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**S&P Global**

Market Intelligence **Pathfinder**

# Gaining a Competitive Advantage with a Strategic Approach to Payments

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# About this paper

A Pathfinder paper navigates decision-makers through the issues surrounding a specific technology or business case, explores the business value of adoption, and recommends the range of considerations and concrete next steps in the decision-making process.

## ABOUT THE AUTHOR



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Jordan McKee is a Principal Research Analyst for Customer Experience & Commerce, leading the coverage of the payments ecosystem at 451 Research, a part of S&P Global Market Intelligence. He focuses on the digital transformation of the commerce value chain, with an emphasis on the major trends and technologies impacting payment networks, issuing and acquiring banks, payment processors and other payments industry stakeholders. His research helps vendors and enterprises assess and address the implications of the ongoing digitization of the shopping journey.

# The 451 Take

The pandemic has permanently elevated the role and business value of payment technology. The need for agile, adaptable payment infrastructure and modern strategies has never been greater to accommodate the elevated role of digital commerce in consumers' daily lives. While the requirement to act is urgent, execution can quickly become a business-wide distraction and a resource siphon. It is imperative that commerce and payment strategy leaders thoroughly assess the viability of their current payment partner(s) to aid in this transformation journey. Best-in-class partners will prove their value by driving a variety of favorable business outcomes that optimize costs, revenue, processes and the overall customer experience. Most importantly, they will help to shoulder the complexity of interfacing with the global payments system to allow merchants to maintain a steadfast focus on their core business.

## Key Findings

- COVID-19 has served as a forcing function for change in commerce by compressing several years' worth of digital shopping and payment behavior adoption into a matter of months. All told, 451 Research estimates that the pandemic has helped to push global digital commerce transaction volume above \$4 trillion in 2020 – a 23% increase over the year prior.
- It's no surprise that the most technologically advanced merchants are making payments a business priority. 451 Research's Voice of the Enterprise Merchant Study indicated that 70% of digital transformation leaders view payments as a highly strategic area of focus within their business, compared to just 41% of digital transformation laggards.
- Payments are about much more than facilitating a sale. They're a direct and highly personal brand touchpoint. Failure to serve up a frictionless, secure and seamless purchase experience compromises both current revenue and customer lifetime value.
- In-house orchestration of payments and fraud-prevention technologies can siphon off precious capital and developer resources, averting focus away from the core business. It can also throttle speed to market, delaying the launch of strategic initiatives, such as a new business line or entering a new market.
- A winning payment strategy should maximize revenue growth and minimize costs by mitigating – or eliminating – the impact of the multiple points of failure and friction that can occur in the payment flow. Effective strategies accomplish this by harnessing a combination of front- and back-end approaches that elevate the customer experience, enhance decision-making and drive efficiency.

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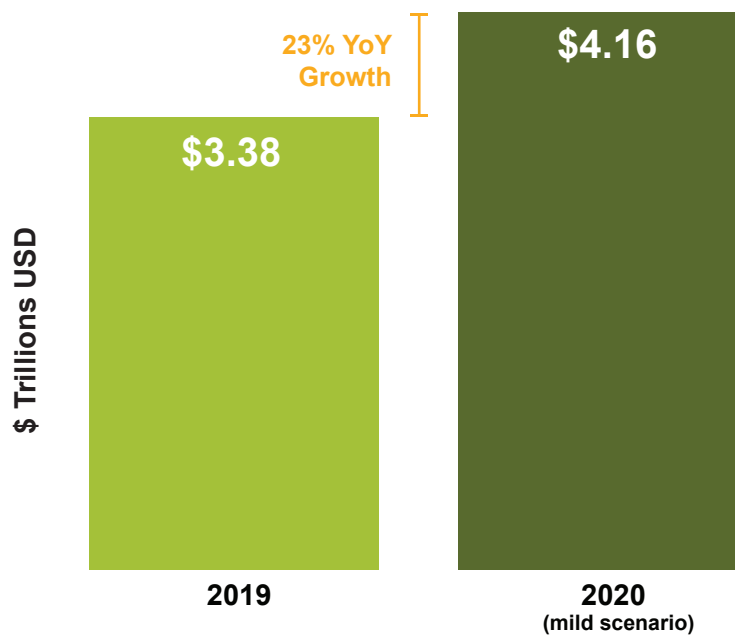
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# COVID-19 Has Accelerated the Strategic Importance of Payments

COVID-19 has served as a forcing function for change in commerce by compressing several years' worth of digital shopping and payment behavior adoption into a matter of months. The acceleration of digital sales channels has been at the forefront of this change. In 451 Research's Q3 (2020) Voice of the Connected User Landscape: Connected Customer survey, we found that 89% of respondents shopped online in the last 90 days and 72% indicated that they had shifted at least some of their in-store spending online as a result of the pandemic. All told, this has helped to push global digital commerce transaction volume above \$4 trillion in 2020 – a 23% increase over the year prior (Figure 1).

Figure 1: Global e-commerce experiences dramatic growth in 2020  
Source: 451 Research's Global Unified Commerce Forecast – Scenario Analysis 2020



Omnichannel shopping has been a key driver of the offline-to-online behavior shift. We noted significant new user adoption of experiences such as mobile ordering and ‘buy online pick up in store’ (e.g., click and collect) throughout 2020 in our consumer surveys. Tellingly, first-time users expressed high satisfaction rates, pointing to the longer-term impact that omnichannel experiences will have in shifting card-present volume into card-not-present channels (Figure 2). Underscoring the permanence of this behavioral change, roughly a third of consumers said they are more comfortable shopping online compared with the onset of the coronavirus pandemic, and about a quarter strongly agree that they will continue to shop online for most items once COVID-19 restrictions are lifted.

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Figure 2: Omnichannel shopping drives sales online

Source: 451 Research's Voice of the Connected User Landscape: Consumer Population Representative Survey, Connected Customer, Q3 2020 & Q4 2020



While digital commerce has been a lifeline for merchants during the pandemic, not all have been able to effectively embrace this market shift. Fraud, false-positive transaction declines and limited payment options are just a sampling of the challenges that have throttled the success of digital sales channels for underprepared merchants. Merchants that weren't in a position to adapt were often hamstrung by a combination of inadequate partners, outdated payment infrastructure and/or the absence of modern payment technologies.

It should be noted that the business consequences of a subpar digital payment strategy are not trivial. Our research suggests the primary action consumers take when encountering a negative online checkout experience is to buy the item from a different retailer or brand. More concerning, half of shoppers who have had a negative experience say they are less likely to return to that merchant in the future. At a time when every sales dollar and customer relationship matters more than ever, merchants cannot afford to let the payment experience put revenue in jeopardy.

It's no surprise that the most technologically advanced merchants are making payments a business priority. 451 Research's Voice of the Enterprise Merchant Study indicated that 70% of digital transformation leaders view payments as a highly strategic area of focus within their business, compared to just 41% of digital transformation laggards. The takeaway for commerce strategy leaders is clear: The highest-performing organizations are placing significant importance on payment technology and strategies to power their digital accelerations.

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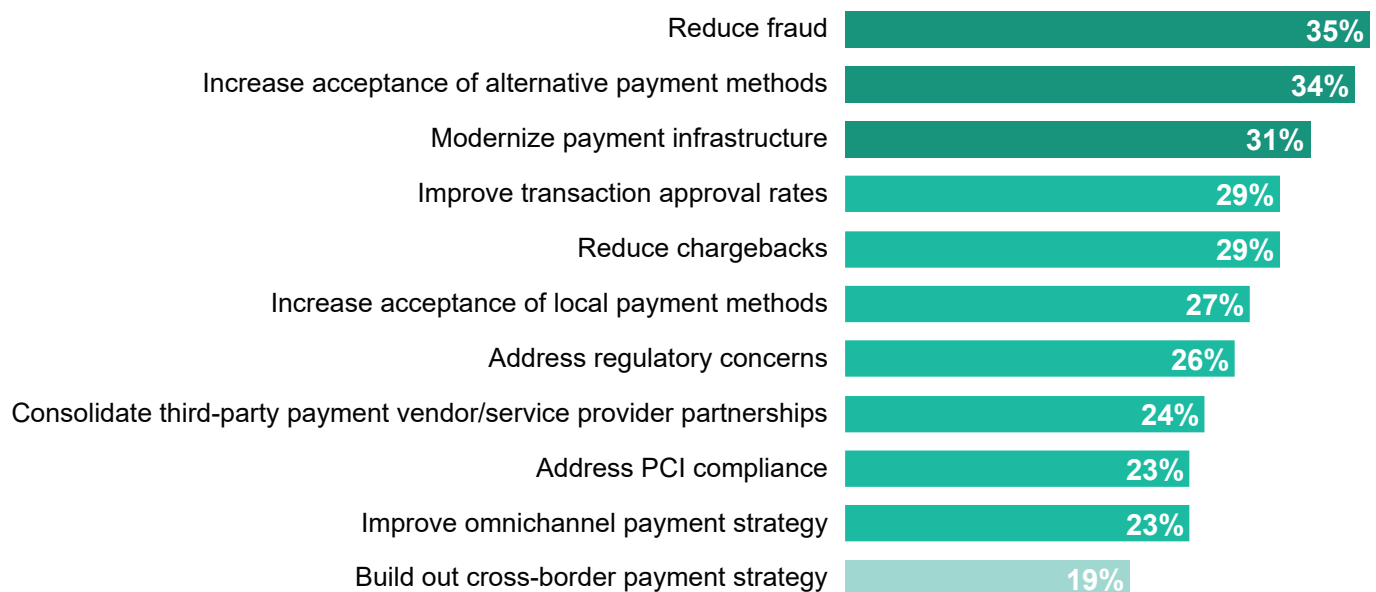
# Enterprises Face an Array of Payment Challenges

Converting payments into a strategic advantage is admittedly easier said than done. As merchants' revenue, scale and geographical presence increase, the impact of payments on their business – and their continued growth – becomes more acute. Payments for these types of merchants also have a tendency to become increasingly complex and more difficult to manage. As the business grows, payments teams must address a growing list of requirements, such as entering new markets and enabling new business models. This brings with it a range of new considerations and tasks: maintaining compliance with regional mandates, integrating and managing multiple payment methods, and addressing emerging fraud threats, to name a few. As indicated in Figure 3, there is no shortage of challenges that stand in the way of progress.

Figure 3: Merchants are pursuing a variety of initiatives to improve their payment strategies

Source: 451 Research's Voice of the Enterprise: Customer Experience & Commerce Merchant 2020

Q: Which of the following payment initiatives are of the highest importance at your organization? Please select all that apply (n=266)



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Reflecting on the various payment challenges that merchants are facing globally, it's clear that commerce and payment strategy leaders are prioritizing three initiatives: managing fraud, chargeback and regulations/compliance to mitigate business impact; expanding payment options to reach different geographies and demographics; and modernizing payment technologies to drive operational and customer success.

- **Managing Fraud, Chargebacks and Regulations/Compliance to Mitigate Business Impact** – Given the direct and often severe consequences of fraud, it comes as little surprise that fraud reduction registers as the top payment initiative for merchants. The challenge with fraud is that its impact is multifaceted, inevitably creating implications across all areas of a merchant's business. Beyond losses, fraud – and more specifically, the measures put in place to prevent it – can have an extensive impact on the customer experience in the form of false-positive transaction declines. On the other end of the spectrum, merchants that fail to take the necessary steps to protect their customers can face difficulty in establishing trust, resulting in damage to their brand and reputation.

The operational impact associated with mitigating and addressing fraud can be extensive. The Strong Customer Authentication requirements necessitated by PSD2 in Europe, for instance, have resulted in a complete upheaval of the checkout flow for most online merchants. Underpinning each of these concerns are the resources that must be committed to fight fraud. Merchants have historically employed sizable teams of risk analysts to write and adjust fraud rules and manually investigate chargebacks, but without the support of machine learning (ML), the effectiveness and efficiency of in-house analysts is reduced. 451 Research advocates for an 'analyst and machine' approach to fraud, where analysts interpret and augment ML results while enhancing ML models with their own business expertise.

- **Expanding Payment Options to Reach Different Geographies and Demographics** – Payment methods and preferences differ widely by geography, creating significant challenges for merchants as they look to serve an increasingly global clientele. The consequences of this are not to be underestimated. Failure to effectively accommodate the payment preferences of cross-border shoppers often leads to cart abandonment; according to our Voice of the Connected User Landscape Q2 (2020) Connected Customer survey, 48% of cross-border shoppers have abandoned a purchase because their preferred payment method wasn't available.

Addressing this challenge requires extensive knowledge of local markets. Consumers in the Netherlands expect to pay with iDEAL, while those in Brazil may want to use Boletto, and those in Germany may demand GiroPay or Sofort. Then there are local card networks to consider, like Bancontact in Belgium and Carte Bancaire in France, and post-payment/voucher systems like Konbini in Japan. Merchants must also consider the multitude of digital wallets gaining traction across geographies, ranging from Apple Pay, Alipay and Skrill to emerging options such as Click to Pay. Additionally, they must take into account the various buy-now-pay-later methods, such as Affirm, Klarna and Sezzle, that are finding favor with younger consumers. The number of considerations is daunting to say the least, and the complexities of adding and maintaining multiple payment options across numerous payment scenarios and geographies (e.g., contracts, reconciliation reports, versioning, updates) is extensive.

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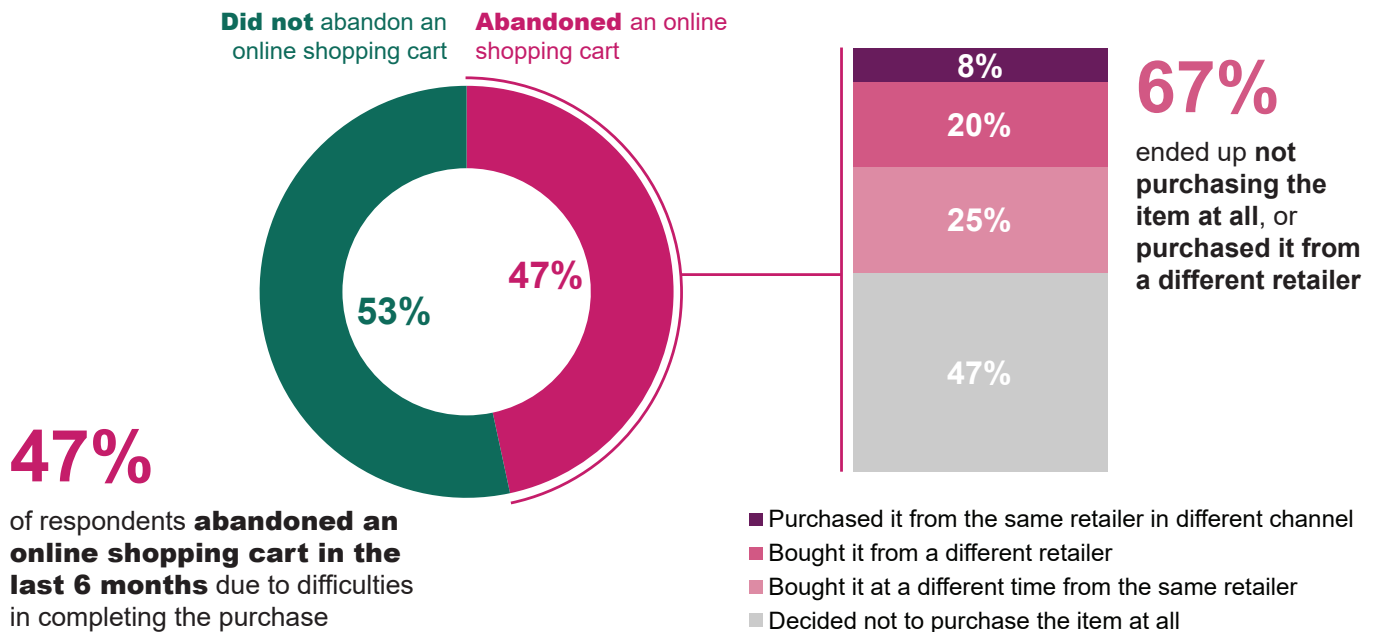
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- Modernizing Payment Technologies to Drive Operational and Customer Success** – It should come as no surprise that more than one in five online merchants say that their current payment acceptance infrastructure has become a significant inhibitor to the growth of their business. Having a payment infrastructure that can efficiently and effectively support transactions across sales channels and borders is becoming paramount to operational success. Siloed and disconnected approaches to processing payments stands in the way of great customer experiences and can create challenges when it comes to reconciling customer data. Similarly, a lack of connections into local markets will compromise conversions and business growth. Adding relevant acquiring partners in local markets can help to address this hurdle, but without a centralized means of managing those vendors and connections, fragmentation results. This inevitably creates difficulties in extracting and aggregating payment data while demanding greater internal management. It's not uncommon for internal silos to emerge around different payment channels and payment methods, leading to operational issues and disconnects.

Taking another step back, it's apparent that each of these primary payment challenges ultimately has a direct impact on a merchant's business. Payments are, after all, a direct and highly personal brand touchpoint. As indicated in Figure 4, failure to serve up a frictionless, secure and seamless purchase experience compromises both current revenue and customer lifetime value. It can also have a ripple effect across a customer base should shoppers take to social media to share their unsatisfactory experiences. Payments and commerce strategy leaders must remember that without an effective payment framework in place, investments made further up the funnel by their business partners (e.g., advertising, marketing, merchandising) will inevitably decrease in effectiveness and value.

Figure 4: The business impact of payments is increasing

Source: 451 Research's Voice of the Connected User Landscape: Consumer Population Representative Survey, Connected Customer Q2 2020



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# Don't Let Payments Become a Business-Wide Distraction

While it's clear that developing a plan to address payment challenges must become a business-wide priority, execution can quickly become a business-wide distraction. In-house orchestration of payments and fraud-prevention technologies can siphon off precious capital and developer resources, diverting focus away from the core business. It can also stifle speed to market, delaying the launch of strategic initiatives such as a new business line or entering a new market.

This isn't to say that need for internal payments teams is lessened, however. Aligning with the right payment platform will allow employees that are dedicated to payments to shift their focus toward payment innovation and strategy and away from more laborious operational tasks. Similarly, it will allow merchants with small payments teams to deploy capabilities that were previously deemed unattainable due to resource capacity constraints.

Ultimately, partners should be measured by their ability to act as an accelerant for business innovation while eliminating complexity for the organization. Below, we've identified five key attributes that merchants can use to evaluate the ability of their payment partner(s) to deliver results for their business.

Figure 5: Attributes to look for in potential payments partners

Source: 451 Research

CAPABILITY	COMMENTS
<b>Global reach with local market expertise</b>	Connections into local acquirers/partners and access to the most relevant payment methods in each country is essential to enable international acceptance. Best-in-class partners will have direct integrations into local payment methods and infrastructure to ensure the highest approval rates possible.
<b>Robust, data-driven fraud and risk management capabilities</b>	A strong pedigree in fraud and risk management backed up by modern technologies (e.g., EMV 3-D Secure, ML) and a deep base of cross-industry and cross-geography data is fundamental for keeping losses low and approval rates high. Additionally, protection across the customer journey, from account creation to payment transaction, is essential.
<b>Platform capable of abstracting complexity</b>	The ability of a payment platform to simplify operational (e.g., routing volume to multiple acquirers, onboarding new payment methods) and regulatory (e.g., PSD2 SCA) complexity will result in cost savings and greater efficiency. Modular platforms take this one step further by ensuring merchants can move forward with a strategy tailored to their individual business needs.
<b>Omnichannel proposition</b>	A payment platform that can transcend sales channels will ensure uninterrupted customer journeys. It will also offer a centralized view into customer behaviors and activities, and a means for launching new shopping experiences (e.g., buy online pick up in store/click and collect) with greater ease.
<b>Integrations into latest payment technologies</b>	A strong payments partner should offer integrations into fast-growing payment methods (e.g., buy now pay later) and new security technologies (e.g., network tokenization, EMV 3-D Secure) to help merchants stay ahead of market shifts and future-proof their business.

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# Effective Payment Strategies Drive Business Outcomes

To move forward with crafting an agile and adaptable payment strategy, commerce teams must get down to brass tacks and come to a consensus on the key outcomes they are looking to achieve. Ultimately, the true measure of success is positive results. A winning payment strategy should maximize revenue growth and minimize costs by mitigating – or eliminating – the impact of the multiple points of failure and friction that can occur in the payment flow. Effective strategies accomplish this by harnessing a combination of front- and back-end approaches that serve to elevate the customer experience, enhance decision-making and drive efficiency. Success should ultimately be measured by the extent of business outcomes produced (Figure 6), such as:

- **Higher authorization rate.** With the industry-wide approval rate for digital commerce transactions sitting at 80-85%, it's obvious that merchants are losing too many legitimate transactions. Technologies such as Dynamic 3DS, EMV 3-D Secure, account updater, smart retry logic and local acquiring connections can all play a powerful role in lifting approval rates. When leveraged in conjunction with each other, improvements well north of 300 basis points are not uncommon, resulting in a very noticeable topline impact.
- **Improved conversion rate.** Payments are the inflection point of the shopping journey, where investments further up the sales funnel are ultimately realized. The goal at this stage, therefore, must be to reduce the amount of friction in converting shoppers into buyers. Remember, in digital commerce, a better shopping experience is just a click or a tap away. Execution is about leveraging technologies such as local payment methods, digital wallets and tokenized card-on-file transactions to streamline the path to purchase and reduce opportunities for abandonment or failure.
- **Reduced churn.** Customer churn is a continual concern for merchants, especially those with recurring revenue business models. Here, expired cards are devastating to customer retention and business success. Our research shows that in the past 12 months, more than two in five cardholders have had their credit/debit card reissued due to an event such as expiration, loss or fraud. What's more, in certain subscription categories, nearly one in five customers will let their subscription cancel if they miss a billing event. Capabilities such as account updater and retry logic can meaningfully push back against payment-induced churn.
- **Decreased false declines.** False declines are a perpetual challenge that leave revenue on the table and damage customer relationships. Fraud capabilities that pull in behavioral data to build a richer view of the identity of each interaction and the level of trust that can be associated with it offer a powerful ally. Technologies such as EMV 3-D Secure, which allows for greater information sharing between merchants and issuers, and network tokenization, which creates greater trust in the payment data exchange, offer an added layer of defense.
- **Increased access to new customer segments.** Payments are the gateway to new customer segments. Accepting local payment methods can open up access to new markets, while offering payment methods popular with specific demographics (e.g., 'buy now pay later' for Millennials) can play a significant role in influencing the decision to complete a purchase. Consider that one in three consumers aged 18-37 say availability of an installment payment option has influenced their decision to buy.

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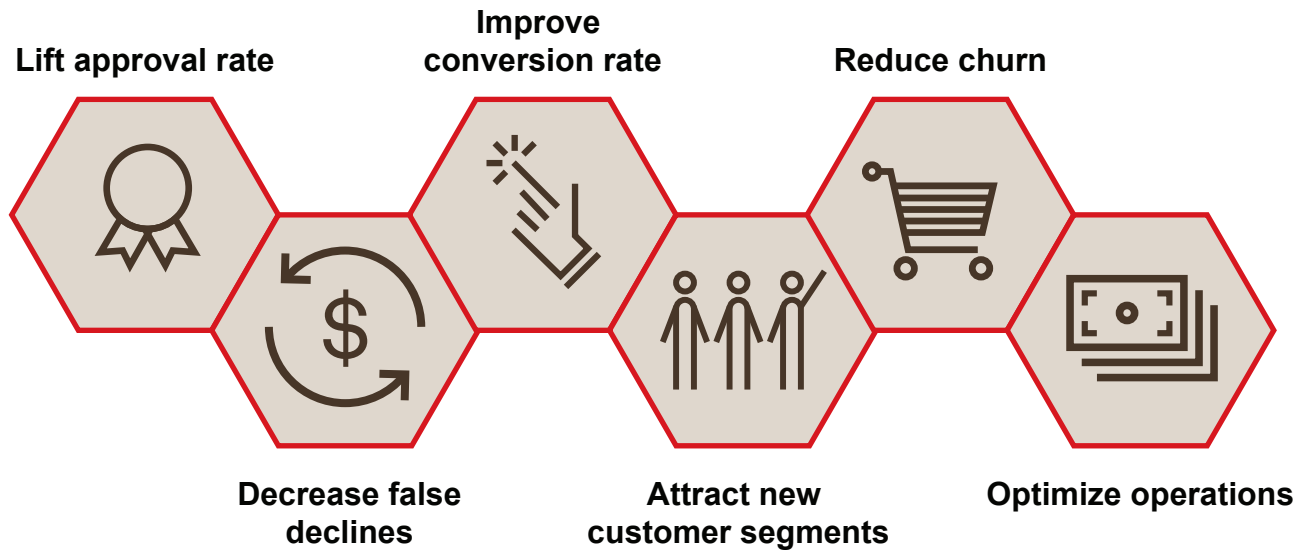
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- **Optimized operations.** The overarching outcome merchants should seek to achieve with payments is operational optimization. Improved cash flow, decreased time addressing customer issues, faster reconciliation of customer data and reallocation of employees away from mundane operational tasks are just several of many operational outcomes that a sound payments strategy can produce.

The question every payment and commerce strategy leader should ask is simple: Does our payment strategy, and more critically our payment infrastructure, help our business drive these business outcomes effectively today? If not, it might be time for reevaluation.

Figure 6: Payments priorities must shift to business outcomes

Source: 451 Research



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# Conclusions

Best-in-class merchants have embedded payments into their competitive strategies and are implementing processes to optimize their payment flows. They're approaching payments as mission-critical business infrastructure and implementing the framework to optimize their approach to payment acceptance. With COVID-19 exacerbating existing business pressures and igniting new ones, these merchants will be at an advantage. There is still time for others to follow suit, and the rationale for doing so is simple: there are few areas within a merchant's business where the near-term gains from strategy optimization will be as significant as they are with payments.

Fortunately, merchants do not need to build out large in-house teams to tackle payment optimization on their own. Commerce and payment strategy leaders should seek out partners that have the infrastructure in place to deliver multiple business outcomes while abstracting the complexity of payment management for their organizations. This approach will allow them to reap the advantages of payment strategy optimization while allowing them to refocus on their core business.

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