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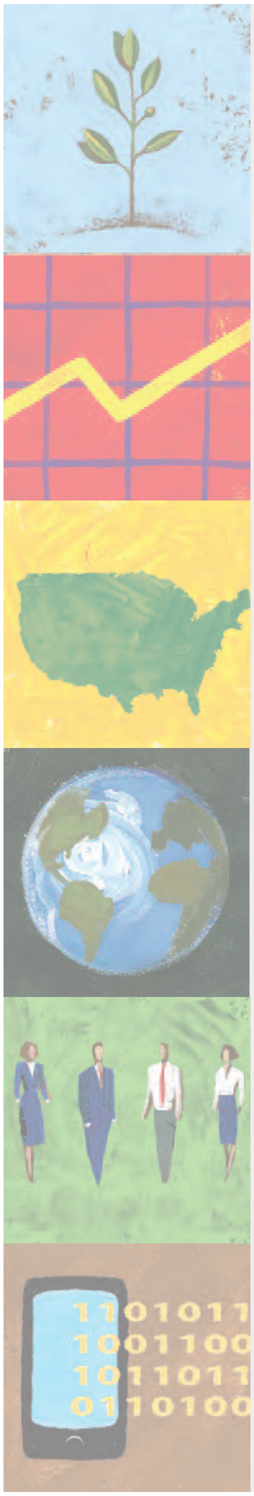

McKinsey on **Payments**

Digital wallets in the U.S.: Minding the consumer adoption curve

Digital wallets have been slow to capture consumer attention, but finally seem poised to enter the U.S. mainstream. For would-be digital wallet players, then, the key questions are: How fast will consumers adopt digital wallet products, and how is the market likely to unfold? The answers, of course, depend on the nature of the products offered and consumers' willingness to adopt them. This article provides insight into the market-entry process by exploring how the consumer adoption curve relates to mobile payments technology.

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To better understand how that curve will likely work for digital wallets, McKinsey turned to advanced data analytics and other sophisticated tools to understand how consumers think and feel about mobile payments products in the U.S. The findings of this research identify several relevant market segments and reveal how each integrates with the consumer adoption process. This insight can be a useful aid in developing more effective market-entry strategies for a diverse range of potential market entrants, and provides learnings that can also be applied across other geographies.

How fast will the digital wallets market grow?

Recent activity by mobile wallet providers in the U.S. has grown considerably. Chief among these activities are product announcements (Samsung Pay, Chase Wallet, Android Pay, MasterPass and Visa Checkout), product launches (Apple Pay, Citi Wallet) and acquisitions (LoopPay by Samsung and Softcard by Google). On the consumer side, however, progress has been relatively slow, with mobile payments still representing less than 2 percent of consumer spending. Even market participants like PayPal, who have achieved higher online market shares, are still struggling to make progress in the broader pool of in-store purchasing. Popular peer-to-peer (P2P) services, such as Venmo (or PingIt and MobilePay in Europe) have also made little headway in this arena.

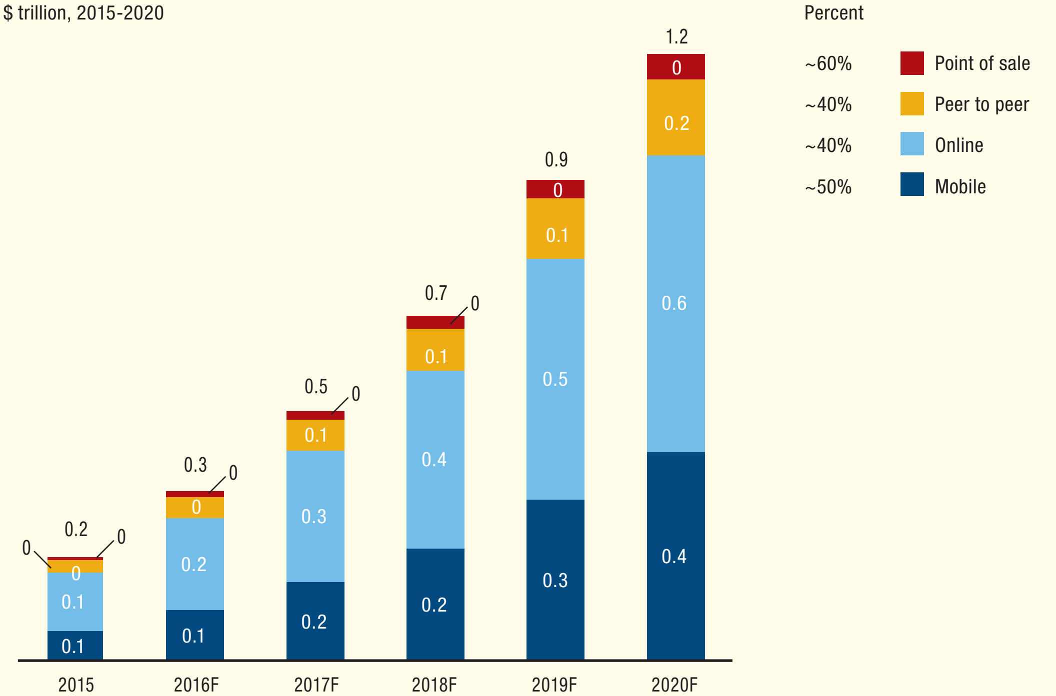
All this prompts the question: Will consumers ultimately adopt digital wallets on a widespread basis, and if so, when and at what rate? Recent research suggests that mobile payments will approach 9 percent of consumer spending by 2020, with certain consumer segments leading that advance. Most of the early volume will probably occur in online and mobile payments, rather than in point-of-sale (POS) transactions. In fact, almost half of e-commerce volume already flows through stored credentials—either digital wallets or cards on file. Such findings suggest that digital wallet providers will need to offer value propositions that are compelling to specific market segments that can, in turn, ignite more widespread adoption.

To estimate the potential for digital wallet adoption in the U.S. during the next five years, McKinsey employed predictive analytics technology in conjunction with data models aimed at estimating the growth potential under various market scenarios. The models drew on data from other digital wallet introductions, including the Starbucks smartphone app, M-Pesa (Kenya) and Alipay (China), as well as on data related to probable U.S. market drivers, such as e-commerce and smartphone penetration levels. Based on the projections of these models and other research findings, McKinsey estimates that approximately $200 billion in transactions are already flowing through digital wallets in the U.S. And the base-case scenario indicates this volume should reach 18 million transactions by 2020, or a total of $1.2 trillion. This represents about 18 to 20 percent of total U.S. retail spending. Approximately $1 trillion of that will come from mobile and e-commerce transactions (Exhibit 1).

Exhibit 1

Mobile and online payments will drive digital wallets adoption

Digital wallets in the U.S.: Value of payments
$ trillion, 2015-2020



Source: CrowdANALYTIX 2015; McKinsey analysis

Digital wallet defined

The term *digital wallet* has been loosely used in reference to a diverse range of financial services, products and technologies. For clarity, McKinsey defines a digital wallet as software that enables consumers to conveniently store various types of payments credentials, such as information about credit and debit cards, bank accounts, and prepaid or gift cards. Wallet owners can then use their stored credentials to digitally pay various parties and merchants for transactions being made online or with their mobile device at brick-and-mortar merchants equipped with NFC terminals; and they can even make peer-to-peer money transfers.

While the base case conservatively projects in-store mobile wallet transactions will reach $50 billion by 2020, some scenarios forecast significantly greater volumes. The most critical factor will be the ability to attain broad merchant acceptance and the merchants' willingness to offer consumers sufficient incentives to motivate substantial digital wallet use, as Starbucks succeeded in doing. Historically, merchant reluctance to accept new payments forms resulted from unclear adoption incentives and the high cost of altering POS infrastructures. But recent projections show that high adoption rates by brick-and-mortar merchants, as Starbucks licensees demonstrated, could create a four-fold increase in digital wallet use, reaching $200 billion by 2020. Because the U.S. market is in the early stages of mobile wallet use at retail, it is difficult to predict whether this accelerated growth will occur across the broader marketplace.

Who will adopt digital wallets, and when?

Anticipating substantial growth of digital wallets in the U.S. might be unsurprising in light of the increase of activity noted earlier. However, marketplace success still demands that participants better understand which consumer segments and product attributes will most likely drive growth, and designing relevant entry strategies. To address these questions, McKinsey turned to its latest Global Mobile Payments consumer survey, a study of 1,000 consumers that is designed to segment markets based on consumers' needs and attitudes regarding mobile payments and digital wallets. Needs-based segmentation helps identify which product attributes will probably drive consumer decisions in selected target markets, enabling marketers to design compelling value propositions that align with segment needs. Needs-based segmentation is often a stronger indicator of consumers' near-term decisions than demographic data and behavior-based segmentation. This is an important distinction for rapidly growing market categories such as digital wallets (Exhibit 2).

Consumer segment 1: Mobile enthusiasts

People in this segment tend to be early adopters of mobile wallets. They enjoy trying new things with their mobile phones, including making payments. If they have concerns about security or are interested in promotional offers, the concerns are typically minor. More important are convenience and the prospect of being able to leave their wallets and cards at home. As the youngest group in survey (47 percent are under the age of 35), mobile enthusiasts value traditional credit card attributes, including fraud alerts, low interest rates and high credit limits. Product attributes likely to attract this segment include a seamless mobile payments experience coupled with intuitive new features and interfaces. A compelling wallet offering might integrate merchant and peer payments, as well as a storage capability for personal credentials, such as a driver's license.

Segment 2: Deal hunters

Deal hunters seek promotional offers, rewards and discounts. Their primary motivation is not necessarily budget constraints; they're the wealthiest consumer segment, with 28 percent reporting household income greater than $100,000. But getting a deal makes them feel good. They are somewhat more skeptical about digital wallets and mobile payments than mobile enthusiasts, but nonetheless will likely adopt them within the next few years. This group prefers wallet offerings that integrate loyalty programs with rewards for supporting specific merchants, or with spending in certain categories.

Segment 3: Bank loyalists

Members of this segment focus on carefully managing their finances. Beyond that, they are generally ambivalent about digital wallets, preferring to use debit cards and other bank-focused payments solutions. These middle-income consumers consider deal-

Exhibit 2

In digital payments, consumer segments differ significantly

	Mobile enthusiasts	Deal hunters	Bank loyalists	Security skeptics	Budget conscious
Key defining attitudes	Like faster, simpler ways to make purchases	Love rewards and loyalty programs	Like bank-focused wallets, avoid credit cards	Conerned about privacy and technical reliability	Have no interest in mobile payments
Percent of U.S. consumers	26%	24%	17%	16%	17%
Percent greater than 65 years old	12%	7%	15%	34%	31%
Percent less than 35 years old	47%	32%	32%	15%	20%
Household income greater than $100,000	18%	28%	15%	18%	16%
Household income less than $25,000	15%	23%	25%	25%	31%
Percentage that use smartphones	73%	73%	66%	47%	54%
Self-described "early adopters" of mobile payments	17%	5%	7%	3%	1%
Self-described "resistant" users of mobile payments	6%	6%	18%	39%	30%

Source: McKinsey Global Mobile Payments Consumer Survey, 2014-2015 focused wallets and offers as bothersome distractions. Bank-focused wallets that facilitate tracking of account balances and expense management will therefore have the strongest appeal.

Segment 4: Security skeptics

These consumers are highly concerned about privacy and product reliability. They are less inclined than others to own a smartphone or even have a mobile device with Internet access. Security skeptics are also the most mature segment (34 percent are 65 or older). Their skepticism means they are the most likely to resist digital wallets. Forty percent say they have no interest in mobile payments. Identity theft and security are prime concerns for these consumers, who will avoid any form of mobile payments unless these concerns are addressed.

Segment 5: Budget conscious

Like bank loyalists, the budget conscious segment is function-centered. Its members employ various payments methods to manage their modest budgets. They comprise the lowest-income group, with 31 percent reporting household incomes of $25,000 or less. The budget conscious also have the lowest mobile-payments adoption rate. They are also deal seekers (38 percent are interested in deal-centered wallet offerings), although they are motivated more by their need to manage limited resources than by the thrill of the chase. Wallets likely to entice this segment will offer cash back

Exhibit 3

Appeal of digital wallet attributes varies by segment

Highest-priority features, by segment

	Segment				
Product features	Mobile enthusiasts	Deal hunters	Bank loyalists	Security skeptics	Budget conscious
Rewards		✓			✓
Loyalty programs		✓			✓
Identification	✓				
Peer-to-peer transfers	✓		✓		
In-person retail (POS)	✓				
Social connectivity	✓				
IT reliability				✓	
Technical performance				✓	
Mobile banking and bill pay			✓		
Low interest borrowing/credit	✓		✓		
Speed/ease of “check-out”	✓	✓	✓		✓
Digital goods	✓	✓			

Source: McKinsey Global Mobile Payments Consumer Survey, 2014-2015 or deliver other forms of significant consumer value.

Developing an effective multiphase marketing strategy

Understanding how each consumer segment prioritizes its needs will enable digital wallet participants to tailor their marketing strategies and offerings to maximize adoption and usage (Exhibit 3). However, given the limited size of individual market segments, winning widespread product adoption could require designing products that will appeal to multiple segments. More specifically, wallets will need to include more than just basic payments capabilities, and offer convenience-centered value propositions, which are fast becoming table stakes. Being device-centered products, Apple Pay and Android Pay, for example, attract mostly mobile enthusiasts. Other product attribute options include financial management and control capabilities that might appeal to the bank loyalist segment, or rewards and loyalty program links to pursue the deal hunter segment.

Players who target bank loyalists will need to leverage or build deep trust with their customers, and motivate them to migrate from bank cards to digital wallets. Adapting current card benefits, such as credit and spending controls to digital wallets could facilitate this transition. This approach might also include offering credit within wallets, or partnering with banks to integrate such an offering. On the other hand, those who decide to pursue the deal hunter segment might need to invest in features and infrastructure that enhance the shopping experience and offer meaningful rewards. These might be partnerships with merchant or credit card loyalty programs, integration with POS infrastructure to enable automatic redemption or pay-with-points features, as well as continuous sourcing of compelling merchant offers.

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Although consumer trends are difficult to predict, in the U.S. digital wallets seem ready to move onto the fast track. So now is the time for current and would-be participants in this potentially vast arena to identify which strategic market approaches are likely to maximize their chances for success. McKinsey's research and observation of digital wallets and other leading-edge payments approaches around the globe strongly suggest that a consumer-needs market segmentation strategy should be a major focus for all types of players. The segments identified here are based on research findings for U.S. consumers, and consumer needs and financial habits certainly differ from market to market; however, experience suggests that a similar needs-based approach offers the best opportunity for long-term success regardless of the target market.

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