MOBILIZING THE STORE CARD

Just as they once issued proprietary plastic, retailers are introducing their own mobile wallets. But just how much consumer appeal do these apps have, and will they work equally well for all merchants?

BY JOHN STEWART

In the business of mobile payments, everyone is familiar with the trio of so-called Pays—Android Pay, Apple Pay, and Samsung Pay. After all, the apps are backed by major corporations that have thrown considerable resources into marketing to both consumers and merchants.

But everyone in this business is also quite familiar with the mobile app offered by Starbucks Corp. If you're a merchant, it's likely you've been paying very close attention. The Starbucks app, which includes the coffee chain's reloadable prepaid card, has grown phenomenally from its modest origins at 16 stores in September 2009. It now accounts for one-fifth of all the chain's transactions.

That has not gone unnoticed. In the past year, prominent merchants like Wal-Mart Stores Inc., CVS Health Corp., and Kohl's Corp. have rolled out proprietary mobile-payments apps. Long before that, Dunkin' Brands Group Inc. and the massive Subway sandwich chain had joined Starbucks in the fast-casual segment with their own wallets.

More are expected to follow, and soon. Retailing giant Target Corp. said in January it plans to launch a mobile wallet some time this year, without being more specific, according to a report by Reuters.

"Multiple retailers have a number of engineers working on mobile apps," says Mohammad Khan, a payments-industry veteran who is now president and cofounder of OmnyPay Inc., the San Francisco-based company that developed the Kohl's Pay app. "The mobile app is the most critical asset these retailers have."

Given competitive dynamics and results like those of the Starbucks wallet, it's not hard to see why more merchants are building their own apps. What's less clear is whether all such apps are created equal. Certain mobile wallets, experts say, are more likely than others to succeed.

"A shakeout is inevitable. Some of these [proprietary apps] will fall by the wayside," predicts Ryan Douglas, an analyst who follows store cards at First Annapolis, an Annapolis, Md.-based consultancy.

'WALLET-FREE' EXPERIENCE

Still, several factors have combined to create favorable conditions for store-controlled wallets. For one thing, what might be called "mobile consciousness" among customers has shot up in a remarkably short time, forcing retail management to adjust. While just 16% of retailers reported in 2015 that their customers always or frequently made purchases on a mobile device, fully half reported the same thing only a year later (chart, page 26).

Another factor has to do with the wads of money merchants are leaving on the table because of what customers perceive as shoddy service. One firm estimates these lost sales total $150 billion annually (box, page 26). A mobile app can begin to repair that relationship with faster checkout times, free products via rewards, fuller product information, appointment-setting and order-ahead capability, and other benefits.

Walmart Pay, for example, tries to save time for customers by letting them scan a code while in line at the cash register. That allows them to walk away as soon as the cashier has scanned and bagged the items. "That's where the general-purpose wallets fall down," says Zilvinas Bareisis, a senior analyst who follows payments at Celent. "They don't have that. It's a pure payment experience."

Yet another force behind proprietary apps is the inherent strength of the retailer's brand. For at least nine chains, the proprietary charge or prepaid card accounts for at least one-third of sales (chart, page 24), building a stronger customer bond while reducing interchange costs for accepting general-purpose credit and debit cards.

Merchants may be able to magnify that result with cards embedded in a mobile wallet. Users of digital cards spend on average 20% more than customers using the plastic versions, says Kelly Kroskie, senior director of acquisition and digital capability at Alliance Data Systems Corp., a Plano, Texas-based company that creates and runs private-label card programs, both plastic and mobile.

"We're also seeing they take more trips to the store," she adds, perhaps because of the convenience. "I can just pull the card up on my phone easily," she says, "so I can get in and out more quickly."

Some venues do even better. The average ticket growth is 30% for CardFree, a San Francisco-based developer that has built mobile apps for Dunkin' and other fast-food companies, according to Jon Squire, CardFree's chief executive.

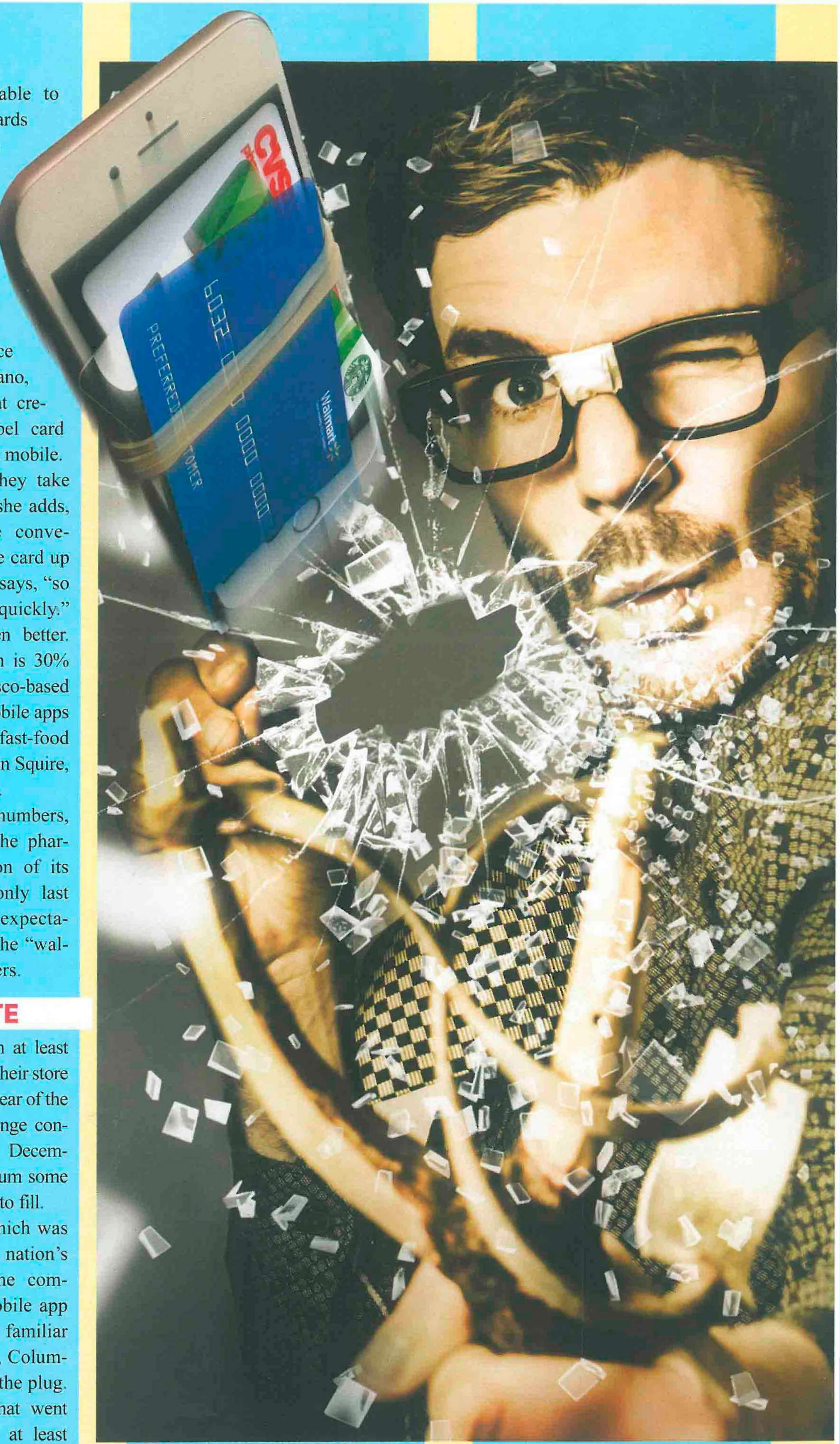
CVS won't cite any numbers, but a spokesperson for the pharmacy chain says adoption of its wallet app, introduced only last summer, is exceeding expectations, in part because of the "wallet-free experience" it offers.

CURRENTC'S FATE

But what may have driven at least some merchants to digitize their store cards was the collapse last year of the Merchant Customer Exchange consortium ("Merchant Pay," December 2015). That left a vacuum some major retailers have rushed to fill.

The MCX venture, which was controlled by 40 of the nation's biggest chains and airline companies, was piloting a mobile app called CurrentC in that familiar consumer-product testbed, Columbus, Ohio, when it pulled the plug.

Opinions differ on what went wrong, but observers say at least



some of the member companies were clearly prepared to move ahead with their own wallets once it became clear CurrentC wasn't panning out. Indeed, Wal-Mart announced Walmart Pay months before MCX shut down its project last June. CVS, another member, launched CVS Pay just two months later.

"Wal-Mart came out [with Walmart Pay] right away. They must have started on that long before" CurrentC failed, says OmnyPay's Khan. As for CVS, the spokesperson says only that the company's Digital Innovation Lab developed CVS Pay "in a matter of months" before the August 2016 announcement.

COST-CUTTING FOLLIES

With a number of retailer mobile apps already in the market and more on the way, observers are starting to speculate on the proprietary wallets' prospects for success. While several store card programs command significant shares of sales, it's not clear that store apps can do as well.

Five of the top-performing store card programs, for example, are mixtures of private-label plastic and cards cobranded with Visa or MasterCard. One program, that of outdoors retailer Cabela's, is purely a cobranded affair. To avoid sharing customers—and the data they generate—some experts argue merchants should concentrate on a proprietary wallet featuring only proprietary cards.

"The repeat customer is the one that's going to use the wallet," says OmnyPay's Khan. "You have to deliver the right value." And that's easier to do, he argues, with an app and a card completely controlled by the merchant.

But Khan and others caution that retailers should avoid one big trap: the idea that a proprietary wallet should be used chiefly to drive down payment card acceptance costs. As much as merchants abhor interchange, "it's not really about private-label cards and forcing everybody into a cheaper payment method," says Celent's Bareisis. "I think that thinking has gone away."

Long-time mobile-wallet observers agree. "If [merchants] are looking at [apps] to control costs or beat the banks into submission, I don't think that cuts it," says Cherian Abraham, digital payments and commerce executive at Experian Decision Analytics.

Even Wal-Mart, a staunch advocate for lower acceptance costs that last year shut Visa out of some of its Canadian stores in a row over interchange, allows customers to load any card in Walmart Pay. And some observers argue that MCX's strong focus on putting a lid on these costs may have been a big weakness for CurrentC.

But that doesn't mean cost isn't a potential problem. Retailer wallets could face considerable competition from Chase Pay, an app from banking giant JPMorgan Chase & Co. that launched in November and offers discounted processing through the bank's ChaseNet acquiring platform. Holders of any of Chase's 90 million credit and debit cards can load those cards into the app.

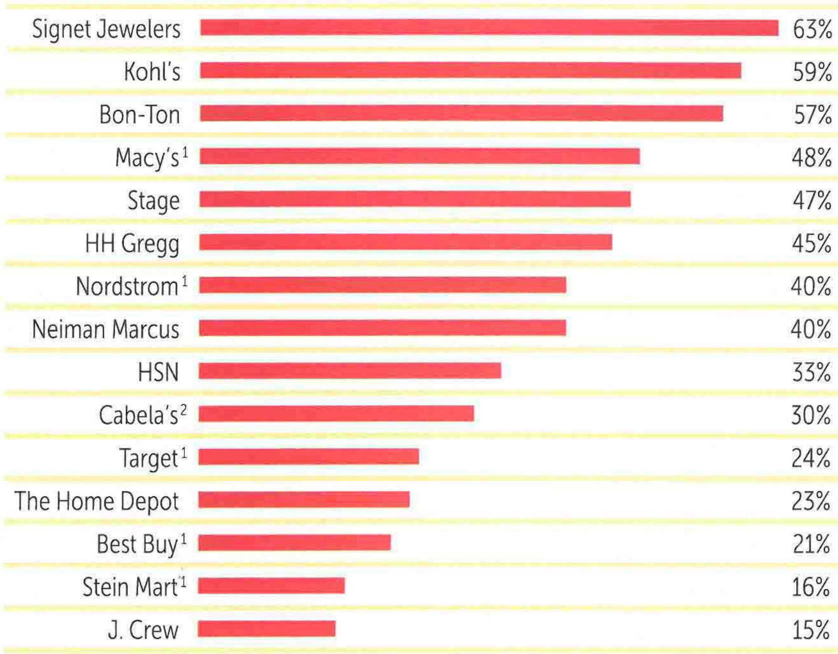
Chase has already cut deals with retailers like Starbucks to embed Chase Pay in their apps as a payment method. "Chase Pay is unique in that it is promoting itself into retailer apps as a cheaper acceptance option," notes Michael Moeser, director of payments at Javelin Strategy & Research, by email. "This probably has one of the strongest opportunities to succeed since it can be a standalone Pay and sit inside a retailer wallet."

'APP FATIGUE'

Other challenges confront retailers launching or investigating wallets. Some of these could lead to

THE POWER OF PRIVATE LABEL

(Percentage of store sales from proprietary cards)



1. Combination of private-label charge card and cobranded card. 2. Cobranded card only.
Note: Data are for 2016 or for the most recent reporting period. Source: First Annapolis Consulting

that "shakeout" in merchant apps that First Annapolis's Douglas says is likely.

For one thing, merchant apps are so new that no one knows yet how many of them consumers are willing to load, but the betting is that the number could be quite limited. Many consumer phones are already cluttered with the variety of Pays from tech giants and a crop now emerging from banks.

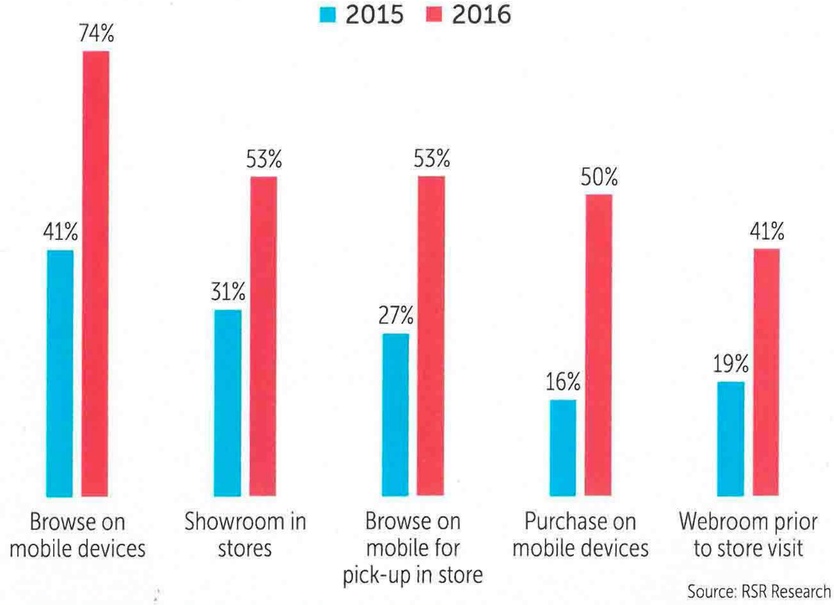
"There's app fatigue going on now," says Mike Love, president of Mozido Inc., an Austin, Texas-based company that develops mobile-payments services for banks and merchants. That being the case, the problem for each additional app is "what are you going to do to get people to download it?" Love asks.

That problem could be compounded by the investment of time and money required to build a wallet app. That's an especially serious issue where technology investment is already constrained. "We do see a high demand on resources" at retailers, says Florin Arghirescu, a senior vice president at Synchrony Financial, which like Alliance Data runs store card programs on behalf of retailers.

Synchrony has introduced a plug-in that allows retailers to integrate a digitized store card within their existing shopping apps, with no additional fees. "It's our job to partner with our retailers to make that integration easy for them," Arghirescu says. Half a dozen merchants have launched the plug-in,

THE RISE OF MOBILE CONSCIOUSNESS

(Percentage of retailers saying customers always or frequently ...)



POOR SERVICE HAS A HIGH PRICE TAG

Brick-and-mortar retailers are struggling to keep up with online stores, but they'd struggle far less if they could better deploy in-store technology, according to a report issued last month.

A big problem for shoppers is lackluster customer service, which last year cost retailers $150 billion in lost sales, says the report, "State of Retail 2017," sponsored by TimeTrade Systems Inc.. a Tewksbury, Mass.-based company that provides mobile applications and other technology to help retailers improve customer engagement. The survey of more than 2,000 consumers was conducted by research firm Survey Sampling International LLC between Nov. 6 and Nov. 12.

On average, respondents said they would boost their in-store spending by 4.7% if stores rendered more personalized service. "Just imagine the positive financial impact on brick-and-mortar retailers if revenue jumped by 5%," said Gary Ambrosino, chief executive of TimeTrade, in a statement. "Right now, retailers' revenue projections and stock prices are under pressure as the landscape continues to change. A renewed focus on providing shoppers with a better, more personal in-store experience would go a long way toward stemming the tide of defection to competitors and online sellers."

Merchants can use mobile devices such as smart phones and tablets to deliver improved service, the study says. Indeed, customer perception may matter as much as the actual deployment and use of mobile technology. Some 57% of the surveyed consumers said they felt more confident they had been given prompt and personalized service when they saw that clerks were working with each other on mobile devices to help customers.

"So, customers are still planning on shopping in stores, but retailers need to keep up with mobile trends if they expect to keep their doors open," concludes the 25-page report.

he says, with "a robust pipeline of clients that are interested."

But not all apps will appeal equally. A merchant like Starbucks or Dunkin' becomes for many customers a daily ritual. For these consumers, the app takes on the attributes of an article of faith as features like rewards points and order-ahead capability ("The Time Value of Money," February) bring free coffee and add time to the day.

Indeed, Starbucks executives reported in their most recent quarterly earnings call that Mobile Order & Pay, the popular order-ahead feature it added to its app in 2015, has become a victim of its own success. So many customers are using it that congestion at what the coffee chain likes to call its "handover plane" in its stores is discouraging customers, who walk out as soon as they see the order-ahead crowd.

Department stores, on the other hand, aren't likely to have that problem. Here, customers may spend more time in the store but are more casual about frequency. But then will mobile wallets perform less well for these stores, particularly if the stores accept a general-purpose payment wallet?

"How does that work for a retailer where the customer goes once a week or once a month or less?" asks Troy Bernard, director of marketing and products at CPI Card Group, which manufactures cards for both bank and retail programs. "How many of those apps do I want on my phone, or do I want them all aggregated in my Apple or Samsung wallet?"

EARLY DAYS

For now, it's early days for retailer wallets. Optimism abounds. A shakeout among these new apps may indeed be coming, but Alliance Data's Kroskie, for one, doesn't see factors like app fatigue or low shopping frequency causing it.

"I don't think it's about traffic. I think it's about convenience," she says. "What Starbucks did with its frequency is it made the app more of a norm rather than a customer delighter."

In other words, customers will respond the same way if offered the same convenience, regardless of how often they visit the store. The app, then, "is not less relevant or less valuable," Kroskie insists, for discounters, department stores, or, for that matter, high-end restaurants.

Few things about mobile wallets are certain these days, but one thing is for sure: The coming months are likely to put that proposition to the test. DT

—Additional reporting by Jim Daly