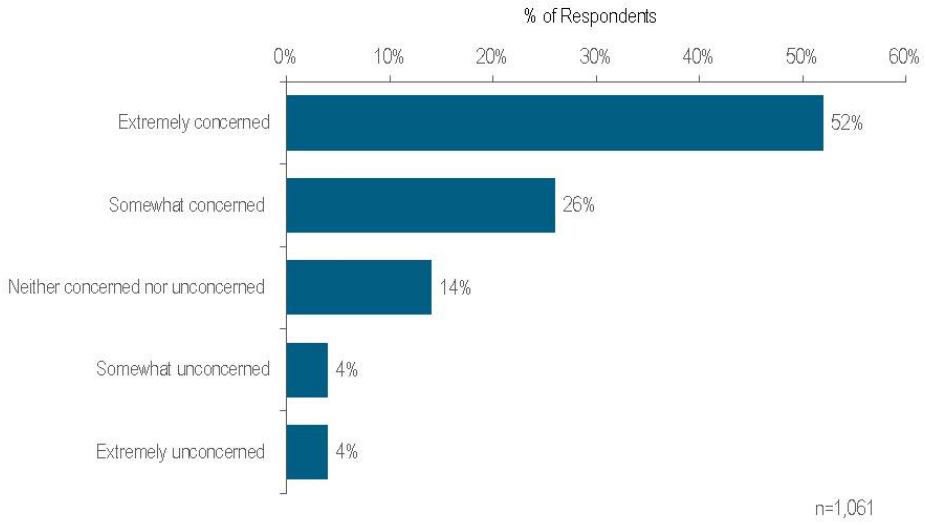
Source: Cisco IBSG, 2012

Emergence of Facebook Payments

When analyzing the impact of social networking on payments, Cisco IBSG focused mainly on the potential role of Facebook as a payments player, driven primarily by Facebook's significant penetration in the consumer arena, its application for money transmitter licenses, and its potential threat to traditional financial services institutions.

Cisco IBSG's findings from the consumer survey (which are consistent with those of the omnichannel study that addressed the risks that social media presents to banking in general) showed that 78 percent of respondents expressed concerns about privacy when it comes to merging social media with finances (see Figure 10).

Figure 10. Percentage of Respondents Concerned About Unauthorized Individuals / Organizations Having Access to their Personal Information.

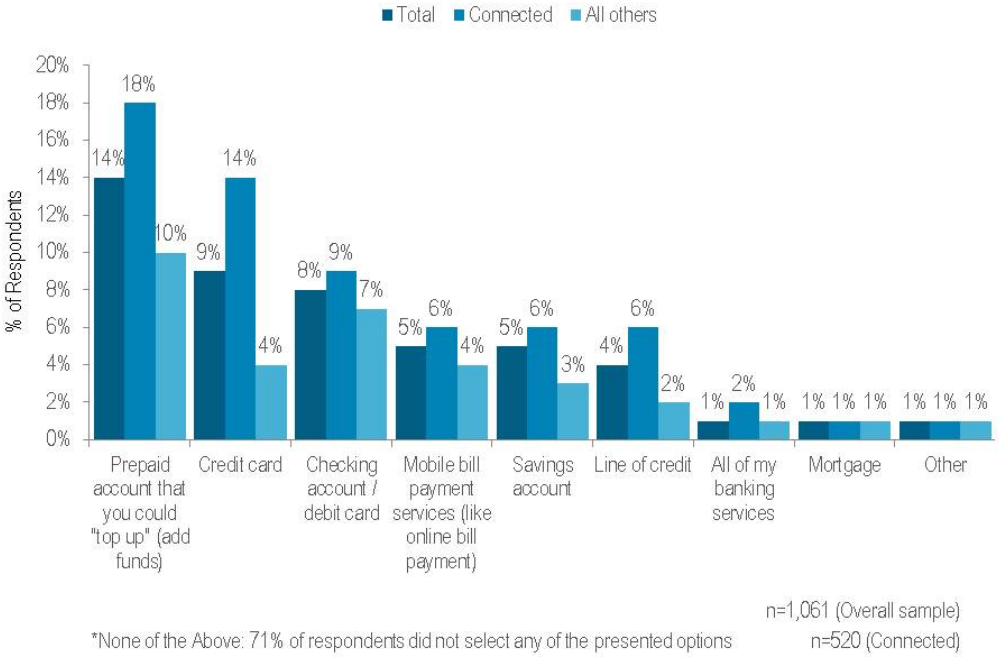


Source: Cisco IBSG, 2012

Consumer concerns over privacy do not preclude Facebook's potential role in payments: in our study, 17 percent of respondents said they were interested in a direct link to online marketplaces via Facebook.

Consistent with our mobile wallet findings, while almost none of the respondents showed a willingness to consider Facebook a full banking alternative, about 29 percent said that they were willing to consider payment or banking services if offered by Facebook (see Figure 11).

Figure 11. Percentage of Respondents Interested in Facebook Payment and Banking Services.



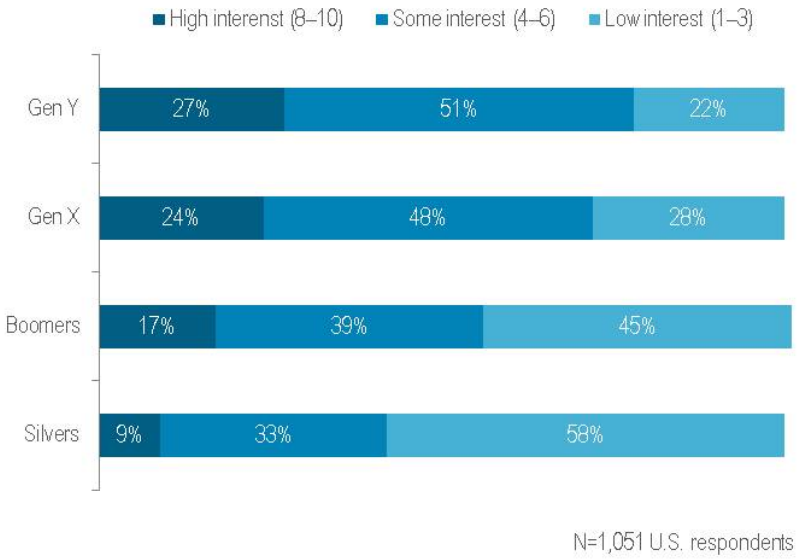
Source: Cisco IBSG, 2012

The Infomediary Opportunity

The Cisco IBSG studies revealed the importance of information security and the infomediary's role in managing, protecting, and potentially monetizing consumers' personal information on their behalf. We also refer to this service as "digital footprint management."

Our research also showed that there is a strong interest among consumers for a trusted institution to play the role of infomediary in charge of securely managing consumer data (see Figure 12). Such interest is expressed across all generations and is particularly strong among Gen Y, which often is assumed to be willing to share personal information in the virtual world without much concern for potential risks related to the misuse of such information.

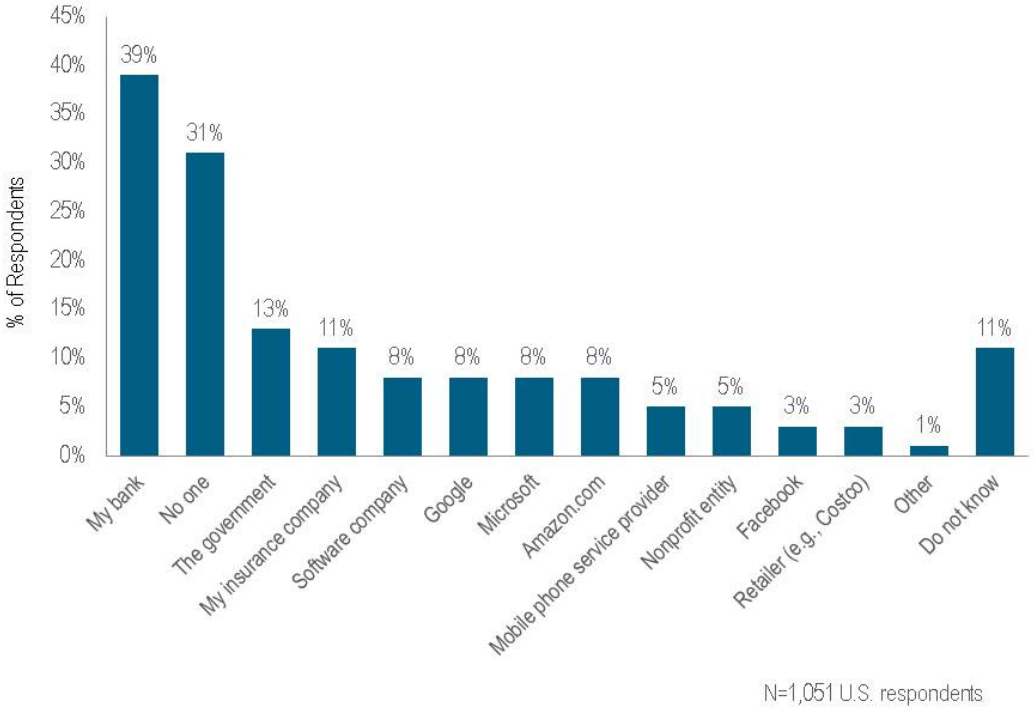
Figure 12. Interest in Digital Footprint Management by Age (U.S. only).



Source: "Winning Strategies for Omnichannel Banking: Cisco IBSG Global Research Reveals New Ways for Banks To Prosper in an Omnichannel World," Cisco IBSG, June 2012

When it comes to choosing an infomediary to provide a digital management solution to consumers, our findings revealed that banks are favored over governments, technology companies, telcos, and social networks (see Figure 13).

Figure 13. Organizations Respondents Are Willing To Choose for a Digital Footprint Management Solution.



Source: "Winning Strategies for Omnichannel Banking: Cisco IBSG Global Research Reveals New Ways for Banks To Prosper in an Omnichannel World," Cisco IBSG, June 2012

Next Steps

Engage Now through Alliances and Acquisitions

Traditional financial services players are well positioned to take advantage of the transformation emerging in the payments industry, as momentum and trust are on their side. However, new entrants—whether telcos, mobile platform owners, social networks, or, more recently, retailers—have sufficient footprint and credibility to significantly disrupt the payments value chain. If and when this happens, the damage is likely to spread to other banking products and services. Therefore, traditional players do not have the luxury of adopting a wait-and-see attitude. They must engage now through a combination of alliances and acquisitions to position themselves favorably. Examples of such partnerships are already taking place in the United States:

- **Isis Mobile Wallet** is an alliance involving telcos and financial services institutions, including JPMorganChase and Discover.
- **Google Wallet** has attracted the likes of Citigroup.
- **MasterCard's** recent acquisition of Truaxis will provide additional mobile commerce capabilities to its PayPass Wallet.

It is likely that industry standards will converge at some point as alliances continue to evolve and new, dominant technological capabilities emerge. However, the advantage of making an early move might prove critical as payments go mobile and perhaps social.

Focus on Areas of Greater Relevance

As they embark on the mobile-wallet journey, incumbents must pay particular attention to developing those features that are most relevant to consumers—such as security, convenience, and mobile commerce—and avoid areas where technology, maturity, or consumer acceptance have failed to materialize. Specifically:

- Develop commercial agreements / partnerships with key retailers to ensure:
    1. Partner-of-choice status when it comes to merchant-funded offers and joint marketing programs
    2. Seamless POS reconciliation using favorable standards and technologies
    3. POS-based services and discounts that generate service-based revenue for banks
- Invest in building world-class big data and analytics capabilities to enable the personalization needed for tomorrow's next-generation commerce.

Do Not Wait for NFC—Focus on What Is Achievable Today

The focus on NFC is overshadowing immediate opportunities. In reality, very few consumers have phones that are NFC-capable, and the recent release of the iPhone 5 without an NFC chip has wiped out any dreams of short-term consumer NFC uptake, especially in a context where less than 2 percent of merchants have a POS system equipped to process such payments.[19]

[19] "Apple and NFC: Will They or Won't They?" Payments.com, September 4, 2012, http://www.pymnts.com/commentary/apple-and-nfc-will-they-or-won-t-they/

Therefore, financial services institutions should focus on seamless, reliable online mobile shopping capabilities through virtualized and cloud-based payments, using a variety of "remote" alternatives (bar codes, proximity, and more) to enable payments in the physical world without NFC. Examples of viable alternatives are emerging rapidly, and include Starbucks (bar code-based), PayPal and Home Depot (phone number at POS), Square (proximity-based), LevelUp (QR code-based), and biometric-based alternatives.

Just as important is the need to enable the mobile wallet for online shopping. As noted earlier, entering payment and address information while shopping online can be taxing. With mobile becoming the device of choice for Internet access, mobile wallets should enable one-click payments when shopping online. This is a highly sought feature for our survey respondents, and is one that FinTech start-ups such as Dashlane are already targeting.

Anticipate and Address Consumer Concerns over Information Control

The Cisco IBSG studies clearly indicate growing consumer concerns about the use of their personal information at a time when life experience and human interaction are becoming increasingly digital.

It is essential for traditional financial services players to invest in developing a secure platform for consumer commerce and payments, given the need to access consumer information in building more accurate customer profiles that enable financial organizations to provide more relevant offers and win commerce value propositions. This point is especially true given consumers' trust in the incumbent financial services players' ability to safeguard and manage their personal information. Such a platform should address the need for:

- **Security—**over personal information and identity theft
- **Control—**defined, at a minimum, as the ability to opt-in and opt-out of offers
- **Relevance—**enabling consumers to define the types of offers in which they are interested or, potentially, to choose consumer-based revenue-sharing schemes in exchange for access to their information

The challenge for financial services players will be in delivering a platform that is financially attractive and viable.

Looking ahead, Cisco IBSG anticipates that as more and more "things" become connected to the Internet, payments will increasingly take place among machines; according to Cisco, more than 99 percent of the things in the physical world that could be connected to the Internet are currently unconnected.[20]

As this unfolds, the world of machine-to-machine (M2M) payments will certainly be on the menu of the next evolution of our payment systems. Think of your refrigerator ordering milk from a supermarket POS nearby for you to pick up on your way home, or your roof paying for repair work as it detects a leak. Additionally, we can expect M2M payments to result in a large number of micropayments that need to be processed seamlessly.

[20] "How the Internet of Everything Will Change the World...for the Better," Dave Evans, Cisco, November 2012, http://blogs.cisco.com/news/how-the-internet-of-everything-will-change-the-worldfor-the-better-infographic/ -more-90780

Implications for traditional players will be addressed in subsequent Cisco IBSG thought leadership. It is clear, however, that many of the capabilities required for M2M payments will be gained by developing and investing in the mobile payments services of today.

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