



# Smart Commerce

Banks battle for customers  
at the frontline of digital retail

 **ERNST & YOUNG**  
Quality In Everything We Do

## Contents

---

<b>Introduction</b>	<b>01</b>
<b>Executive summary</b>	<b>02</b>
<b>Research methodology</b>	<b>04</b>
<b>Research results</b>	<b>06</b>

---

### 01

<b>The growing threat to banks</b>	<b>06</b>
A. Smart Commerce defined	07
B. Smart Commerce demand and drivers	10
C. Smart Commerce adoption	12
D. The threat to banks	16

---

### 02

<b>Banks' responses</b>	<b>19</b>
A. Strategic ambitions and drivers	20
B. Opportunities beyond payment	24
C. Challenges to strategy delivery	26
D. Skill and capability gaps	32
<b>Our views and recommendations for financial services institutions</b>	<b>36</b>
<b>Contacts</b>	<b>38</b>

---

# Introduction

The retail world in developed countries is undergoing a dramatic transformation. Driven by the seemingly unstoppable rise of e-commerce and online market models, extensive smart phone and 3G/4G penetration, social media adoption, and maturing technology such as contactless payments, GPS, image recognition and augmented reality, the way shoppers buy and merchants sell in all contexts is entering a new, digitally enhanced era. This is characterized by two key phenomena: digital payment methods that simplify and enrich the point-of-sale (POS) experience physically and online, and data-rich communication between merchants and consumers, particularly leveraging the mobile channel.

There are a variety of new terms already in use to describe this fast-changing value chain, but no single name is used across industries and markets. At Ernst & Young, we choose to refer to this developing digital retail landscape in its entirety as "Smart Commerce."

Indeed, at Ernst & Young we are investing a significant amount of time analyzing how individual aspects of consumers' purchasing experience are evolving within the broad context of Smart Commerce and, in particular, what the implications of those changes may be for banks and their relationship with customers. As part of this analysis, we have recently undertaken research with financial services firms and some complementary participants from other industries to capture the latest industry thinking on the likely scope of Smart Commerce development, to define the commercial drivers and barriers and to explore the strategic ambitions of our respondents as they address this critical but rapidly evolving commercial environment.

The results of our interviews provide powerful insights into the degree to which our banking respondents believe their broader consumer franchises are at stake and the overall digital commerce ambitions and progress-to-date within financial services. Smart Commerce presents both fundamental risks and attractive growth opportunities for financial services organizations, the balance for each depending principally on its current position and level of ambition. We trust you will find the conclusions of our research insightful and useful as you debate and formulate your own planned level of participation in the day-to-day digital shopping lives of consumers and merchants.



Tariq Khatri

Partner  
Ernst & Young



Bernhard J.  
Klein Wassink

Principal  
Ernst & Young

Handwritten signature of Tariq Khatri in black ink.

Tariq Khatri

Partner  
Ernst & Young

Handwritten signature of Bernhard J. Klein Wassink in black ink.

Bernhard J. Klein Wassink

Principal  
Ernst & Young

# Executive summary



**76%**

of respondents voiced concern that Smart Commerce will distance them from customers if customers start to use non-bank digital wallets instead of a bank card to buy things.

## Research results

- ▶ Banks see their loss of relevance to customers due to intermediation as the key threat from the mass adoption of Smart Commerce services.
  - ▶ Respondents believe that simplified digital payment, complemented by enriched merchant/consumer communication, will be at the heart of Smart Commerce but expect it also to include entirely new digital shopping services.
  - ▶ Smart Commerce development is being driven not only by consumer needs but also by those of merchants and by large profit pools, some outside of payments.
  - ▶ Two of every five respondents believe that Smart Commerce will be a mass-market phenomenon within two years.
  - ▶ Banks regard the main risk posed to them by Smart Commerce as that of customer intermediation – and the decline in bank relevance to consumer commerce should this occur.
- ▶ Banks are planning to deliver ambitious Smart Commerce services to counter the threat of intermediation.
  - ▶ Most respondents want to be a Smart Commerce “solution provider” offering integrated solutions incorporating both payments and broader “purchasing facilitation” services (e.g., digital loyalty, promotions and receipting), and most intend to deliver this within two years.
  - ▶ Over 80% of respondents believe banks can support targeted digital merchant promotions using customer data in addition to their traditional payment services role; however, one in eight thinks that banks should stick to providing only payment and finance services in Smart Commerce.
  - ▶ Participants identified three main challenges to delivery of Smart Commerce strategies: overcoming conservative internal cultures; selecting the “best” solution when there is no clear winner and fraud/data security risks are a key concern; and ensuring regulators are kept up to speed.
  - ▶ Most participants also need to address capability and skills gaps – notably in distribution, mobile app development and in social media.

## Our views and recommendations for financial services institutions

- ▶ At Ernst & Young we recognize both that the intermediation fears exhibited in this study are well founded but also that Smart Commerce presents an unusual opportunity for financial services institutions to generate revenue from a profit pool to which they have had little access to date: retail sales promotion.
- ▶ We believe that all firms supporting retail payments will need to design a response tailored to their market and competitive contexts, capabilities and ambitions but, above all, with sufficient flexibility to manage the uncertain future in this exciting and fast-moving space.





## Research methodology

41 Participants

14 Countries



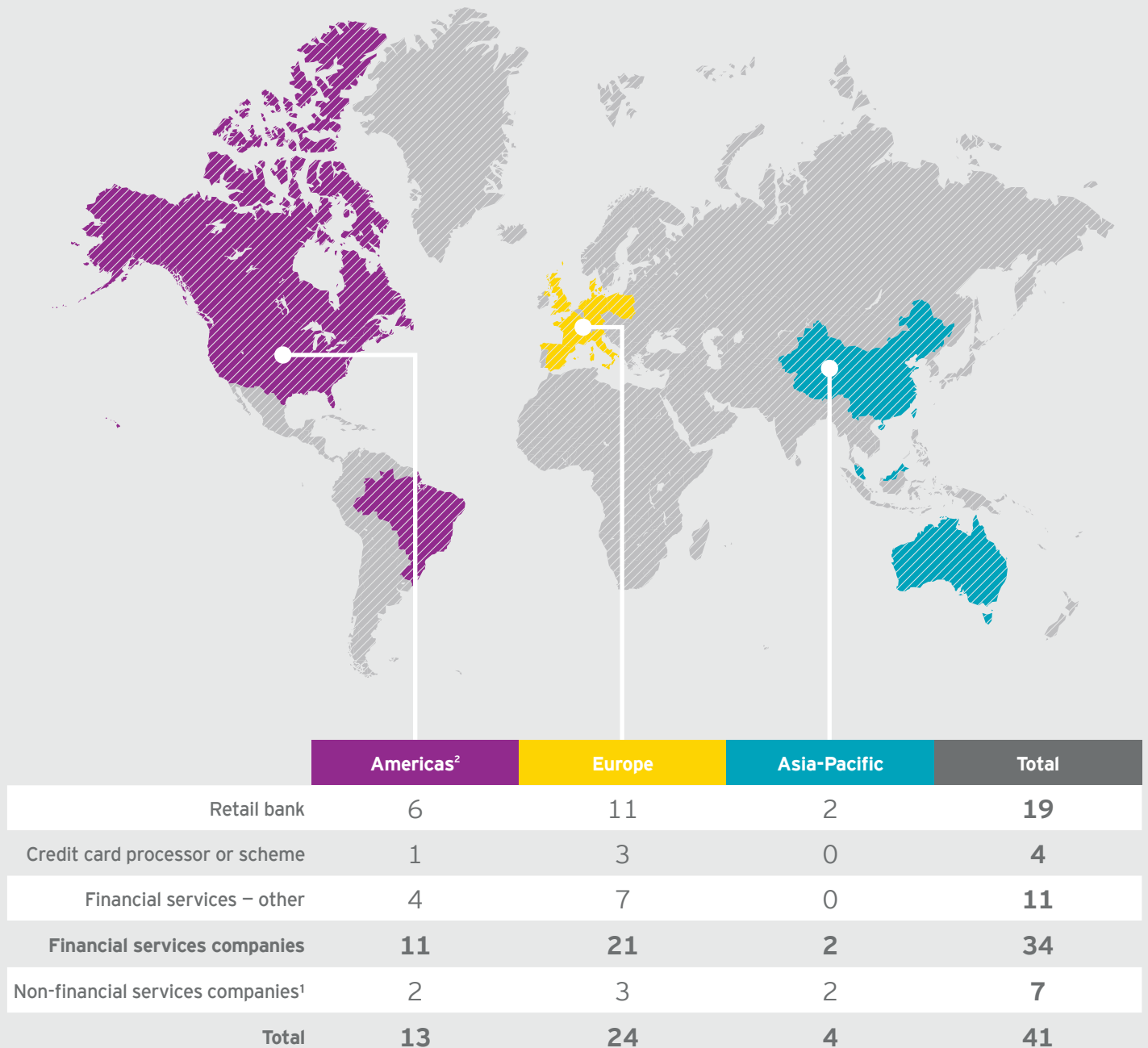
Ernst & Young conducted in-depth interviews with 41 senior executives between December 2012 and April 2013, either face-to-face or by telephone, with individual interviews lasting 45 to 60 minutes each.

Our interviews covered a variety of industries involved in Smart Commerce (financial services, retail, technology and telecommunications), but financial services organizations were the focus of our research and we have therefore included only quantitative data on individual questions based on the responses from these companies. Within the financial services responses, differences between banks and non-banks were statistically insignificant except where specifically noted. The respondents were all responsible to a significant degree for the Smart Commerce strategy in their organizations and most were CEOs, COOs or Directors for areas such as retail banking, consumer payments, digital or innovation.

The table opposite shows the breakdown of interviews by broad industry group and the country/region in which respondents were interviewed. Where we have quoted respondents directly, we have provided a brief business description followed by the country/region of interview in parentheses.

Reflecting that some respondents chose not to answer all sections of our interviews, the base size of respondents varies by question.

## Summary of interviews by industry and region



<sup>1</sup> Retail, technology and telecommunications  
<sup>2</sup> Includes one respondent from Latin America

To support our interviews, we provided respondents with a number of supplementary descriptions and definitions to clarify questions and aid responses. Where relevant, we have included this additional information alongside the relevant chart in the report.

# The growing threat to banks

## 01

### **Banks see their loss of relevance to customers due to intermediation as the key threat from the mass adoption of Smart Commerce services**

#### **Key findings:**

##### **A. Smart Commerce defined**

Respondents believe that simplified digital payment, complemented by enriched merchant/consumer communication, will be at the heart of Smart Commerce but expect it also to include entirely new digital shopping services.

##### **B. Smart Commerce demand and drivers**

Smart Commerce development is being driven not only by consumer needs but also by those of merchants and by large profit pools, some outside of payments.

##### **C. Smart Commerce adoption**

Two of every five respondents believe that Smart Commerce will be a mass-market phenomenon within two years.

##### **D. The threat to banks**

Banks regard the main risk posed to them by Smart Commerce as that of customer intermediation – and the decline in bank relevance to consumer commerce should this occur.



Section 01 – The growing threat to banks

## A. Smart Commerce defined

Respondents believe that simplified digital payment, complemented by enriched merchant/consumer communication, will be at the heart of Smart Commerce but expect it also to include entirely new digital shopping services.

At the start of our interviews, we provided our interviewees with a basic definition of the two key areas that we believe characterize Smart Commerce including both payment and additional services as follows:

**1. Digital payment methods that simplify and enrich the experience at POS, both physical and online**

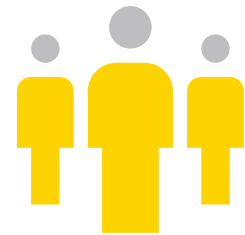
- ▶ Consumers use digital wallets both online and initiated from a mobile to pay for face-to-face transactions.
- ▶ Payment uses a simple consumer-friendly identification and verification method, consistent across face-to-face and remote channels.
- ▶ Loyalty points are automatically added at POS for customers and vouchers/ coupons automatically redeemed with payment.

**2. Rich communication between merchant and consumer, particularly leveraging the mobile channel**

- ▶ The consumer/merchant relationship features a regular exchange of information between selected merchants and their customers on all channels.
- ▶ Consumers receive targeted and relevant digital promotions and vouchers on their PC and mobile, often based on their proximity to a purchasing opportunity.
- ▶ The mobile phone/tablet is a constant shopping companion to the consumer and is also used by retailers to communicate in store to customers.

Interviewees' responses on how accurately this description of Smart Commerce matched their own views reveal much about the current standing, ambition and potential strategic responses of our respondents. Smart Commerce will happen. This part of the survey was unequivocal – with all respondents believing Smart Commerce will develop in at least some of the areas defined.

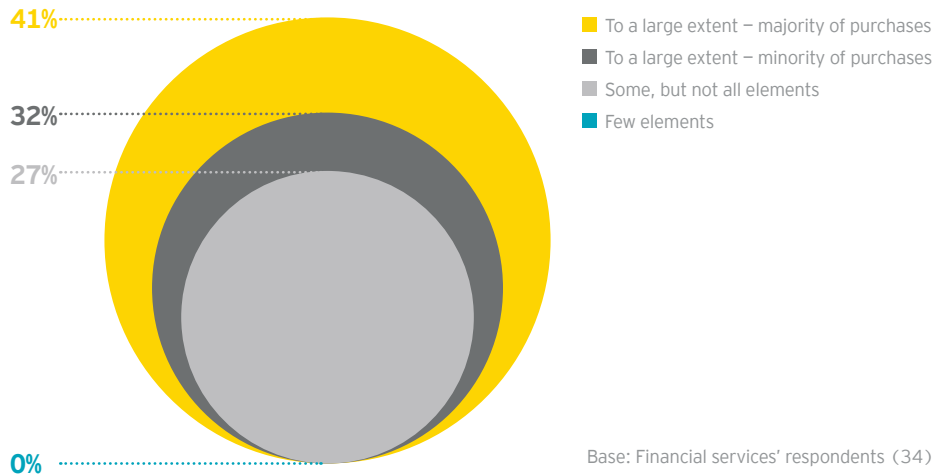
Seventy-three percent of respondents agreed with the retail future we described to a large extent, with 41% believing that this description would characterize the majority of purchases.



Nearly three-quarters of respondents agreed that Smart Commerce is coming.

## A. Smart Commerce defined

### How closely does the characterization of Smart Commerce provided match your view on how the purchasing experience will develop?



Within the detail of responses, a number of interviewees noted the importance of Smart Commerce solutions being integrated and working seamlessly across physical and remote channels. Another characteristic commonly identified was the anticipated increase in simplicity of the buying experience. The smart phone was also recognized by respondents as a key enabler of the enriched merchant/consumer communication described, this role being more significant in most answers than that as a mere payment device.

*"From a payment perspective the trick is not enriching the shopping experience but making it simpler. If any new solution is not quicker or easier than the current systems it won't work with shoppers – they're not engaged enough."*

**Global Credit Card Processor (Europe)**

A few respondents expanded that Smart Commerce will change forever the sequential in-store purchasing experience that currently ends at a physical checkout. In particular, point-of-selection purchasing in aisles was mentioned by several respondents as a likely Smart Commerce development.

*"We believe that the checkout experience will evolve considerably in Smart Commerce. There are likely to be no tills and customers will be able to shop in aisle. We see Smart Commerce as integrated with wider financial services and specifically linked to consumers' banking experience. For example, a digital receipt as part of a bank statement."*

**Global Credit Card Processor (Europe)**

However, some participants felt that our definition was too narrow and that Smart Commerce will incorporate broader offerings than the digitization of the current POS experience.

A number of respondents also stated that they believed Smart Commerce will develop into a much broader service offering than the one outlined. In particular, respondents said they believed Smart Commerce success will incorporate much more than digitizing the current POS and retail experience, a step that was seen as merely a staging post en route to new digital shopping “tools” for consumers and merchants.

This is partly because some respondents saw digital versions of payments and promotions as not enough in themselves to change consumer behavior significantly. According to our interviews, there is little wrong, for example, with current in-store debit and credit card payment mechanisms. Respondents cited the failure of existing Near Field Communication (NFC) technology to achieve widespread adoption thus far as a powerful example of consumers’ apathy toward incremental improvements, particularly those that fall into the “solution looking for a problem” camp.

Meanwhile, a number of targeted promotions and loyalty schemes already use mobile phones as a channel. However, the majority of respondents do not believe there is scope for a sustainable competitive advantage in mass discounting, whether digitally delivered or not.

The real value in Smart Commerce is likely to come from new services, which will genuinely improve customers’ lives and help merchants meet consumers’ needs more efficiently and conveniently.

---

*“The real opportunity in Smart Commerce is in creating brand distinctiveness with a differentiated digital personalized experience. We see Smart Commerce as addressing ‘How can I make you happy?’ not ‘What can I sell you today?’”*

**International Retailer (Europe)**

According to our interviews, the real value in Smart Commerce is likely to come from new services, which will genuinely improve consumers’ lives and help merchants meet consumers’ needs more efficiently and conveniently. Many of these new services are also likely to be disruptive to existing offerings. Our respondents said these disruptive services are likely to bring together location tools, social networking, scanning, mobile and payment technologies in new ways, potentially evolving in a manner that has not yet even been considered. Putting aside different views on future Smart Commerce services, all respondents recognized that the creative and insightful use of data will be at the heart of these offerings. Our interviewees also recognized that the creation and ownership of the right data is likely to be a critical differentiator for firms looking to play a part in a Smart Commerce future.

---

*“The key part of Smart Commerce is actually not in the area of payments at all, but in the area of ‘cloud integration.’ For merchants this may involve non-payment functionality such as stock control. For consumers it may involve functions such as the ability to pre-order and have goods waiting for you when you get to the store.”*

**Retail Bank (Americas)**

## B. Smart Commerce demand and drivers



Smart Commerce development is being driven not only by consumer needs but also by those of merchants and by large profit pools, some outside of payments.

Over two-thirds of respondents said they see demand for Smart Commerce already coming from merchants and consumers.

---

*"There is huge demand for Smart Commerce solutions."*

**Retail Bank (Americas)**

Sixty-eight percent of respondents recognize existing customer demand for aspects of Smart Commerce. This demand was generally not seen, however, at least in financial services firms, in the form of direct customer requests for such services or positive responses to research but in actual adoption and satisfaction among users with some early manifestations of digital payment and other Smart Commerce solutions. A number of card processors identified existing demand from retailers keen to be at the forefront of digital innovation.

---

*"It's not yet a question of demand. We are still some way away from having the infrastructure in place to support digital commerce extensively at the POS whether physically or virtually. But when we do provide capabilities within our account structure, the adoption rate has been fast."*

**Retail Bank (Europe)**

One retailer we interviewed, however, commented that its customers were actually approaching it with proactive suggestions for Smart Commerce services, which they could envisage were feasible and would add real value to them.

---

*"We're constantly getting suggestions from customers for apps and digital services to make their shopping easier. Customers expect us to be able to use our data to help them."*

**Multi-national retailer (Europe)**

---

**68%**

of respondents recognize existing customer demand for aspects of Smart Commerce.

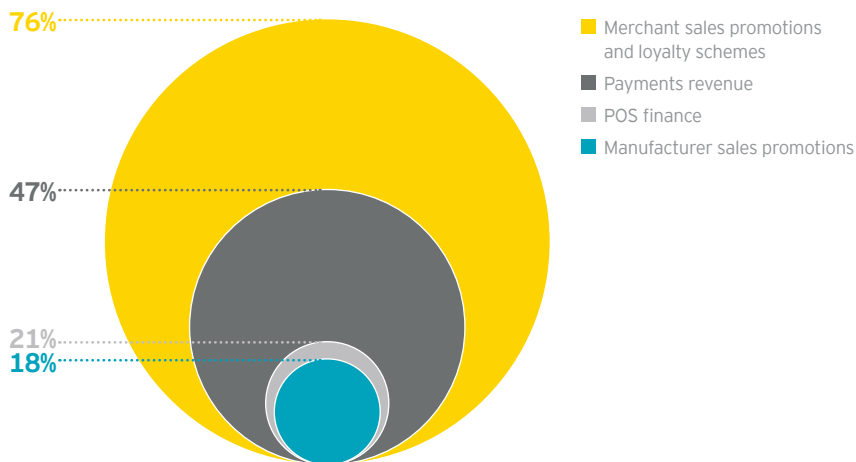


**Many see significant commercial drivers, in particular, merchant sales promotions.**

Merchant sales promotions was, by some distance, viewed as the key profit pool driving Smart Commerce development, cited by nearly four out of five interviewees. These respondents believe that helping merchants to sell more efficiently and effectively will fund the costs of innovation behind much of Smart Commerce.

The focus of much digital payment effort to date has, by contrast, been focused on helping consumers buy more conveniently. Respondents recognized that it is ultimately retailers and manufacturers that pay for commerce services and have the most to gain from digital improvements.

**Which are the main profit pools driving Smart Commerce development?**



Respondents could select up to two answers

Base: Financial services' respondents (34)

While payments revenues were regularly mentioned by banks as a driver of Smart Commerce development, the majority did so in a defensive context and recognized the role of Smart Commerce in protecting existing revenue, albeit one where pricing is already under severe pressure. A number of other respondents, typically online and digital companies, see the opportunity to gain share of the payments market and the critical importance of payments to a broader Smart Commerce offering. In this respect, several banks explicitly imagined a world where the larger digital organizations would give away the payment element in order to promote Smart Commerce transactions.

*“Fundamentally retailers will pay for Smart Commerce to drive their sales but manufacturers may also decide they can go direct to consumers and bypass retailers. There are no NEW profit pools in here. They already exist but will be distributed differently.”*

**Global Digital Payment Services Provider (Europe)**

*“The large, online, digital payment platforms are looking to drive revenue out of the data and are even willing to give away the payment revenue to make money on the promotion.”*

**Retail Bank (Americas)**

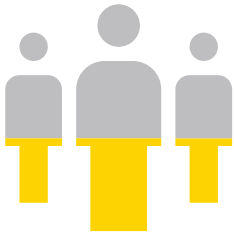
*“There is a belief that there is a new revenue stream in payments. There isn’t.”*

**Retail Bank (Americas)**

**Examples of Smart Commerce**

- ▶ Digital coupons redeemed automatically at the point of payment
- ▶ Digital statements as a vehicle for targeted offers based on where a consumer shops
- ▶ Delivery of location-based messaging to a customer’s smart phone triggered by proximity to a particular store

## C. Smart Commerce adoption

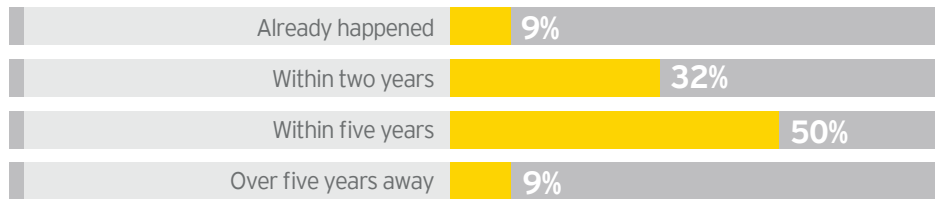


41%

believe that mass adoption will occur within two years.

Two of every five respondents believe that Smart Commerce will be a mass-market phenomenon within two years.

**How soon will Smart Commerce be a daily experience for most consumers in your market?**



Base: Financial services' respondents (34)

*"We expect to deliver cloud-based services to our addressable market within two years and to deliver mass market NFC solutions within 5 years."*

**Retail Bank (Europe)**

*"Smart Commerce services will come fast. Everyone is trying to make offerings easy and user-friendly for the consumer."*

**International Retailer (Europe)**

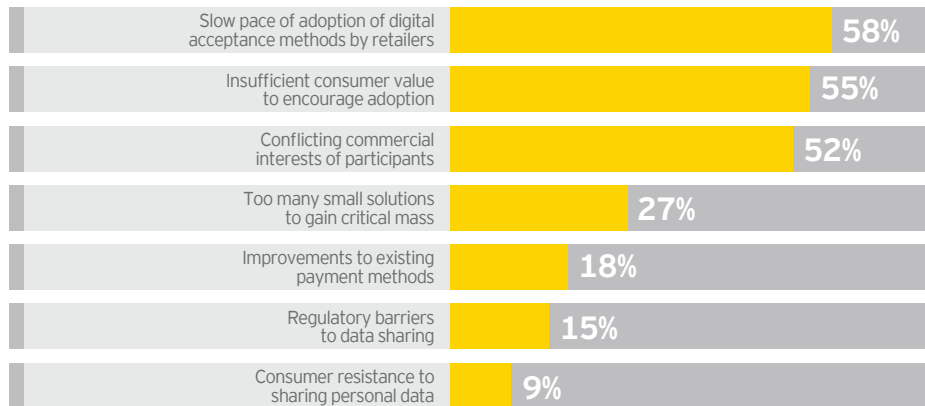
Put simply, respondents believe that Smart Commerce is evolving quickly with 41% believing that it will be a regular experience for most consumers in their market within two years. Our survey showed a near-universal view that Smart Commerce will be a daily experience for most consumers in developed markets by 2018, though a larger proportion believe Smart Commerce will become mass market within five years rather than within two.

*"We have 14 financial services customers already running Smart Commerce platforms, but Smart Commerce is not ubiquitous yet."*

**Global Technology Provider (Americas)**

Among our North American respondents this proportion is reversed: the majority of respondents believe Smart Commerce will be a daily experience for US consumers within two years.

**In your view, which are the most significant inhibitors to Smart Commerce development?**



Respondents could select up to three answers

Base: Financial services' answering (33)

Our survey participants identified a number of obstacles, which may be restricting the pace of Smart Commerce development. Three inhibitors were mentioned by more than half of the respondents: the slow pace of retailer adoption, the lack of added consumer value in digital payment solutions offered to date and the impasse brought about by conflicting commercial interests between parties at different points in the value chain.

While slow retailer adoption was mentioned most often, the reason cited for this by respondents was frequently that retailers do not believe that the solutions delivered to consumers so far offer enough value to encourage adoption. Respondents understood that retailers are unlikely to invest heavily in the infrastructure for new POS propositions that are not compelling to their end customers. Our respondents, though critical in part, accept that renewing terminals in-store carries significant cost for merchants. There is also widespread recognition that the proliferation of smaller payment solutions is a further contributory factor to slow retailer adoption when there is limited visibility of likely winners.

*“Will merchants want to invest if there are no lifts in sales as a result? Investment is not just in the technology, but in staff training and infrastructure. The question for merchants will be ‘does this bring me extra business?’ If the consumer proposition is strong, retailers will adopt it as retailers follow consumer demand.”*

**Global Digital Payment Services Provider (Europe)**

**50%**  
say that it will take up to five years for mass adoption to take place as three inhibitors remain to be addressed.

## C. Smart Commerce adoption



The clear message from many remained that any Smart Commerce payment solution needs to deliver a step-change in added value to the existing experience in order to hasten any meaningful shift in consumer behavior. According to our interviews, current Smart Commerce solutions do not fulfill these goals in the physical retail environment.

---

*"It has to be more convenient – the barrier to consumer acceptance is ease rather than value."*

**Global Credit Card Processor (Europe)**

Existing NFC payment solutions were again the focus of many negative comments in this area. Respondents talked about current Smart Commerce offerings as "supply-side solutions in need of a problem" that offered little genuine improvement for consumers. Some respondents also pointed out that there is little wrong with existing in-store card payment options.

---

*"There is no benefit to the customer at the moment – they are still waiting in line and getting no value-add for using digital wallets."*

**Retail Bank (Americas)**

---

*"When solutions are offered that add real value consumers will adopt them."*

**Global Credit Card Provider (Europe)**



Conflicting commercial interests was the third of the three major barriers to Smart Commerce progress expressed in our research. In the more detailed responses, some highlighted the sheer number of potential participants in the value chain and the absence so far of any major new profit pools. With new players competing in long-established market with aggressive business models, the scope for commercial tensions and disruption is seen as particularly problematic.

---

*"It's not clear who should take the lead in Smart Commerce. It is a bit like a gold rush. Everybody in the value chain wants to get a share of the riches, even the shovel maker. All firms are reaching for more than they are 'entitled' to but ultimately everyone is chasing the same profit."*

**Retail Bank (Europe)**

Other respondents singled out individual participant types for effectively holding Smart Commerce development to ransom and for demanding what the respondents obviously felt was an unreasonable proportion of sales values. Mobile network operators (MNOs) were mentioned more than any other type of participant in this respect, with very little recognition from other participants of any value they currently bring to Smart Commerce. According to our interviews, what power the MNOs had has been significantly diluted since the launch of the iPhone and the subsequent launch of rival smart phones, which act as platforms for third-party app development. Progress is now limited by arguments over the share of transaction fees due to different industry participants.

---

*"MNOs and banks have held up development. For five to six years it has been technically easy to build the solutions but MNOs wanted 10% of payment values. There is a mismatch in expectations of value – a 'commercial standoff.' MNOs wouldn't give access to the phones – and they control access to the important secure element."*

**Global Credit Card Provider (Europe)**

## D. The threat to banks

---

Banks regard the main risk posed to them by Smart Commerce as that of customer intermediation – and the decline in bank relevance to consumer commerce should this occur.

**Some banks are concerned about the potential loss of direct revenue from cards and current account balances.**

Alongside the belief in a Smart Commerce future, banks and card processors feel threatened by it. Most respondents indicated some concern about the direct revenue impact of their customers' adoption of digital wallets for purchasing. The poor relative economics of accepting cards as a funding source makes it likely that wallet providers will strongly encourage direct funding from bank accounts through an Automated Clearing House (ACH) instead. This is likely to reduce card usage and revenue for bank card issuers.

The other direct impact cited by a third of interviewees was that some consumers would start to maintain a balance in their digital wallets, which previously would have been held in a current account, thus reducing a vital source of low-cost funding previously considered reliable and stable.

---

*“Eventually we lose the customer and all the wider value that flows from the relationship if we don't maintain the relevance of the bank.”*

**Retail Bank (Europe)**

---

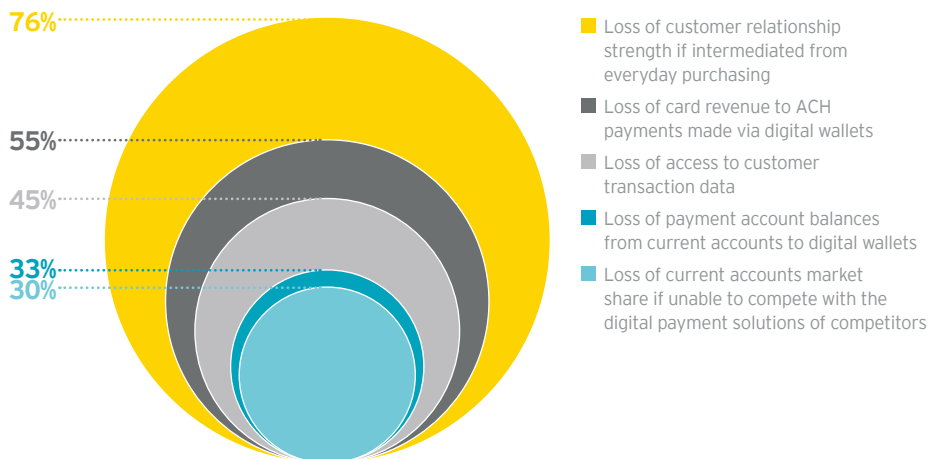
*“Person-to-person (P2P) payment completely wipes out interchange and card transactions so the options (for us) are bad, worse and worst.”*

**Retail Bank (Europe)**

However, more are concerned at the potential dilution of the end-customer relationship and its impact on brand relevance and customer data.

Seventy-six percent of respondents voiced concern that Smart Commerce will distance them from customers if consumers start to use non-bank digital wallets instead of a bank card to buy things. Many respondents envisaged a world where banks and card companies are intermediated by new entrants and digital payments systems (including those of other banks) that marginalize other banks and card issuers from their relationship with customers and reduce the information on consumer behavior that they hold. With no or little transaction level data, the potential to provide sales promotion services to merchants and earn revenue from this attractive profit pool referenced in Section 02 – Banks’ responses on page 19 is likely to be all but lost. Banks and card brands that no longer play a daily role in consumers’ lives would become little more than utility providers of commodity financial services in this environment.

**Which of these revenue risks from Smart Commerce should banks be most concerned about?**



Respondents could select up to three answers

Base: Financial services’ respondents (34)

“There is a threat of losing business to non-bank players. Within our bank there is a phrase that we ‘don’t want to be a dumb pipe’ that is, just the conduit for payments where the value is taken by other parts of the process.”

**Retail Bank (Americas)**

“There is a threat of losing business to non-bank players. Within our bank there is a phrase that we ‘don’t want to be a dumb pipe’ - that is, just the conduit for payments where the value is taken by other parts of the process.”

**Retail Bank (Americas)**

“New, digital payment services providers make banks lose the ability to see customer needs and it therefore becomes hard to see the value of new offerings. Banks become commodities in this context.”

**Retail Bank (Europe)**





# Banks' responses

Banks are planning to deliver ambitious Smart Commerce services to counter the threat of intermediation

02

## Key findings

### A. Strategic ambitions and drivers

Most respondents want to be a Smart Commerce “solution provider” offering integrated solutions incorporating both payments and broader “purchasing facilitation” services (e.g., digital loyalty, promotions and receipting), and most intend to deliver this within two years.

### B. Opportunities beyond payment

Over 80% of respondents believe banks can support targeted digital merchant promotions using customer data in addition to their traditional payment services role; however, one in eight thinks that banks should stick to providing only payment and finance services in Smart Commerce.

### C. Challenges to strategy delivery

Participants identified three main challenges to delivery of Smart Commerce strategies:

1. Overcoming conservative internal cultures
2. Selecting the “best” solution when there is no clear winner and fraud/data security risks are a key concern
3. Ensuring regulators are kept up to speed

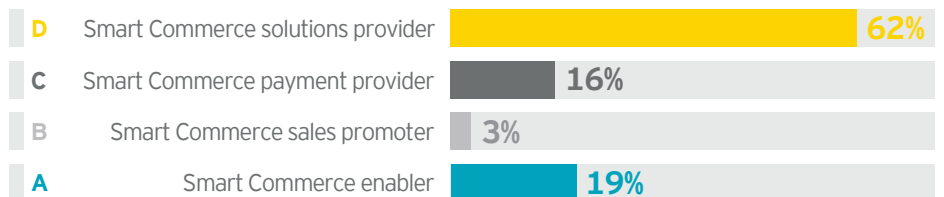
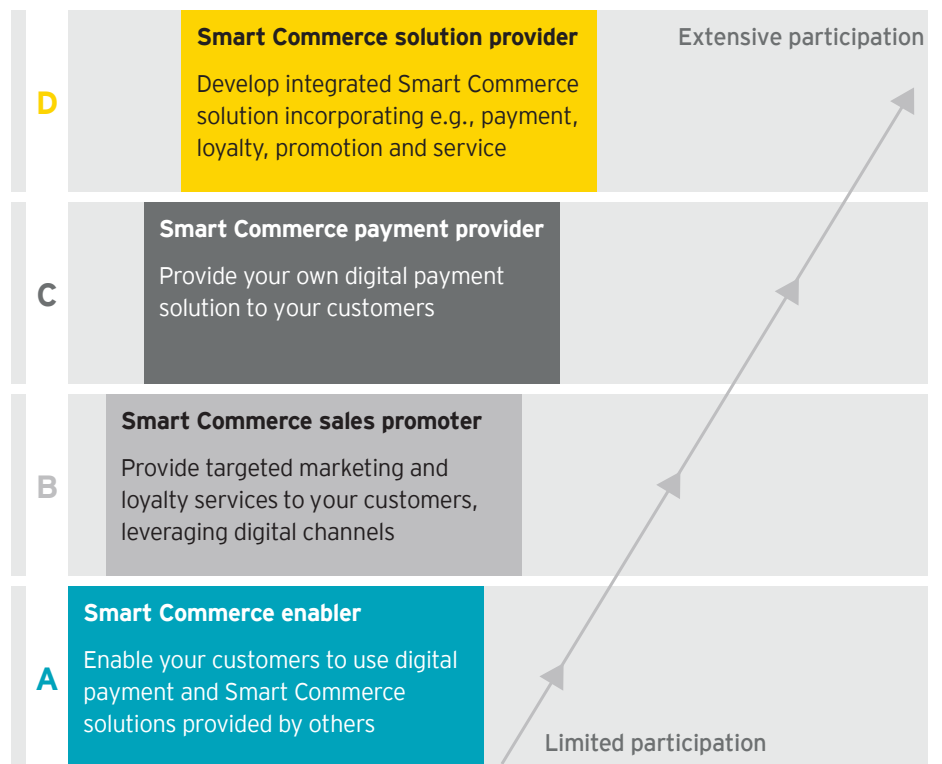
### D. Skill and capability gaps

Most participants also need to address capability and skills gaps – most notably in distribution, mobile app development and in social media.

## A. Strategic ambitions and drivers

Most respondents want to be a Smart Commerce “solution provider” offering integrated solutions incorporating both payments and broader “purchasing facilitation” services (e.g., digital loyalty, promotions and receipting), and most intend to deliver this within two years.

**Which strategy option shown below is the closest match to your Smart Commerce strategy?**



Base: Financial services' answering (32)

Nearly two-thirds of respondents have ambitious aims to be a Smart Commerce “solution provider” and in short timescales.

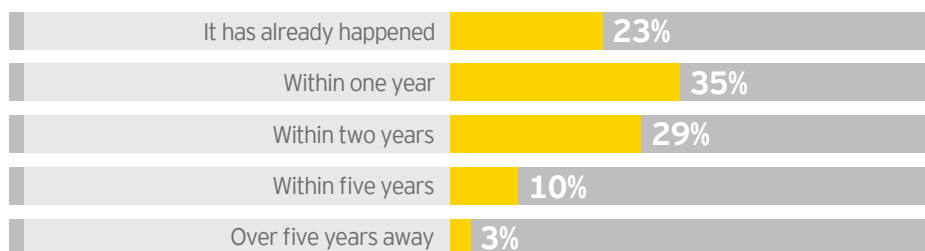
During interviews, we presented participants with a set of defined options describing their likely Smart Commerce strategy. When we asked respondents which one most closely matched their strategy nearly two-thirds responded that they are aiming to be a Smart Commerce “solution provider” offering extensive and integrated Smart Commerce services. Most of these respondents preferred not to talk specifically about what they were developing but, perhaps predictably, the most ambitious firms were those banks that still retain merchant acquiring businesses or those that are either part of or have close ventures with retailers. The solution components that were mentioned included payment, couponing, retailer loyalty, location-based services (promotion and customer service).

The remaining third were less ambitious, choosing to either stick to a role in the domain of payments or simply to offer e.g., “white labeled” Smart Commerce solutions from others to their customers with limited, if any, customization.

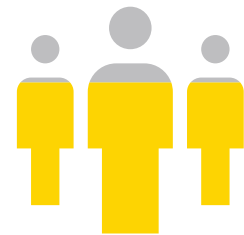
Interestingly though, the extent to which organizations were choosing to build their own Smart Commerce solutions did not necessarily correlate with the scale of their ambitions. At least one large bank indicated that it was aiming to become a Smart Commerce “solution provider” by intelligently combining the best third-party solutions available to give it speed to market and flexibility.

When we asked about the timescales for delivery of these plans, nearly 90% indicated that their solutions would be in market within two years, with a majority of these intending to deliver within a year.

### How soon will your Smart Commerce strategy be delivered to market?



Base: Financial services' answering (31)



Nearly two-thirds of respondents have ambitious aims to be a Smart Commerce “solution provider” and in short timescales.

**87%**

indicated that their solutions would be in market within two years, with a majority of these intending to deliver within a year.

## A. Strategic ambitions and drivers



Respondents' Smart Commerce ambitions were motivated principally by enhancing customer relationships and payment revenue.

The commercial drivers behind these ambitions were explored in our questions on the nature of the Smart Commerce opportunity for respondents' organizations. The most popular answer indicates that half of respondents see the opportunity in Smart Commerce within the defensive commercial context of **retaining and improving customer relationships**.

Respondents both within and outside of traditional financial services recognized banks as possessing a key asset in customer relationships and customer data with a very broad view of their customers' purchasing behavior. Many banks therefore see the opportunity in leveraging this data to increase customer loyalty and retain existing business revenues by maintaining relevance to customers through improved customer experiences and differentiated propositions. The customer experience examples mentioned by respondents arise from the view that banks could offer more to customers, particularly in the post-purchase "Service" stage of the commerce lifecycle. Examples mentioned were digital receipting and tools to help consumers understand where they are spending their money.

---

*"We are extremely data rich but we make poor use of it. The opportunity is in more efficient and effective use of our data to provide a truly differentiated offer in terms of value to the customer. For example, if someone is about to spend £300 we could give them real-time data that would tell them whether they can afford it, or whether they could afford it but be in real trouble next week. We can then give customers options in terms of purchasing, purchasing with an advance, etc. Customers have never been less trusting of retail banks but never in more need of bank advice."*

**Retail Bank (Europe)**

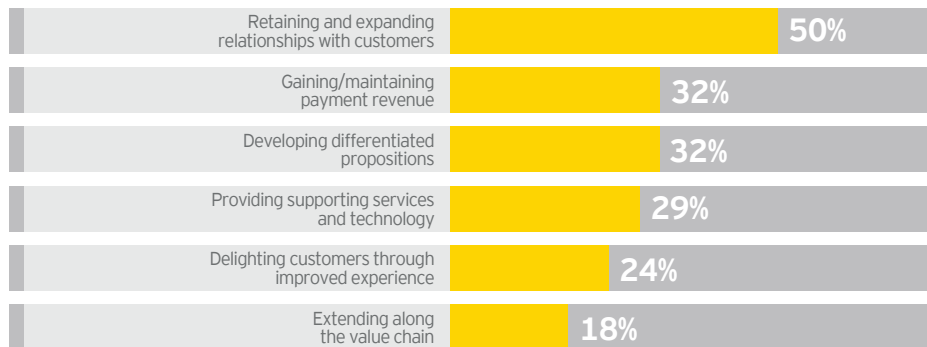
---

*"We have a fantastic advantage today if we wake up and do something. With balance sheet, trust, distribution and global scale, we have a great opportunity to build the future for digital payments."*

**Global Credit Card Provider (Europe)**

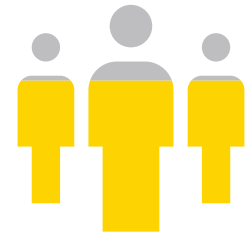
Nearly a third of interviewees were seeking to gain or maintain payment revenues. While digital payment providers are certainly targeting the payment revenues of the banks and card industry, banks themselves mainly see the payments opportunity in Smart Commerce on two fronts: first, maintaining existing revenue streams by delivering a more seamless and enhanced payment solution, and second, growing the use of lower-cost and more scalable Smart Commerce payment solutions at the expense of cash.

**What do you see as the opportunities arising from Smart Commerce for organizations such as yours?**



Respondents could select up to three answers

Base: Financial services' answering (33)



Nearly a third of interviewees were seeking to gain or maintain payment revenues.

“We have a fantastic advantage today if we wake up and do something. With balance sheet, trust, distribution and global scale, we have a great opportunity to build the future for digital payments.”

**Global Credit Card Provider (Europe)**

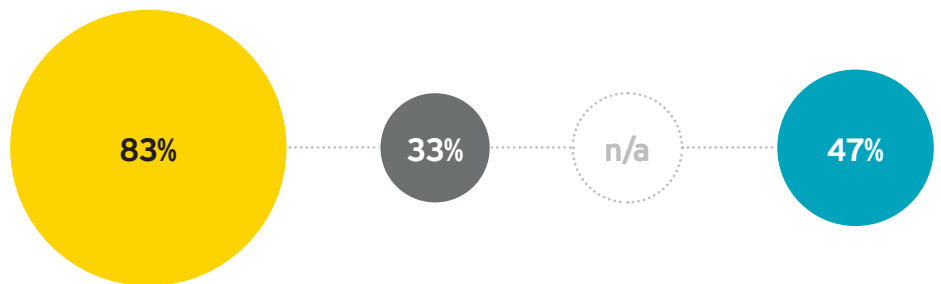
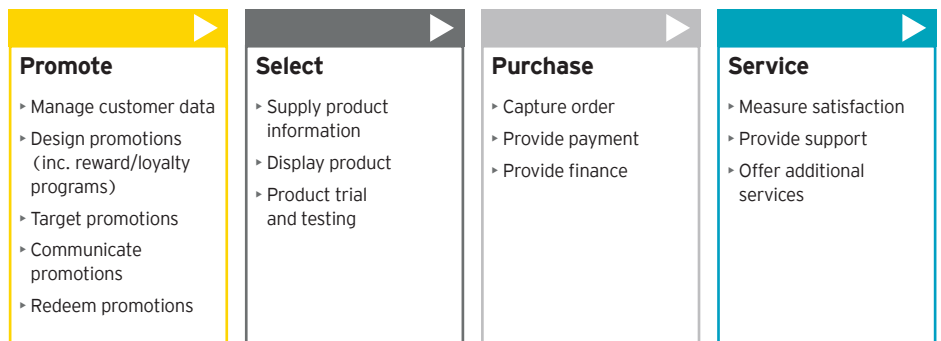


## B. Opportunities beyond payment

Over 80% of respondents believe banks can support targeted digital merchant promotions using customer data in addition to their traditional payment services role; however, one in eight thinks that banks should stick to providing only payment and finance services in Smart Commerce.

**Beyond “Purchase,” which of the other three elements of the Smart Commerce value chain below can banks participate in?**

### The Smart Commerce value chain



Respondents could select up to three answers

Base: Financial services' answering (30)

Eighty-three percent of respondents saw potential for banks to go beyond the “Purchase” stage of the value chain to offer services in Smart Commerce promotion, although relatively few actually expressed this as a specific opportunity for themselves. Once again, our interviewees recognized the powerful and valuable data that banks have at their fingertips.

The detail of responses from interviewees focused on developing end-to-end solutions shows the desire to control customer data and the opportunities respondents believe may exist to attract new customers and generate new revenue through differentiated offerings. A new wave of promotions that use consumers' bank payment transaction data in a more intelligent and targeted manner was seen by many respondents as the most likely route for banks to follow. This compares to the limited and imprecise nature of much existing digital promotion, which is based on location or the purchasing history of a customer with just a single merchant.

*"We plan to be very active. We want payment mechanisms put into digital wallet along with credit cards, promotions that create loyalty, rewards strategies that compound savings giving customers meaningful discounts on some purchases."*

**Retail Bank (Americas)**

*"Banks have an opportunity in the way they operate to use data to drive promotions. However, they will need alliances to add value in other elements of the value chain."*

**Digital Payment Services Provider (Europe)**

*"Assuming the current account remains the key processing hub then banks have a role to play in promotion, but they need to move quickly to maintain their relevance."*

**Technology (Europe)**

However, this was not a universally held view, with some respondents expressing concern about banks participating in areas in which they have no experience and which may end up damaging their reputation and brand. Others pointed out that while banks may want to participate in all areas of the value chain, they doubted banks had the skill sets necessary to achieve this lofty ambition with little to add in the "Promote" and "Select" sections of the value chain in comparison to specialists. Credibility in new areas was also seen as an issue for banks to overcome when participating outside of the payments sphere. In all, 12% of respondents suggested that banks should remain solely in the "Purchase" stage of the value chain.

*"Banks are not the organizations to help consumers select and choose which products to buy."*

**Retail Bank (Americas)**

More than  
**80%**  
of respondents believe  
banks can support  
targeted digital  
merchant promotions...



... however, one in eight  
thinks that banks should  
stick to providing only  
payment and finance  
services.

## C. Challenges to strategy delivery

“We are a financial services provider, with internal processes that are long-standing and well-established. It is very difficult to compete with the Californian ‘hackathon’<sup>3</sup> model.”

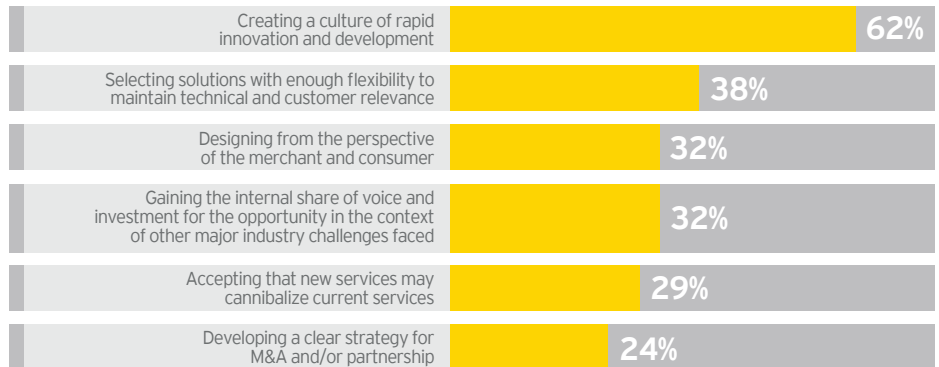
**Global Credit Card Provider (Europe)**

Participants identified three main challenges to delivery of Smart Commerce strategies:

1. Overcoming conservative internal cultures
2. Selecting the “best” solution when there is no clear winner and fraud/data security risks are a key concern
3. Ensuring regulators are kept up-to-speed

Most banks need to overcome a conservative culture, which nearly two-thirds say does not support rapid innovation and change and nearly one-third feels is concerned about the cannibalization of other services.

### What are the key challenges you face in delivering your Smart Commerce strategy?



Respondents could select up to three answers

Base: Financial services' respondents (34)

For banks and credit card processors (and even one or two of the digital payment providers) the difficulty of creating a culture supportive to rapid innovation and development is seen by many (62%) as a key constraint on Smart Commerce progress. With the burden of legacy systems, are many banks even capable of the overhaul necessary to deliver the more accelerated new product development that consumers now demand? Our respondents concede a more entrepreneurial culture represents a significant change in approach for organizations better known for robust and lengthy testing processes, and for building bespoke in-house technology rather than buying bolt-on solutions. This conservative culture also finds another echo in the 29% of respondents for whom concern about cannibalization of existing banking payment products is seen as another potential roadblock.

3 An event in which computer programmers and others involved in software development, including graphic designers, interface designers and project managers, collaborate intensively on software projects.

---

*"We are a financial services provider, with internal processes that are long-standing and well-established. It is very difficult to compete with the Californian 'hackathon' model."*

**Global Credit Card Provider (Europe)**

**Some banks don't know what the best Smart Commerce solution to offer is when no clear winner has yet emerged and fraud/data security risks are a key concern.**

- ▶ More than a third are challenged to build sufficient flexibility into a solution that at the same time manages data security and fraud risks.
- ▶ One in three finds it hard to design from the end user perspective, particularly the merchant.
- ▶ A quarter aren't clear on their M&A strategy, probably as a result of the above.

Selecting solutions with sufficient flexibility was recognized by more than a third of respondents as a key operational development challenge. In particular, respondents recognized the difficulty in striking a delicate balance between investing for Smart Commerce growth and not investing too much in a platform or architecture that may be quickly superseded.

---

*"The key is to develop the strategic skills, to design things which allow us to interface with external partners but which are not completely customized builds that won't work with anyone else if we have to change course. This is the one that keeps me awake."*

**Retail Bank (Europe)**

---

*"There are long lead times in technology development so will the solution be relevant when it is launched?"*

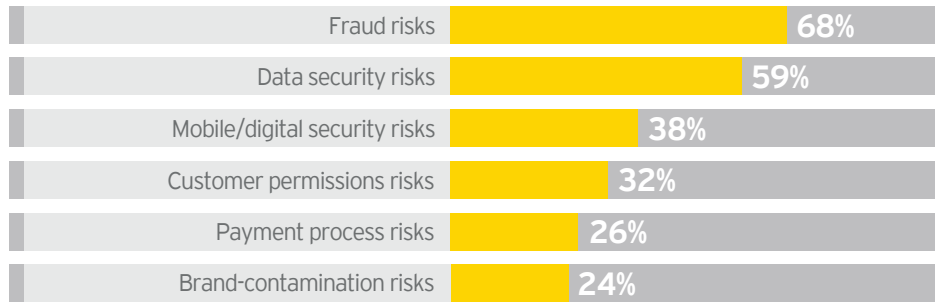
**Payments Processor (Europe)**

## C. Challenges to strategy delivery

*"Security and fraud are the biggest issues. Data is just not going to be secure – things are not going to be private and there's not much you can do about it. In that context customer permissions may well end up becoming very significant."*

### **Retail Bank (Europe)**

#### **What are the key operational risks that Smart Commerce providers will have to manage in order to succeed?**



Respondents could select up to three answers

Base: Financial services' respondents (34)

The key operational risk that Smart Commerce solution providers have to manage regards the security of customer data in an environment where new devices and participants will become part of the commerce ecosystem. Two-thirds mentioned fraud as a key operational concern, 59% data security and 38% mobile and digital technology security – the top three responses to this question.

While many financial services providers have robust legacy systems and processes to help prevent and manage fraud risk, our respondents expressed concerns that the proliferation of solutions on new and largely untested platforms means Smart Commerce is vulnerable to fraud.

According to our survey, these concerns are compounded by the potential scale and depth of customer data that are likely to be involved in joined-up Smart Commerce solutions and by the sheer number of parties likely to be involved in a single customer purchase journey.

A number of financial services respondents also expressed concerns that new solutions providers are operating with less stringent risk models that will put the entire Smart Commerce initiative back years if a major security or fraud breach occurs. There were differing views expressed about whether banks would ultimately suffer reputational damage in the event of a security breach outside of their control.



---

*“A lot of small providers are flying in the face of 50 years of card processing experience, and what makes it so difficult for banks is that we are not willing to compromise the safety of transaction services. There is a huge instability and liability issue, but it will blow up soon, and who is going to be on the hook? Not the banks this time.”*

**Retail Bank (Americas)**

In addition, according to our respondents, banks do not believe they enjoy the luxury of being able to learn from failure with their solutions because of the significant reputational and brand-contamination risk that accompanies it, even if the actual financial consequences of a specific failure are minor. Other firms in the Smart Commerce value chain including retailers and technology companies are seen as having a significant relationship advantage with customers on this front.

---

*“As a bank we don’t have the culture of issuing something with a bug and then providing a version 1.2 to fix those, in the way that technology companies do. With a bank it has to be right first time.”*

**Retail Bank (Americas)**

A third of respondents also believe that they are not yet well positioned to understand the needs of either consumers or merchants to enable them to design Smart Commerce solutions from the user’s perspective. Banks have, as reflected by the previous discussion on risks, been hugely preoccupied with risk management often at the expense of a seamless and easy customer experience, particularly in e-commerce. Our respondents recognized that they also have limited insights into customer needs outside the financial components of purchasing and also have little perspective on the needs of merchants outside this narrow area.

## C. Challenges to strategy delivery



---

*"Historically we have 'talked to ourselves' when developing, rather than looking at the merchant and consumer. There has also been a tendency to focus on protecting the revenues we have. Looking forward, we have to decide who we are designing for – is it a 52-year-old, or his 20-year-old daughter?"*

**Card Processor (Americas)**

---

*"We want to design solutions from the perspective of the merchant and consumer – but often get caught up in internal way of thinking."*

**Retail Bank (Americas)**

According to our respondents, the lack of visibility as to the "best" approach makes strategic planning difficult, underpinning the importance of retaining flexibility. One in four agreed that they still do not have a clear M&A strategy to support their Smart Commerce ambitions. While buying new technology was favored by only a few respondents, many of those that did believe acquisitions or commercial partnerships had a role to play in filling skill set gaps recognize it as a way of "fast tracking" their Smart Commerce strategy.

In contrast, some respondents saw acquisitions as a high-risk strategy, though it was unclear from responses whether that view held consistently across hardware and software, across acquisitions of all sizes or at all points in the value chain. Banks also expressed concerns about committing to a single technology and the importance of retaining technology flexibility. The intention to partner with third-party technology providers to "see what works" was a common response.

---

*"The answer is not clear today. Other banks want to be a leader in this space, but we are still unsure on how to address the issue. We want to be a smart follower to leverage what comes up and keep our options open."*

**Retail Bank (Europe)**

**Others feel they must also get regulators ready for Smart Commerce.**

In some areas, regulators are seen by respondents to be somewhat in denial at the large-scale adoption of new payment processes that could easily fall outside of the existing regulatory framework. Some banks articulated the view that the newer payment solutions are already operating beyond the remit of a single regulator. However, banks recognize the role they have to play in helping to educate regulators and in shaping regulation that is fit for purpose in the world of Smart Commerce.

Within Europe, there is some debate over the need for single, cross-border regulations to replace a patchwork approach of differing national regulations as Smart Commerce develops. Will a standard emerge led by a few key industry players?

---

*"The current regulatory mindset is based on a world where the bank owns the payment system, but Smart Commerce changes this and regulators are not ready for this."*

**Retail Bank (Americas)**

---

*"There will have to be changes to recognize that new organizations are entering the supply chain that don't fit the existing definitions of regulated firms by existing authorities, for example, a company that maintains electronic/digital wallets; does it fit the definition of a financial institution or a deposit taker?"*

**Retail Bank (Europe)**



## D. Skill and capability gaps

60%

of respondents highlighted a need to bolster distribution to deliver their Smart Commerce strategy.

Most participants also need to address gaps in skills and capabilities – notably in distribution, mobile app development and in social media.

The individual respondents were all involved in the Smart Commerce value chain to a greater or lesser degree but had varied roles within their organizations. Even accounting for these differences, our bank participants expressed needs for a broad range of additional capabilities to deliver their intended Smart Commerce strategies. The majority highlighted two or three capabilities where they believed their organization needed to add to existing resource and skill sets.

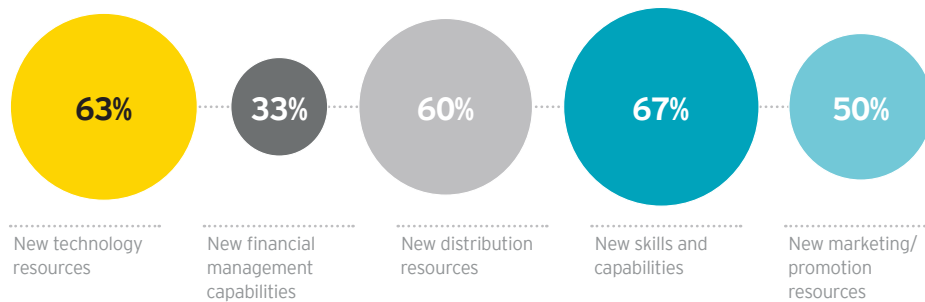
Within the broad category of “New skills,” mobile product and application skills were a particular area of need cited. Meanwhile, enhanced distribution capabilities to retailers and additional promotion skills, particularly in the area of social media, were identified by half or more of our respondents. Predictably, as most respondents are established financial services players, fewer felt that their financial management capabilities needed augmentation to support their Smart Commerce strategies.

Where interviewees planned to augment skills, most felt that recruitment was the preferred approach over training or acquisition of an established business. The change required for Smart Commerce thinking was, for many, too great to expect existing staff to be able to adapt in short enough timescales. Bringing in new staff was seen as a good catalyst for this change. But acquiring a whole business e.g., a mobile software development business was generally considered too much of a risk, and most wanted to manage the transition from using third-party support to providing this internally more gradually.

*“Our decision on which route to take to address capability shortfalls depends on the urgency. Mostly we like to build in-house, but if it's urgent and it's available we shouldn't be afraid to buy.”*

**Retail Bank (Americas)**

**Which of the five complementary capability types shown below does your organization need to deliver its Smart Commerce strategy?**



Base: Financial services' respondents (34)

**New technology resources**

For example:

- ▶ Handsets
- ▶ Mobile network
- ▶ Mobile software
- ▶ Applications
- ▶ Mobile/digital risk management technology
- ▶ Data warehouse and analysis

**New financial management capabilities**

For example:

- ▶ Customer identification and verification
- ▶ Authorization/settlement
- ▶ Credit and fraud risk assessment
- ▶ Funding
- ▶ Payment
- ▶ Deposit taking

**New distribution resources**

For example:

- ▶ Mobile customer bases
- ▶ Retailer relationships
- ▶ Payment acceptance capability (POS and remote)
- ▶ Consumer/retailer brands

**New skills and capabilities**

For example:

- ▶ M&A/partnership development
- ▶ Digital/mobile product or application development
- ▶ Digital/mobile risk management
- ▶ Third-party technology management (e.g., coordinating solutions for multiple handsets)
- ▶ Regulatory compliance

**New marketing/promotion resources**

For example:

- ▶ Social media marketing
- ▶ Mobile marketing
- ▶ Loyalty scheme management
- ▶ Retail promotions capability

Multiple-choice question whereby respondents selected all the categories that applied to them.



## D. Skill and capability gaps

---

Both banks and retailers have well-established distribution strengths, yet 60% of respondents highlighted a need to bolster distribution to deliver their Smart Commerce strategy. Partnership was seen as the preferred route by banks seeking new distribution, focused as they are on enabling merchants to accept their payment and other solutions. Such partnership may take the form of a straightforward commercial arrangement to access a retail client base through e.g., a promotions management company rather than a more complex partnership or joint venture, which might be valuable if joint development were required.

Nearly two-thirds of our respondents also identified a need for new technology spanning wallets, payment services, data warehousing and analytics software and mobile apps for banking, personal finance management and merchant promotion support. A fair number suggested that they would expect to use the technology built by third parties (e.g., the card schemes digital wallets) to support their strategies but some banks still plan to build such solutions internally. Where respondents expanded on their intentions to build new technologies in-house, many did so in reference to the culture of their organization and the desire to "build and own everything."

---

*"Segmentation, customer modeling, marketing (technology) because they're available and we need them quickly and I'm not too worried about building in-house."*

**Retail Bank (Europe)**



# Our views and recommendations for financial services institutions

Banks face some serious threats and the risk of gradually being diminished to utility status. However, if they make the right choices, banks could find themselves enjoying a continued and expanding role at the forefront of the Smart Commerce revolution.

This is an exciting time to be involved in consumer commerce. However, the speed of change and uncertainty of Smart Commerce also leads to significant concerns. One of the most surprising insights from this study was the real and widespread fear articulated by established organizations that Smart Commerce development will result in intermediation, with potentially significant consequences for banks that go well beyond payment service revenues.

These fears are well founded. The new players in the Smart Commerce value chain are already demonstrating aggressive business models that are vastly different from the traditional payment and banking model. These models are based on rich data on consumer transactions that cross-subsidize payment services by promoting and sharing in merchant and manufacturer profit pools with potential to further displace banks' traditional place in the purchasing experience.

That so many of the respondents see themselves as potential providers of broad and integrated Smart Commerce solutions is, we believe, an acknowledgment of this threat and illustrates for us how seriously this issue is being taken in financial service institutions across the globe. Indeed, Smart Commerce is one of the few areas of significant discretionary investment still remaining in many banks in an environment of heightened regulatory pressure and general cost reduction.

The differing pace of Smart Commerce adoption geographically is yet another strategic challenge facing banks – and a variety of strategies and partnerships are likely to unfold against this backdrop. Larger banks may be able to leverage their distribution reach in partnership with smaller firms that have attractive Smart Commerce technology but no clear path to market. Meanwhile, less aggressive and less agile financial services groups should see the defensive value in developing Smart Commerce services to maintain competitive parity with payment intermediators (both new entrants and other banks). In all cases, however, we believe that a multi-strand Smart Commerce strategy is wise while significant uncertainty in a number of dimensions remains. This could mean running for a period with parallel or competing solutions.

To maintain relevance to their customers, banks and payment providers will have to find ways of accommodating the rapid development timescales demanded by Smart Commerce within organizations used to a much slower pace of change. They will also need to think in new ways about how their Smart Commerce services can add value in the broader context of consumers' lives and merchants' businesses as well as addressing the new fraud and data security risks they present.

For many this will involve relearning the merchant business with which many banks have lost connection. Indeed, merchants are the new value pool for Smart Commerce and are innovating on their own account with services including payment. Larger merchants (particularly online but also in physical retail) are already offering proprietary payment services, which intermediate banks and threaten to go further. Smaller merchants will also want to use the power of Smart Commerce solutions provided by third parties to enable them to punch above their weight.

With so much in this space still to be determined, we believe that the next few years hold the promise of a real step-change in consumer commerce. Banks face some serious threats and the risk of gradually being diminished to utility status. However, if they make the right choices, banks could find themselves enjoying a continued and expanding role at the forefront of the Smart Commerce revolution.

#### About Ernst & Young

Ernst & Young is a global leader in assurance, tax, transaction and advisory services.

Worldwide, our 167,000 people are united by our shared values and an unwavering commitment to quality. We make a difference by helping our people, our clients and our wider communities achieve their potential.

Ernst & Young refers to the global organization of member firms of Ernst & Young Global Limited, each of which is a separate legal entity. Ernst & Young Global Limited, a UK company limited by guarantee, does not provide services to clients. For more information about our organization, please visit [www.ey.com](http://www.ey.com).

#### About Ernst & Young's Global Banking & Capital Markets Center

In today's globally competitive and highly regulated environment, managing risk effectively while satisfying an array of divergent stakeholders is a key goal of banks and securities firms.

Ernst & Young's Global Banking & Capital Markets Center brings together a worldwide team of professionals to help you achieve your potential – a team with deep technical experience in providing assurance, tax, transaction and advisory services. The Center works to anticipate market trends, identify the implications and develop points of view on relevant sector issues.

Ultimately it enables us to help you meet your goals and compete more effectively. It's how Ernst & Young makes a difference.

© 2013 EYGM Limited.  
All Rights Reserved.

EYG no. EK0140



In line with Ernst & Young's commitment to minimize its impact on the environment, this document has been printed on paper with a high recycled content.

This publication contains information in summary form and is therefore intended for general guidance only. It is not intended to be a substitute for detailed research or the exercise of professional judgment. Neither EYGM Limited nor any other member of the global Ernst & Young organization can accept any responsibility for loss occasioned to any person acting or refraining from action as a result of any material in this publication. On any specific matter, reference should be made to the appropriate advisor.

The opinions of third parties set out in this publication are not necessarily the opinions of the global Ernst & Young organization or its member firms. Moreover, they should be viewed in the context of the time they were expressed.

[www.ey.com](http://www.ey.com)

ED None

# Contacts

## Global Financial Services

**David Barker**  
Partner  
[dbarker@uk.ey.com](mailto:dbarker@uk.ey.com)  
+44 20 7951 2005

## Americas Financial Services

**Bernhard J. Klein Wassink**  
Principal  
[bernhard.kleinwassink@ey.com](mailto:bernhard.kleinwassink@ey.com)  
+1 212 773 4634

**Melanie Henderson**  
Senior Manager  
[melanie.henderson@ey.com](mailto:melanie.henderson@ey.com)  
+1 212 773 1857

## Asia-Pacific Financial Services

**Richard Williamson**  
Partner  
[richard.williamson@hk.ey.com](mailto:richard.williamson@hk.ey.com)  
+852 2846 9696

## EMEA Financial Services

**Tariq Khatri**  
Partner  
[tkhatri@uk.ey.com](mailto:tkhatri@uk.ey.com)  
+44 20 7951 1305

**Jon Male**  
Director  
[jmale@uk.ey.com](mailto:jmale@uk.ey.com)  
+44 20 7951 7004

## Japan Financial Services

**Noboru Miura**  
Partner  
[miura-nbr@shinnihon.or.jp](mailto:miura-nbr@shinnihon.or.jp)  
+81 3 3503 1115