MERCHANT PAYMENT ACCEPTANCE AND MOBILE SERVICES

A reality check at large merchants in Germany and the UK
Payments, at its core, is a market that thrives on economies of scale. Many products and technologies have been presented and discussed over the years. Some seem revolutionary and some just outrageous, but they all have one thing in common: If a product cannot gain traction with both consumers and merchants, it will not scale.

While it is interesting to look at pilot projects that show off new technology and great ideas in localised areas, to be considered truly impactful in the realm of payments and commerce, we have to take a look at the big players.

To get the big picture, we conducted a reality check with the intent of seeing how far the largest merchants are in regard to payment acceptance at the POS and what exactly they are doing in regard to mobile services.

To achieve the aforementioned relevance, we decided to focus our research on the truly big players in retail. To this end, we selected 60 merchants over seven verticals in two European countries: the UK and Germany.

The selection was made by identifying the largest merchants of each vertical to generate a representative group for the market. In this way, it represents the importance of sectors such as food, but does not overshadow all other sectors, as if we used a direct volume approach.

The data collection took place at the end of 2015 and thus shows a snapshot of reality. Research was done primarily with publicly available sources.

1. REALITY CHECK FOR MERCHANT PAYMENTS

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<thead>
<tr>
<th>UK</th>
<th>GERMANY</th>
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<td><strong>Food</strong></td>
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<td>ASDA</td>
<td>REWE</td>
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<td>Sainsbury’s</td>
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<td>Morrisons</td>
<td>Hornbach</td>
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<td>TESCO</td>
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<td><strong>Fashion &amp; Clothing</strong></td>
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<td>Argos</td>
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<td>Currys</td>
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<td>Saturn</td>
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<td><strong>Furniture &amp; Decoration</strong></td>
<td><strong>Furniture &amp; Decoration</strong></td>
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<td>Dunelm</td>
<td>IKEA</td>
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<td>Apple</td>
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1 Department stores are retail establishments offering a wide range of consumer goods in different product categories known as “departments”. This goes beyond the narrower classic definition sometimes used in the UK including independent departments with their own staff and their own tills. Thus it can also include some variety stores and other multi category merchants.
2. MARKET OVERVIEW

The two analysed countries differ significantly in their retail payment mix at the POS as well as their retail concentration.

The UK is an advanced payments market with 69% of POS volume being paid for with cards and only 31% still being cash-driven.

Furthermore, the fact that 30 tracked merchants in our analysis make up 50% of the transaction volume shows a significant retail concentration in the UK market.

On the other hand, Germans are traditionally considered “cash-loving people”. While more than two thirds of the UK POS volume is paid with cards, Germans are more conservative and still pay 55% of their purchase volume in cash.

In addition, the retail concentration is not as advanced but still on a high level with 37% of German retail volume being contributed by the tracked top 30 merchants.

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1 Analysed 30 merchants in relation to total retail volume of the country
Source: EPC Yearbook 2014-15; Statista; INNOVALUE
3. STUDY APPROACH

After selecting the relevant merchants, we collected basic information such as group association, country of origin, retail volume of the brand and group within the country. Further relevant data was collected to analyse each merchant in two dimensions.

- **Payment acceptance**: What kind of payment methods does the merchant accept at the POS?

- **Mobile services**: What kind of value added services (VAS) does the merchant offer his customers via his own mobile app/s?

From this we derived different maturity levels ranging from 0 to 3 (acceptance) and 0 to 4 (mobile VAS).

Each merchant was assigned two separate maturity levels according to his most advanced accepted payment method and offered service, respectively.

It is to be noted that we only considered single branded apps by the merchants available on the relevant app stores during the research period. We did not include 3rd party apps such as Payback or Nectar nor mobile-optimised web sites.
4. RESULTS:

4.1 MERCHANT PAYMENTS ACCEPTANCE AT THE POS

The UK merchants show a significantly higher maturity level regarding payment acceptance.

Acceptance of contactless payments in the UK has especially been pushed by factors such as the adoption by Transport for London and the initial European introduction of mobile wallets (e.g. Apple Pay).

The German market is expected to catch up slowly due to initiatives led by the schemes, implementation of regulation as well as the introduction of mobile wallets. This will lead to consumer demand and force the merchants to implement more advanced payment acceptance.

Overall 63% of merchants in the UK already offer contactless payments while the number in Germany is only half of that (30%).

All of the analysed UK merchants accept credit cards. Credit card acceptance was pushed significantly when the UK switched from a domestic debit scheme to the international debit scheme Maestro by MasterCard. “Honour all card” rules promoted the acceptance of credit card acceptance alongside debit cards.

About 27% of the merchants in Germany accept only debit cards and no credit cards. These numbers were even higher before the recent effects of the interchange regulation and, they are expected to decline further.

Within the top five German food retailers, three merchants (Aldi, Lidl, and Netto) joined their two peers (Rewe and Edeka) in credit card acceptance last summer.

This adds over EUR 57 billion in potential credit card volume. With food retail accounting for about one third of the German retail market we expect a significant rise in credit card spending.

Neither the UK nor Germany have any large merchants left that do not accept card payments.

Analysed merchants per maturity level in %

<table>
<thead>
<tr>
<th></th>
<th>GER</th>
<th>UK</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash only</td>
<td>0%</td>
<td>0%</td>
</tr>
<tr>
<td>Debit cards</td>
<td>0%</td>
<td>0%</td>
</tr>
<tr>
<td>Credit cards</td>
<td>37%</td>
<td>30%</td>
</tr>
<tr>
<td>Contactless (card, phone, wearable)</td>
<td>43%</td>
<td>63%</td>
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In regard to mobile services, we see a more balanced picture. Both countries show a high number of innovators (46 % UK, 33 % GER) that offer interaction with the local store systems or even full proximity payments.

True omnichannel experience, the holy grail of retail, necessitates tracking of the customers and integration into the store systems. Thus only these players at maturity level 3 and 4 are ready for the future of retail.

Almost half of the UK’s top merchants do not offer their own mobile app. This is far more than in Germany (44 % UK, 27 % GER). Some of the UK merchants have abandoned their own apps for mobile-optimised websites and 3rd party apps such as Nectar.

In Germany, there is a significant number of merchants that offers only standard online services via an app without any true integration into the merchant’s local store systems.

### Analyzed merchants per maturity level in %

<table>
<thead>
<tr>
<th>Maturity Level</th>
<th>No app</th>
<th>Pure content</th>
<th>Online services via app</th>
<th>Interaction with store system</th>
<th>Proximity payment</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>GER</strong></td>
<td>27 %</td>
<td>7%</td>
<td>33%</td>
<td>23%</td>
<td>13%</td>
</tr>
<tr>
<td><strong>UK</strong></td>
<td>43%</td>
<td>3%</td>
<td>33%</td>
<td>33%</td>
<td>10%</td>
</tr>
</tbody>
</table>
To facilitate further analysis, we combined the two analysed maturity levels and clustered the different players according to their position.

In general, we expected and indeed found a typical development path which is shown as the highlighted corridor.

Within this corridor we can cluster the analysed merchants into four distinct categories:

- **Innovators and First Movers**: These merchants offer their customers the most extensive services – both in mobile services and payment acceptance at the POS.
- **Followers**: Merchants that take time and create offerings if customer demand is increasing or effort/costs are negligible.
- **Players without mobile offering**: Some merchants do not invest in mobile services.
- **Outliers**: Select merchants outside the general development path, advance in one dimension while neglecting the other.
In Germany, we observe a strong correlation between the level of mobile service offerings and the payment acceptance strategy.

**Innovators and First Movers:** In Germany, Innovators come from all verticals and offer the consumer both comprehensive mobile services and at least credit card acceptance. Examples are Netto and Edeka which both use a similar white label closed-loop payment app with automatic coupon redemption at the POS. Douglas, on the other hand, has digitalised an existing loyalty and payment card into their app.

**Followers:** One third of German merchants fall into this group with only a basic mobile offering. This group primarily consists of DIY markets and food discounters.

**Players without mobile offerings:** In Germany these consist primarily of low-cost discounters, mostly furniture stores.

**Outliers:** Ikea, for example, aims for an omnichannel experience with their app and mobile loyalty solution. However, at the time of the data collection Ikea offered only debit card payment. Market experts expect that Ikea will roll out credit and even contactless acceptance in early 2016.
In the UK, there is a sharp divide between innovators and players without mobile offerings that offer no dedicated mobile apps.

- **Innovators and First Movers**: Similar to Germany 43% of merchants offer their customers extensive mobile services. All of these also accept contactless payment. Identified players come from diverse segments such as food, electronics and departments stores.

- **Followers**: Only three of the 30 players are in this cluster with a dedicated app that is not integrated into their local store system.

- **Players without mobile offerings**: In the UK, there is a large amount of players without a mobile offering which also primarily consists of low-cost, discounters.

- **Outliers**: In the UK, customer demand has led to advanced payments acceptance. Some merchants such as Selfridges have announced that they will invest heavily into their mobile offering to make their multi-/omnichannel offerings “future-proof”.

As mentioned before, we observed some players who turned their back on their own apps. These include the co-operative food with a focus on a mobile optimised website and Sainsbury’s who utilise the 3rd party app Nectar for mobile VAS. Both closed down their special offers/deals apps.

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### 4.5 Maturity Matrix Overview – Top 30 UK

![Maturity Matrix](image)

- **Mobile Service Maturity Level**
  - 4 Proximity payment
  - 3 Interaction with store system
  - 2 Online services
  - 1 Pure content
  - 0 No app

- **Acceptance Level**
  - Cash
  - Debit
  - Credit
  - Contactless
5. CONCLUSION: PAYMENT & COMMERCE STRATEGY

Through the combined evaluation of payments acceptance and mobile VAS we believe that both the innovation focus (Innovators and First Movers) and the core business focus (Player without mobile offerings) are valid approaches. The “stuck in the middle position” (Follower) should be avoided. Offering pure online services via an app alone, without true gains for the consumer, is not instrumental in achieving business success in retail.

From our perspective, the future payments strategies of merchants should be implemented in a way that aligns payment mix, sourcing, and operational management in a unified and optimised way, both at the POS and in all other channels.

In order to formulate such a strategy, merchants need to find answers to the following questions:

- Which payment methods will the merchant’s customers demand in the future?
- Which payment methods can be utilised to optimise the merchant’s payment costs while providing the best possible support for the core business?
- Which services should be provided by external service providers and who are the best providers for the merchant’s specific requirements?
- What regulatory changes have to be considered?
  - How can the merchant benefit from positive regulation and minimise negative impacts?
- What current and future technological developments have to be considered and/or anticipated?
- How are internal processes and structures to be adapted to best support the future payments strategies?

We encourage merchants to take a strategic approach to payments and commerce. Only through a viable long-term strategy can merchants support their core business to the fullest.
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Our clients have realised that few management advisory firms hold a comparable level of expertise in our industries of focus.

- **Collaborative advisory:** The best advice is never developed in isolation, behind closed doors, but in partnership with the client. Hence INNOVALUE’s team works as “one team” through a collaborative approach with the clients’ team. This partnership not only makes a difference in terms of quality and value of our advice, but also contributes to a positive impact at a personal level through mutual trust. These factors provide the foundation for recommendations and conclusions that are endorsed, shared and supported, and ultimately implemented, within the client’s organisation.

- **Actionable strategies:** A good strategic analysis which does not stand a chance of being implemented for whatever reason does not have any value. This is why INNOVALUE’s consultants take particular care that recommendations are realistic, feasible, endorsed, shared and supported, and ultimately implemented. At INNOVALUE, this one of our core principles – as INNOVALUE delivers “high-value consulting, down to earth”.

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