

The High-Tech



Payments

Battle

The smartphone is changing how payments are made, but the details are far from settled. Could retailers eventually face another interchange fee scenario?

There's a scene in the 1974 classic film *Blazing Saddles* where Sheriff Bart (Cleavon Little), Jim (Gene Wilder) and Mongo (Alex Karras) erect a tollbooth outside of the fake Rock Ridge, an effort to slow Taggart's (Slim Pickens) advancing gang, which has arrived on horseback.

Requiring each rider to pay a 10-cent toll, it's just one in a long line of comedic moments, as neither Taggart nor his men seem to realize the tollbooth is in the middle of a vast desert, and that they could easily avoid the toll by riding around the gate.

I've been thinking about that scene recently, in light of the controversy surrounding the Durbin Amendment and the effort to reform interchange fees. But while Taggart and his men didn't seem to see a thruway alternative, retailers are beginning to understand that customer payments do not filter solely through Visa and MasterCard.

No matter the outcome of Durbin (think of it as the fight to reduce the tollbooth payment), a number of viable payment alternatives – those that avoid the tollbooth – are beginning to emerge, and they center around the smartphone.

The Future Is Now

For my nieces, it's a dedicated text message machine, for my dad, it's a telephone whose buttons are "too damn small," and for my wife, it's the medium for hurling angry birds at pigs. The smartphone is indeed a versatile tool that appeals to consumers in a variety of ways, an indispensable device whose ubiquity makes it such an attractive – and convenient – vehicle for payment.

As such, its ascension to a preferred payment vehicle could make the card companies – the middlemen in credit and debit card transactions and the cause of today's oppressive swipe fees – far from the monopolistic leviathans they are today, and the only ones standing guard at the tollbooth. (Although they are working to gain a foothold in mobile payments.)

And the fact is, mobile payment technology is already underway. "[T]here are bankers out there [who] still persist in the belief that mobile payments via your iPhone will take years to 'take off,' writes Brett King, a blogger for Finextra Research, an information source for the financial technology community. "[T]hose [who] think this will take another three to five years to honestly

compete with plastic mag stripe or chip-and-pin POS terminals need to change their terms of reference."

In fact, non-traditional (read: non-credit card) payments are standard procedure for online giant eBay, whose customers use PayPal, a push payment format – available online and through an app – where a consumer directs his bank to pay a merchant or even another private party (think of a purchase at a garage sale). The transaction is immediate and it bypasses a processor, and the fraud risk and data security concerns are virtually non-existent.

While PayPal's existing model focuses on online payments, a sizable number of its customers already use PayPal from mobile devices. Of the company's 87.2 million active account holders, 5 million regularly use PayPal from mobile devices, from which the firm processed \$141 million in payment volume last year, notes *Wall Street & Technology* (WST), a multi-platform publication focusing on technology concerns of the financial services industry. And this year, PayPal's mobile payment volume is expected to triple to \$500 million. It's a hefty number, but according to experts, it's just a start. By 2014, the total value of U.S. mobile payments is expected to reach \$214 billion, up from \$16 billion in 2010, according to a 2010 Aite Group report.

"Firms missing the signs that the market is now rapidly shifting will be at a serious disadvantage in the next few years," said Gwenn Bezar, research director with Aite Group, a financial services company, and author of the report.

The Mobile Payment Buffet

So the future is here, but the dust is far from settled, with a number of competing technologies emerging.

"Mobile payment trials and providers

abound,” declared WST, citing four contactless mobile payment schemes currently under development: a coalition of AT&T, Verizon, T-Mobile, Discover and Barclaycard; a partnership between First Data and Tyfone; a partnership of Visa with DeviceFidelity; and Apple iPhone contactless payments. “Then there are mobile payments services such as PayPal Mobile, Mobile Pay...Boku and Square — to name only some.”

“[It’s] a science project...a big mess, with a lot of companies trying to get off the ground,” Bezard told WST. “That’s the process of innovation and competition. Over time we’ll find some consolidations; some players will disappear.”

As such, while some companies, simply by virtue of their size and resources, are considered stronger contenders, “Almost anyone could throw his or her hat in the ring and carry off the prize of mobile payment dominance, the way Google rode off with the search market,” WST wrote.

Touch, Don’t Swipe

The technology generating sizable media buzz is near-field communication, or NFC, which involves tapping an NFC chip-equipped phone to an NFC-enabled POS reader. It’s a simple touch-and-go procedure that quickly and conveniently processes a transaction.

Japan has been using NFC technology to process mobile phone payments since 2004, and its success has bred dozens of test trials in the United States. In 2008, for example, San Francisco’s commuter train system, Bay Area Rapid Transit, launched a four-month test where select commuters could pay for their tickets using a Spring NFC-equipped phone. The process was clean and efficient, but widespread adoption carries one major hurdle: cost.

“The challenge to [retailers is] converting the pay points,” said David Mun-

son, executive director of client management and sales for petroleum at Heartland Payment Systems, the fifth largest payments processor in the United States. “Inside the store, you’ve got one or two pay points to convert, and outside the store, depending on the number of pumps involved...you’re looking at multiple pay points at a retail location and the cost for doing that.”

And it’s not just cost that makes NFC an unlikely and imminent game changer. The technology itself is fraught with inconsistencies.

“As anyone who’s tried to use their contactless card recently will tell you, even terminals that are supposedly contactless-enabled often do not work properly, because they have not been maintained,” said Aaron MacPherson, practice director of payment and security for IDC Financial Insights, commenting at Finextra.com. “And even if they did work, there’s only about

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150,000 of them at most...miniscule compared with the 4 to 5 million [card swipe] terminals in the United States.”

King says such considerations ignore the momentum behind consumer experience and expectations when it comes to the mobile phone. “The dominant position from the card issuers and...banks is that there is already an existing point-of-sale infrastructure in place in the United States, for example, that will take years to replace with NFC or contactless capable terminals,” he wrote.

“Except prior to 2007, there were no [smartphone] apps...but that didn’t stop Apple from creating [them] as part of the iPhone ecosystem...Apple and Google are working on alternate payment schemes that will circumvent the traditional POS systems and networks,” King added.

And at least one bank has already done so.

There’s an App for That

Chase Bank, for example, offers a smartphone app that allows its customers to deposit checks simply by taking a photo with their smartphone of both sides of an endorsed check (remote deposit capture), as well as to make payments to and receive funds from anyone (peer-to-peer payments), as long as they have an e-mail address and are also enrolled in the service.

Either process takes less than a minute, and bypasses the card companies entirely. More importantly, it doesn’t require an extra piece of hardware.

“That kind of technology is reinventing the banking relationship,” said Gray Taylor, cards payments consultant for NACS and executive director of PCATS. “The smartphone, the iPhone, they’re changing the face of payments. For the customer, they get their money a lot faster. And for the bank, it saves them time and money, too.”

Retailers are also getting involved in

the mobile payment system.

Starbucks launched its Starbucks Card mobile app earlier this year, a cashless and plastic-less way to pay for purchases at the company’s 6,800 U.S. locations. The app generates a unique barcode that a Starbucks cashier scans (the same scanner used to scan food item barcodes), which then instantly deducts funds from the consumer’s in-the-clouds payment account.

Currently, consumers refill the account using a credit card (aha!), but Taylor said refilling mobile payment accounts would eventually circumvent the card companies altogether by linking to a bank account.

“The credit card is in danger,” Taylor said. “A better way to link the payment is to push money directly from a checking account via ACH [automated clearing house], it saves a ton of money.”

How much money?

“It costs less than half-a-penny to process an ACH transaction,” Taylor

Security Concerns

Mobile payments may be the future of funding transactions, but much work has to be done, especially relating to security.

“Right now, mobile payments are not safe,” warned Taylor, “and every new offering is likely susceptible to viruses, and not just across the network, but via Bluetooth and Wi-Fi.”

Indeed, earlier this year, the PCI Security Standards Council sent letters to several mobile payment applications, informing them that they were being de-listed from its approved list until the Council could verify that their mobile payment software adequately protected consumer data.

said, "Versus a minimum 17 to 20 cents for a credit card transaction."

You do the math.

Cardholders Join the Fight

Of course, with such dramatic changes looming and with so much at stake, the card companies are not sitting idly by focusing on the status quo.

In March, Visa announced it would launch person-to-person payments in the United States later this year, a digital payments option that extends Visa's reach from the point of sale into the clouds, whereby Visa account holders will be able to send money to anyone who owns a Visa card anywhere using their 16-digit card number, a digital service that it predicts will "enable a new generation of personal payment services," according to its press release.

"We are going to compete not just with PayPal, but other emerging payment schemes," said Joseph Saunders, Visa's chief executive and chairman, during a fall 2010 conference call announcing the company's commitment to mobile payments technology.

American Express is joining the fray, too. In March, it launched Serve, a digital wallet that allows mobile payments, even for non-AMEX cardholders.

Users of the service, which can be accessed through a smartphone (as well as online and with a card), link a bank or card account and direct which one to use when funding a payment.

"It's no secret that the world is moving towards digital transactions, and our goal is to be a market leader," said Dan Schulman, group president for enterprise growth at American Express, to *American Banker*.

The Challenge for Retailers

The real fight, of course, will be around consumer adoption. For that to occur,



the technology must be simple and convenient. But more important, it must be pervasive and accessible. And whoever can tap into those elements stands a strong chance of succeeding (from that standpoint, betting against Google or Apple would seem short-sighted).

There is much to be settled, and how the payment industry looks a year or two from now is anyone's guess. But one thing is certain: Change is coming, and the payment landscape will look different. And the challenge for merchants, therefore, is to ensure a voice in the outcome.

"The c-store industry needs to band together, and with other industries," Taylor said. "They are a critical part of the payments system. They need to stand up and say, 'We will no longer let you come to us with a mandated design.'"

And unless merchants get involved and design the new platform, "They can look to The Who to sing the outcome," Taylor said: "Meet the new boss, same as the old boss."

And of course, that will mean getting in line at the tollbooth. **NACS**

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