



Mobile Payments

Virtualizing Value from Barter to Bits

CONCEPT DOCUMENT



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THE OPPORTUNITY

Credit unions are perched precariously in the center of a tightly-stretched wire that is anchored between two continents named notoriety and anonymity. On one end, media attention and consumer sentiment have swung to our favor, and in recent years we've reaped tremendous benefit from the financial crisis. On the other loom treacherous pitfalls and certain death. Hyper-activity on Capitol Hill, increased competition from non-regulated entities, and narrowing margins all point to one inevitable fate.

As credit unions, we exist in the tenuous balance between returning to (some might wager remaining in) our traditional identity as a second-class financial services provider, or accelerating into first position in the minds of consumers. Amidst all of this tension and turmoil, one might forget to ask an all-important question: What is the wire made of? In my opinion, it's technology. Both the consumers we serve and our internal operations are being impacted daily by rapid cycles of change and innovation in financial technology. Mobile payments are certain to be the next testing ground for credit unions who want to compete in the modern financial services landscape.

But do consumers want this technology? Early survey findings reveal that elusive key segments are already using this technology to some degree, while other segments claim a desire to "digitize" their wallets. In a survey conducted by the Balance Point i3 team in Spring 2012, 54% of respondents said they were "possibly" or "very likely" to replace traditional payment methods with a mobile payment if given the opportunity. 48% also said they would use the service once per week or more frequently. Security concerns remain the primary barrier to acceptance of mobile payments, with anecdotal evidence of accidental NFC transmissions and compromised devices hampering progress. In the Balance Point survey, speed (56%) and ease of use (47%) were highlighted as the primary advantages of the channel, while security (32%) was identified as the main disadvantage. The key takeaway from this data is that while consumers will be open to paying with a mobile device, it must present a compelling benefit over the traditional channels, and a re-education about security of a mobile device will likely have to occur.

Multiple solutions exist in the marketplace, even at such an early stage. Both established providers and new entrants are jockeying for space, while traditional financial institutions dip a tentative toe in various pools, afraid to shackle themselves to an unproven path. Looking abroad for answers about the future, in Europe and Asia many competing technologies have found varying levels of success. In the US, technologies such as EMV, barcode, and NFC all remain on relatively equal footing. High costs of implementation for the merchant paired with both issuer and consumer concerns about security leave us paralyzed in a state of indecision. With many questions still to be answered, my hope is that we are nearing discovery of a solution that would be globally-accepted in the credit union community.

THE SOLUTION

The QR code remains the only proven technology that is actively used on a large scale in the US for facilitating a mobile transaction. In 2011, our proof of concept in the field relied heavily on Starbucks' mobile payments environment. While this was a confined ecosystem, over 2 Million transactions per year are harvested from this technology and it is now a key component of their loyalty program. Starbucks has accepted a smartphone-presented QR-code at the point-of-sale for nearly three years. As a method of payment, it accounts for over 40% of their transactions. Credit unions should pay close attention to these metrics, because the payment does not flow directly from a credit union or bank-issued debit or credit card. Starbucks requires that its customer load a sum of money onto one of their reloadable cards prior to payment, thereby reducing their interchange expense by minimizing the number of individual transactions placed on an issued plastic.

Team Balance Point's concept (Flash Note, *Blueprints for Innovation*, Spring 2012) generated strong enthusiasm at its introduction, and we realized that our idea had sticking power if given an opportunity to develop. Study continued in the field of mobile payments and a provider was discovered that had progressed further in development. A dialogue was opened with Paydiant after learning that Bank of America, BarclayCard, Capital One and several other large issuers were pilot-testing their product. Initial interest in Paydiant stemmed from one key platform component: its white-label branding approach. This holds great appeal for those who cannot or would prefer not to develop proprietary services. Paydiant has built a very similar barcode-based platform to the one that the Balance Point team had wire-framed, but has also included NFC as an option for equipped devices and merchants. Even further, they have constructed both issuer-funded and merchant-funded rewards programs that are integrated into the product.

Paydiant has also attracted acquirers and processors, a key element to success of the platform. Both Vantiv, a top merchant acquirer, and FIS, a top core data processing provider have penned agreements with Paydiant. This is tremendously important as it ties many siloes of the payments stream into one hub. Using an API or a standalone smartphone application, the client would be able to offer a turnkey solution to its members that leverages existing and impending technologies (see Figure 1).

As one might surmise, the mobile payments field is diffuse with both established players and Silicon Valley startups. Paydiant is only one option for credit unions to consider. However, the Paydiant option was selected because it is one of the most fully-developed and financial institution-friendly models. A competing model can be found in the likes of Cambridge, MA startup SCVNGR's product named LevelUp (www.thelevelup.com). This approach is concentrated on QR presentment and acceptance for point-of-sale merchants as well. Its differentiating factor is that it leverages an aggregator-supplied "triple-token" system to replace the data carried on a traditional plastic, while also being able to represent the data within the token as a payment. This system is tremendously open-source, allowing both consumers and merchants to join the ecosystem without any implementation expense. The primary concern with this platform is that there is no clear insertion point for an issuer, which seems to be the intent of the product. Understanding that there are competing products that may represent a potential solution for credit unions, the remainder of this brief intends to further explore the Paydiant solution.

TARGET MARKET

Team Balance Point (*Blueprints for Innovation*, Spring 2012) provided extensive information on the consumer target market for mobile payments. This brief intends to identify credit unions with an appetite for protecting non-interest income while growing key net-worth and age segments as the potential target market for a mobile payments product. The ultimate end-user would, of course, be natural person members. The reason for this shift is that I believe the best possible delivery of this product is through CUSOs, state leagues and corporate credit unions, of which individual credit unions are members themselves. These peer groups are the lifeblood of our industry and can serve a tremendous role in obtaining these services. They would serve the representative interest of their member credit unions to a provider like Paydiant, and would be able to secure much better pricing and service as a volume purchaser.

CONSUMER BENEFITS

- A more modern, secure form of transacting
- Real-time transaction reporting in the same platform as the payment
- Rewards redemption among many different payment outlets in one location
- Control of payment preference

CREDIT UNION BENEFITS

- Protection of critical non-interest income streams
- Growth in new, difficult-to-attract consumer segments
- Deepening relationships with key existing segments who are high net-worth, high transactors

PILOT RESULTS

See Appendix A for a Javelin Research brief on SEFCU's (Albany, NY) pilot program with Paydiant.

OPERATIONAL AND OTHER CONSIDERATIONS

Our understanding of the product is that processing and settlement occurs much like that of a current plastic. With this in mind, the primary function of the front-office credit union staff is to educate members on the utility and function of the payments channel. Workload on the Information Services function would likely increase incrementally to support the additional component of their mobile banking offering, and the Finance function would need to ensure in the early stages that transactions were properly allocated within general ledger accounts.

FINANCIAL PRO-FORMA/ROI

Implementation of a Paydiant rollout in a Metropolitan Statistical Area is a \$300,000-500,000 expense, depending on the scope of work. This would involve either building the standalone branded application or implementing the Software Developer Kit inside an existing application and granting access to the existing participant merchants. Thereafter, the credit union would agree to a 3-5 year agreement with an annual service contract. A threshold-based per-item charge would also exist (i.e. <100,000 transactions, 100,000+ transactions, 500,000 transactions, etc.). The credit union would also promote the product with any existing payments processing agreements that it has with local/regional/national merchants, in order to increase adoption and usage rates for its end-users. Given the tremendous implementation expense for small to medium-sized credit unions, the impetus for us to work toward a collective bargaining structure becomes even more critical. This uniform adoption of a standard for mobile payments also has implications for staffing and skill needs. Considering that this product might perhaps be sold at the CUSO or corporate-level, these groups would likely be able to assist in supporting the product, much like a hosted website or a check-batching program. This would minimize the additional load on all core functions, though not eliminating it completely.

The return on investment for this product is highly dependent on adoption rates. Although pilot results will show, much of this hinges on the willingness of the client credit union to simplify the merchant process, educate end-user members on the power and convenience of mobile, and to consistently recruit merchants to participate in the ecosystem. Understanding that this product is a long-term play for retention of profit centers and for growth in segments that represent sustainability, the credit union may elect to either charge for or provide the service at its own expense.



RESOURCES

Mobile Payments Today (www.mobilepayments.today.com)

Paydiant (www.paydiant.com); LevelUp (www.thelevelup.com)

The Future of Payment Systems for Credit Unions, George Hofheimer, Filene Research Institute. (February 2013)

GETTING STARTED

1. Determine whether offering mobile payments to your members is in-line with their demand and your credit unions strategic vision for the upcoming 3-5 years.
2. Explore the competitive landscape for mobile payments. Understand the difference between peer-to-peer payments, in-app purchasing, tab-based payments and point-of-sale transactions.
3. Explore the Paydiant platform in greater detail by visiting www.paydiant.com.
4. Contact us if interested at innovation@filene.org