

The keys to driving broad consumer adoption of digital wallets and mobile payments



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You may have already imagined this vision of your future:

You head to work in the morning with nothing more than your smartphone in the pocket of your stylish business-casual outfit. While walking to your car, you order and pay for your morning coffee, stopping into the coffee shop for a quick pick up. At your office building, you enter easily, even though you don't have your ID card.

When you head out for lunch, you get a text message offering you a free soda at your local deli. After a few clicks on your phone, you order your sandwich, redeem your free soda, and pay for lunch. On your way to pick it up, you complete a tedious lunchtime shopping errand that your spouse has unexpectedly requested.

You accomplish all this using nothing more than an app or quick wave of your smart phone. No phone calls, cash, credit cards, paper coupons or loyalty cards are needed. Perhaps not even an ID card. Such is the value, ease and convenience promised by mobile wallets.

There has been buzz about the promise of mobile wallets for several years now. Yet, despite the launch (and re-launch) of dozens of applications with various added benefits beyond simply "paying with your phone," consumers are not yet broadly using these applications, and they are certainly not leaving their physical wallets at home.

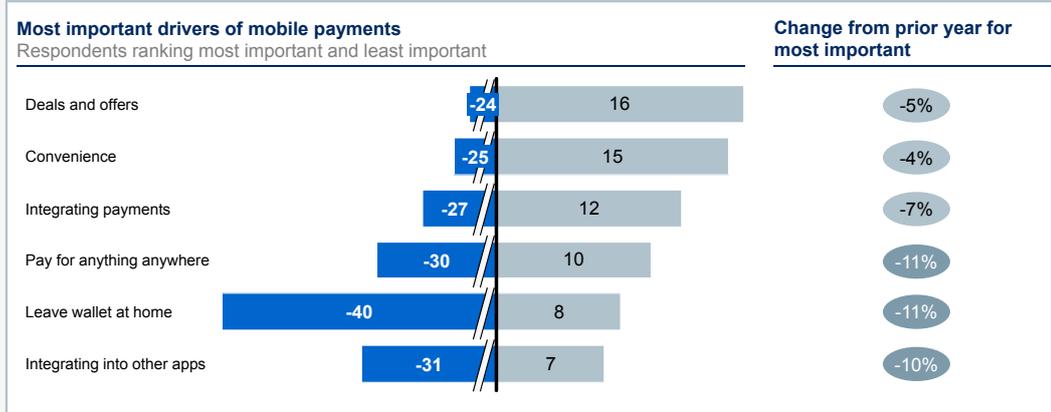
Big potential, still unrealized

In the U.S., consumer enthusiasm for certain benefits enabled by mobile payments remains high, especially around easier usage of coupons and loyalty points. But excitement is moderating as delivery of these benefits remains fragmented across many providers, with none of them commonly accepted by a broad sets of merchants. In fact, consumers say they are less excited about many of the various value propositions enabled by mobile payments (including "leaving their wallet at home"), and they are more skeptical about the broad promises of mobile wallets than they were one year ago. This consumer hesitation is evidenced by the fact that adoption of truly multi-channel "mobile wallets" remains low—fewer than 10 percent of consumers have ever made a mobile-phone based purchase at the point of sale.

Exhibit 1:
Consumers see future benefits in mobile payments but are less enthusiastic than they were a year ago

N=1000

■ Not Excited
 ■ Excited



1 Questions:
 A. "Thinking about the future benefits of mobile payments, what things are most exciting for you (1=not excited, 3=somewhat excited, 5=very excited)?"
 B. "What are the things you are concerned about when using your mobile device to conduct financial transactions (1=not concerned at all, 3=somewhat concerned, 5=extremely concerned)?"

These are the findings from McKinsey's most recent Mobile Payments Consumer Panel. In order to understand current and future mobile commerce and payments behavior, McKinsey surveyed a representative panel of 1,000 U.S. consumers in 2012 and 2013, matching the demographic profile of the U.S. adult population. Our research suggests that the current changes mark an important—but narrowing—window of opportunity. As consumer expectations settle to reflect a more pragmatic view of mobile commerce and payments, both established players and new entrants need to engage a much wider range of consumers with clearer value propositions before the current confusion and lack of broad acceptance leads to a sustained disinterest.

Our view is that such a scenario would be a missed opportunity for many businesses to drive truly incremental value. Mobile wallets and mobile payments can deliver substantial revenue and cost improvements, including reduced customer acquisition cost, increased customer lifetime value, and decreased infrastructure and operational cost. We believe that these benefits can accrue to various types of firms in various verticals. Companies who potentially stand to benefit include merchants, marketing service firms, credit issuing banks, payments processors, merchant acquirers.

One of the reasons that scale consumer adoption has lagged is that many of these players are offering their own stand-alone solutions, fighting to "own the customer." We believe many of those standalone efforts will struggle to gain widespread usage without partnerships that cut across the commerce and payments value chains and that address both consumers and merchants at scale. Without partnerships, these players sustain the status quo and risk squandering the current level of consumer interest in new mobile commerce and payments capabilities. It is worth noting that many stakeholders aren't convinced of the value of these new capabilities (most importantly merchants), and other stakeholders may have an interest in maintaining the status quo. Players with clear benefits to gain must prove the value of the new models to those partners and merchants that must be won over in order to gain scale.

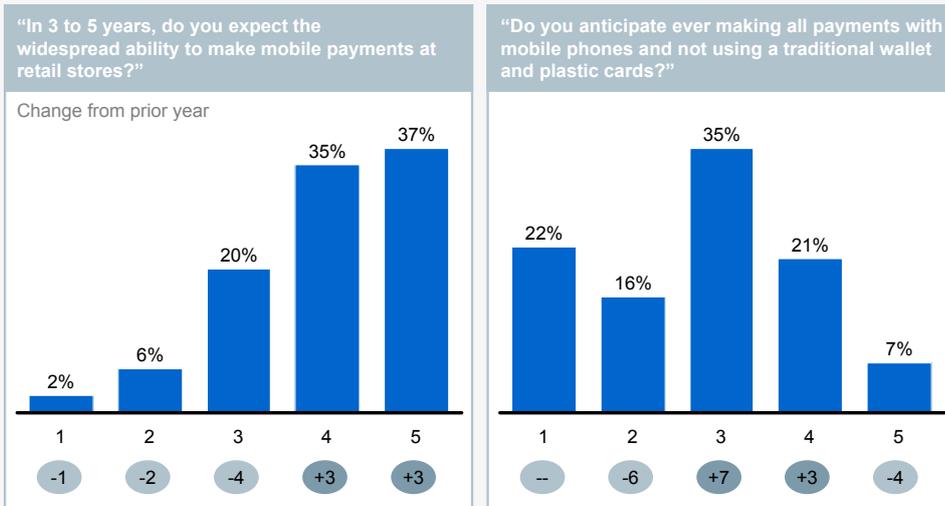
Despite these dynamics that challenge the potential for large-scale adoption of integrated mobile wallets, many observers still believe that the widespread adoption of mobile wallets is not a matter of *if* but *when*. Nonetheless, even the most optimistic observers agree that certain tipping points must be reached in terms of both merchant acceptance of digital wallets and consumer usage of smartphones. The latter is quickly approaching: In the U.S., smart phone penetration reached an important threshold in 2012, rising to 50 percent of consumers, up from about 40 percent in 2011. The current usage levels for various types of mobile payments, ranging from digital app purchases to money transfers, provide a solid foundation for growth.

Our survey found that seven of every ten consumers believe strongly that mobile payments at the point of sale (POS) will be widely available in three to five years. They anticipate a future in which they use a favored digital wallet to complete purchases at national and online merchants, the two categories where the acceptance of digital payments is most important. (Acceptance by local and regional merchants is much less important).

Exhibit 2:

Consumers widely expect retail stores to accept mobile payments but do not plan to exclusively use mobile payments

Scale ranges from 1, "very unlikely", to 5, "very likely" N=1000



SOURCE: McKinsey Mobile Consumer Survey - 2013

To take advantage of this approaching tipping point in consumer smartphone usage, the various mobile commerce solutions stakeholders should not only examine new partnerships to address consumers at scale, but also gain a deeper understanding of the problems they can help consumers solve through the use of mobile technology.

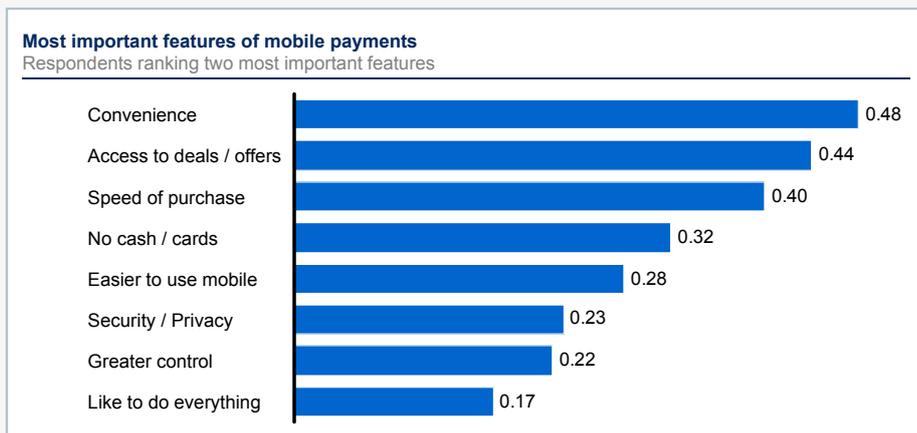
In that vein, here are more of the **key findings** from our consumer research:

The three highest-scoring features to drive consumer usage are paying-with-points, targeted deals and offers, and integrated payments.

A winning wallet should provide an enhanced shopping experience with seamless, loyalty integration, offer redemption, and shopping tools. Although traditional credit cards are the preferred funding source for wallets, 55 percent of respondents say that being able to use reward points at the checkout is essential or very important. This ability to pay with points is the single most popular feature consumers say they want. Consumers also continue to highlight “deals and offers” as important attributes of an integrated mobile payments offering, although interest in this and other drivers has cooled. Sixteen percent of respondents say they are “very excited” about offers delivered via mobile, compared to 21 percent in 2011. Twelve percent cite the importance of integrated payments.

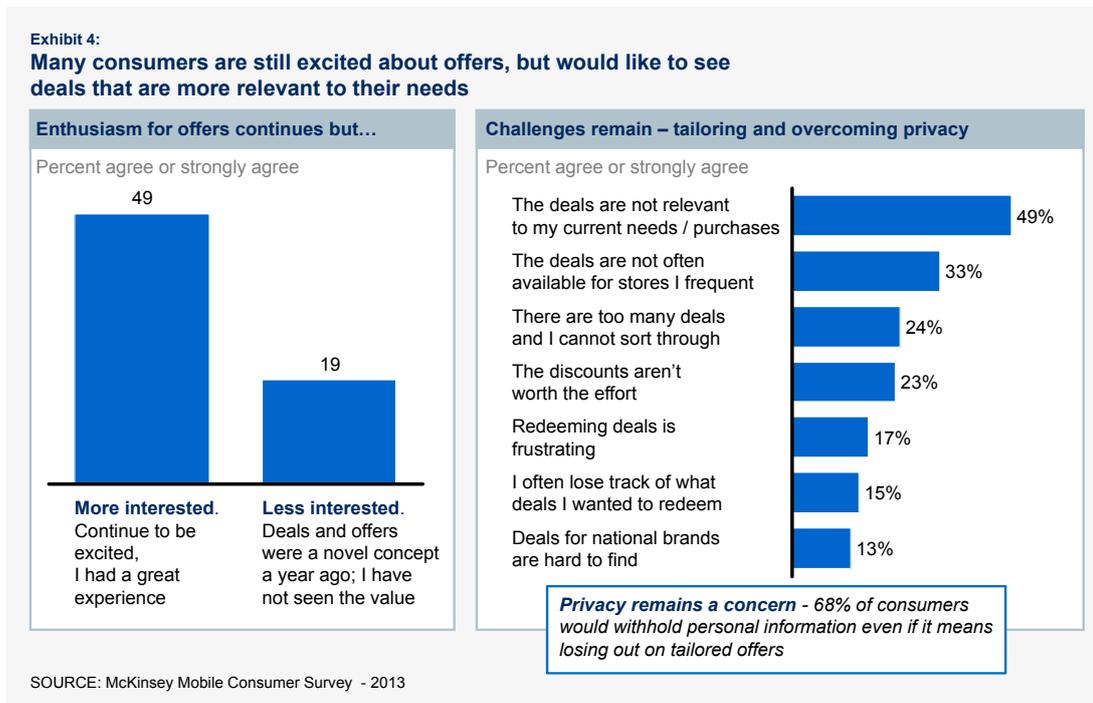
Exhibit 3:

Most important features of mobile payments



SOURCE: McKinsey Mobile Consumer Survey - 2013

The most heavily debated of these features is offers, as many observers are seeing signs of “offer fatigue” among consumers (and merchants). Despite the challenges faced by offer aggregators such as Groupon, consumers today are more enthusiastic about online offers (not just mobile ones) than they have been in the past. Only 20 percent of consumers feel disappointed by the recent offers craze, while 45 percent continue to be excited and more interested than one year ago. The biggest frustration they have is that deals are still not as relevant as they could be for their needs and purchase history. Thirty-three percent say that the deals they get are often not available at the stores they frequent; 24 percent say that there are too many deals and thus hard to sort through; and 23 percent say the discounts offered often aren’t worth the effort. Nearly half of respondents say they would like to see more relevant offers.)



The continuing relevance of payments integration to consumers suggests that a solution which doesn’t allow consumers to easily pay will not meet consumer needs, and thus those providers that solve commerce problems without a payments link will need to partner with payments providers to drive widespread consumer adoption.

Most shoppers want one digital wallet.

Sixty-two percent of respondents say they don’t anticipate using multiple wallets, a finding that places the consumer’s ideal end-state at odds with the current market fragmentation. Today’s mobile payment market is changing rapidly and is littered with incompatible choices and no clear winners, with diverse players locked in a high stakes battle for consumer relationships. High-tech and alternative payments players have made some inroads over the past 18 months, with launches and relaunches by PayPal, Google, Square, LevelUp and many others.

At the same time, traditional payments players are testing a range of approaches. For example, Visa’s V.me platform has been tested as a branded consumer wallet, but recent indications are that Visa will reposition V.me as a platform for banks to create their own branded wallets. In that vein, several major banks are actively working on their own digital wallet solutions. Merchants have also entered the fray, with MCX (Merchant Customer Exchange) developing a collaborative solution. Walgreen’s, Safeway, Starbucks and others are promoting their individual applications.

Which players will win, if any? Consumers clearly indicate the need to trust wallet providers, given the level of financial information shared. But consumers also demonstrate a need for new sources of value in order to change their current behaviors, requiring real innovation in solving unaddressed consumer problems. On the dimension of trust, banks and major payment networks get high marks. Although with a few notable exceptions, they get low marks for innovation, and their customers indicate a high level of indecision about banks’ mobile solutions. To maintain their pre-eminence as payment service providers,

banks must strike the right balance between trust and innovation and make a clear decision to be either a leader or fast-follower.

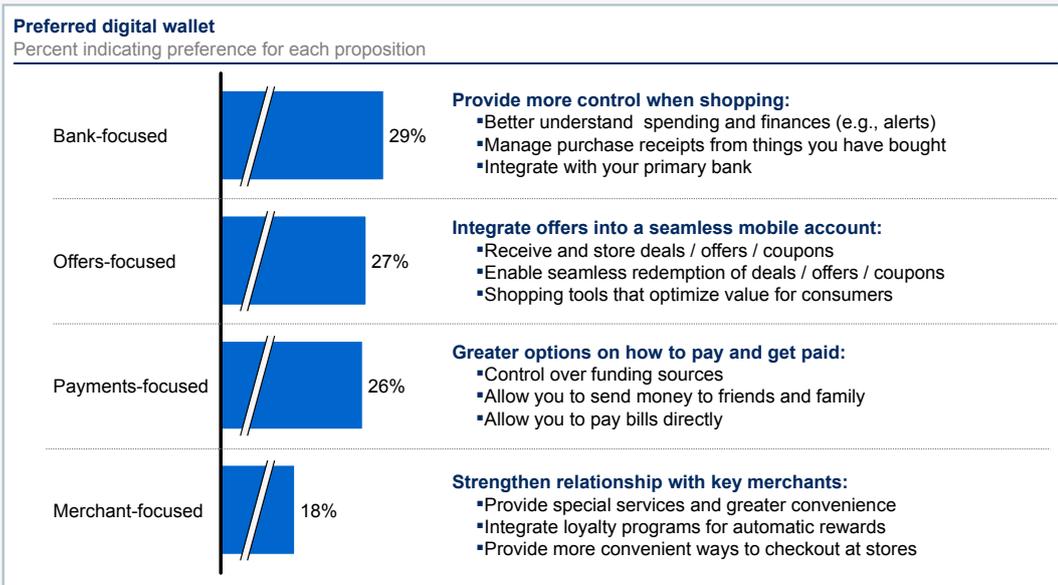
Exhibit 5:
Consumers looking to their banks for digital payments have a range of expectations

Thinking about your bank, what mobile payments and digital commerce services do you expect them to offer you?	
Online banking-type functions	<ul style="list-style-type: none"> ▪ “Nothing apart from a way to check my account balance online” ▪ “Secure online access to my accounts so I can manage bills and how much money goes where.” ▪ “I don’t expect much from them on my mobile, just check my balance, I do everything else online from home (laptop over secure network)”
Maintain par with peers	<ul style="list-style-type: none"> ▪ “I have no idea, but I am sure they will keep up with whatever is the ‘latest’” ▪ “I expect the same as competitors in the area, if other local banks offer this service, I expect my bank to as well” ▪ “I did not choose my community bank for it’s mobile device services, I do expect them to keep up to date with other banks in the area though”
New features and services	<ul style="list-style-type: none"> ▪ “Online purchases, bricks-and-mortar store purchases, utility payments, rent/mortgage payments. In short, I expect them to offer complete mobile payments and digital commerce services.” ▪ “A smartphone version of my credit and debit cards, in the same way as my Starbucks card.” ▪ “Short term credit over mobile app and ability to use by checking and savings directly at any merchant.”

SOURCE: McKinsey Mobile Consumer Survey - 2013

The bank-based digital wallets with the strongest appeal to consumers are those focused on financial control. Consumers find bank-focused digital wallets attractive because they offer greater control when shopping and a better understanding of a person’s spending and overall finances. For instance, bank-based digital wallets can send alerts when a balance is low and manage purchase receipts. Consumers view bank-based financial controls and bill payment options as the second-most important feature of a digital wallet, which could prove a strategic differentiator for banks.

Exhibit 6:
Digital wallets focused on financial control and offers have strongest appeal to consumers



SOURCE: McKinsey Mobile Consumer Survey - 2013

Digital innovators like Amazon and PayPal also rank well for trust and score the highest for broad consumer satisfaction. PayPal, which enjoys a general market perception of both trust and innovation, tops the customer satisfaction charts with a score of 3.9 (out of 4.0) and the company has penetration in approximately one-fifth of smart phones. Google Wallet and Square score well on satisfaction but have lower reported consumer adoption.

Merchant-driven wallets, by contrast, face a mix of challenges and opportunities. On one hand, merchant-owned wallets appear to have the least credibility with consumers at this point. Consumers generally express less trust and interest in using merchant-driven wallets, as they are perceived to be not much different than today's system of retailers having customer cards on file.

On the other hand, seven in ten consumers expect national retailers to accept mobile-based digital wallets, and many consumers favor wallet solutions that integrate loyalty programs from a diverse set of merchants. It's clear that retailers will need to play a core role in driving the consumer value proposition for mobile payments, particularly in providing offers and integrating with existing loyalty programs.

Consumers today are using mobile payments predominantly for app purchases and for buying digital content such as games, books and music.

Fifteen percent say they use mobile purchases to buy apps several times a year, with 9 percent saying they do so once a month. Ten percent buy digital content via a mobile device several times a year; 8 percent once a month. Higher value transactions occur considerably less frequently.

The app with the highest penetration on mobile devices is Facebook. Forty-four percent of consumers say they have the Facebook app downloaded on a mobile device. Amazon's mobile app has been downloaded by 29 percent of consumers, and 29 percent also have their bank's app on a device, with customers of Chase and Bank of America most likely to have a bank mobile app. Fifty-eight and 55 percent of Chase and Bank of America customers, respectively, have the app. This is considerably higher than the majority of banks, which reach one-third of their customers with mobile apps. Community banks lag with the lowest penetration.

Implications for payment providers

The current consumer preferences for paying with points, offers, and payments integration into a single wallet suggest that today's period of expansion and fragmentation will inevitably give way to market consolidation. Against this backdrop, those players seeking to win in providing digital wallets to consumers should focus on four strategic imperatives:

1. Accelerate consumer (and merchant) adoption through partnerships.

In order to reach scale and survive, given the narrowing window of opportunity to capitalize on continuing consumer excitement, mobile wallet providers should build partnerships with existing players that have large consumer and merchant footprints.

2. Refine the value proposition by solving proven consumer problems.

There is continued room for greater relevance and more convenient delivery of deals and offers, something that is likely to be achieved through analysis of data and analytics about consumers in aggregate. Features like redeeming loyalty points at the point-of-sale require players to overcome challenges in partnering with retailers, but hold the potential to rapidly drive consumer adoption if solved across multiple popular merchants. Providers should continue to identify specific use-cases that solve known consumer problems in their commerce experience.

3. Stay true to existing financial drivers.

Players looking to win in mobile wallets and mobile payments should accept the high likelihood that the gains from this disruption are likely to come more in their core revenue streams than in new adjacencies. Banks, for example, should view this as an additional channel to engage customers and extend credit. Loyalty providers should view it as a way to both broaden consumer engagement with the brands they represent and increase customer conversion. Payments networks should view it as a channel to increase payment volumes on their rails. While it is true that there is potential for each player to move into an adjacent area of the commerce or financial value chains, it is more likely that disruption will only occur if existing scale providers across these value chains partner up to bring change for the benefit of a broad set of players.



The stakes in the mobile payments field are high, and given the fast-changing competitive dynamics it is impossible to predict a single winning model. The good news from our panel findings is that various offerings have firm traction with consumers, and that current experimentation, usage and acceptance should continue.

At the same time, consumers ultimately want a more consolidated digital wallet landscape where they can concentrate their banking, commerce, and payments activities into a fewer number of master accounts or applications. The ongoing battle between various stand-alone providers, all of whom have limited individual footprints, likely needs to end in partnerships that will drive significant incremental value for themselves and their customers. Partnerships hold the greatest potential to achieve widespread merchant acceptance and consumer adoption - the true keys to successful innovation in the payments and commerce world.

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