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Future of Money: Digital Payment Advisors Will Transform the Payment Landscape

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DPAs are applications on a customer's mobile device that recommend and help manage the most appropriate payment product for a customer's purchase transaction. Their use and adoption will transform the way that customers manage payments and loyalty, and will impact the future use of social currency.

Key Findings

- Banks and their teams that develop product and payment strategies, and the CIO teams that support them, will not be able to control the use of DPA applications by their customers, but their use will challenge traditional business models and approaches.
- DPA applications bring greater transparency of the costs and benefits of using payment products. Integration with location and context loyalty offers will provide customers with offers that work most effectively with their existing payment cards.
- DPA applications will help customers pay for goods and services with a mix of traditional currency, loyalty points and nonfiat social currencies (e.g., gaming tokens, bandwidth).
- The business case for DPAs will only be sustainable in the longer term when margins from loyalty and social currency exchange are integrated into the proposition.
- The future of DPAs will be tightly linked to the development of digital wallet solutions.

Recommendations

Bank teams that develop product and payment strategies, and their CIO teams that support them:

- Don't initially try to build your own DPA. Address the challenges of DPAs by adapting and deploying flexible pricing technologies for all your payment card offerings, developing integrated payment and loyalty solutions, and building emulation models to track and map the offers that will be made to your customers when they shop.

- Integrate the use of social currencies into your planning horizons. The ability for consumers to pay using a mix of traditional currency, loyalty points and social currencies will become a key payment differentiator.
- Only consider deploying your own digital DPA solution when the option to aggregate loyalty and social currencies begins to make DPA solutions economically viable.

Analysis

The Initial Stages of Digital Payment Advisor Development

The development of digital payment advisor (DPA) applications residing on customer smartphones and mobile devices has the potential to fundamentally change the way that many customers approach their choice of payment solution for higher-value purchase transactions. Eventually, the impact of DPAs may stretch far beyond the immediate constraints of the payment market. By encouraging the use of alternate currencies — loyalty points and social currencies — for purchases of day-to-day products and services, DPAs may start to alter the very subtle psychological balance in place when customers make purchases using cash and payment cards. Spending hard-earned money can feel very different to consumers, compared to spending loyalty points that may have been allocated freely by retailers or airlines. Such shifts will bring significant changes to the entire retail purchase experience and the associated payment value chain.

The use of DPAs will also be one of the key indicators of the shift in power from banks and payment card issuers to their customers. Their use will bring greater transparency to the payment markets and drive significant change in the way consumers select their payment providers, especially for higher-value transactions, where the cost to the consumer or benefits to the customer may vary significantly depending on what payment solution the customer chooses to use. They will also start to impact the actual form of currency used to settle many payments. In the medium term, the future of DPA will be tightly linked to the adoption and utilization of digital wallets by financial service companies, retailers and consumers (see "Gartner's Digital Wallet Solution Segmentation Model").

Gartner does not envision customers using DPAs for every single payment application. More of these applications will offer actionable and useful advice as and when their use will benefit the customers. This will mean that DPAs will initially be used mainly for higher-value transactions. Considering past customer behavior in the payment market, it's unlikely that most customers will be willing to pay sustainable fees for such a service. As a result, to become economically sustainable, DPA applications will change quickly. This metamorphosis will follow two stages:

- The first-stage revenue model will see DPA applications integrated with payment and loyalty management tools, which likely would be offered as an addition to existing loyalty applications or as additional service capabilities from independent (nonbank) digital wallet providers.
- The second-stage revenue model will leverage currency exchange margins that may be accrued through consumers paying with nonfiat local currencies. Hence, if a customer chooses to make a payment using partially dollars or euros and partially airline miles, then the digital payment advisor will derive its own revenue through a margin charge for converting the nonfiat

currencies to a local currency. At this stage, the DPA solutions will start to integrate with many of the digital wallet solutions in the market.

DPA applications will not initially be offered directly by mainstream banks or payment card companies, because by their nature they require brand independence to function effectively and deliver perceived independent advice to customers. However, a longer-term opportunity may emerge for financial services institutions (FSIs) that wish to establish a role in the management, exchange and disbursement of loyalty points and social currencies for their customers. In such cases, FSIs that wish to offer the DPAs may need to establish an independently branded solution (such as some of the insurance price comparison sites, which are in fact owned by insurance companies), to ensure that customers regard any advice offered as being independent and accurate.

The use of smartphones to analyze and integrate historical transactional data with real-time location and contextual data places the power of informed decision making in the hands of customers. By offering the customer a clear indicator of the most cost-effective — or remunerative, when aspects such as potential loyalty rewards or "cash back" options are factored in — payment application to use for a particular transaction, digital payment advisors can cut through many of the marketing and pricing issues that plague today's payment market.

Traditional payment models have relied on customers making their own choices about which payment solution they will use to make a purchase. Although banks, card issuers and card schemes may believe that their marketing and branding messages play a key role in influencing such customer decisions, the reality is that most of those customer choices are based on other factors:

- Habitual "top of wallet" option — The payment card (or other payment solution such as cash or check) most regularly used for day-to-day transactions by the customer.
- Access to "line of credit" — The payment solution that allows the customer access to the most appropriate line of credit to facilitate the payment.
- Incentivized option — The customer uses a particular payment option because of some form of incentive — positive loyalty or reward from the card issuer or directional incentives, whether positive or negative (a discount to use cash instead a payment card) from a retailer.
- Additional factors, such as instructions or requests to use a particular payment solution for specific types of transaction — for example, a specific payment card to manage household expenses, or the mandated use of a particular charge card to pay for company expenses.

For many customers, the majority of these decisions do not necessarily result in the customer making the "best" choice in terms of the costs and the benefits associated with the actual payment transaction itself. Most customers own a variety of payment cards with various interest rates, charges, and terms and conditions. In addition, they will likely own a large number of loyalty cards, be members of multiple loyalty schemes, or possess multiple coupons or discount vouchers. Given the variations in costs and potential benefits to the customer associated with using one or more of these payment cards, loyalty schemes and vouchers, actually understanding the best combination to use is difficult. As a result, in most situations, the majority of consumers will revert to the normal influencing factors and not bother attempting to calculate the benefit.

The Next Stage of Digital Payment Advisor Development

One additional, but highly significant variable will also be added to the equation as DPAs start to build market acceptance. Many customers will have built up additional holdings of noncash assets, such as loyalty points or airline miles, and additional social currencies, such as gaming credits and airtime for their mobile phones. The potential for digital payment advisor applications expands to include their ability to enhance the value of these assets. At present, these noncash assets can only be directly utilized within the closed environments for which they were designed — that is, the specific game or airline group. Granted, in certain countries, some degree of fungibility may be added through the use of proprietary trading sites such as Points.com, or even within the closed environment itself — such as the tradability between certain airline mileage plans and associated credit card reward point schemes. However, this trading is static and reactive, and at the very best remains at the margins of usage for most customers. However, a DPA application can expose the real value of these trapped assets by allowing a customer to pay for a real-world purchase with a mix of local fiat currency and nonfiat loyalty or reward points — even airtime or game play points. The analytics within a DPA would assess the benefits and drawbacks of such a potential arbitrage and advise when and if the reassignment of a noncash asset to help pay for a particular purchase would make economic or practical sense.

Preparing for the Advent of Digital Payment Advisors

Banks and financial services companies — even retailers — cannot ignore the advent of digital payment advisors. Banks and FSIs cannot compete directly with them unless they are willing to issue their own DPA application — that is, they would be willing to recommend that their customers use payment cards from competitor institutions, rather than those issued by the institution. This is not impossible, but would be a major challenge for most banks in terms of their market positioning. Equally, retailers need to monitor the impact of DPAs on the purchase value chain that their customers will engage in.

Instead, banks must adapt their strategies to recognize the impact that the open availability of such information and advice will have on the payment market. Those in charge of payment strategies, and the CIO teams charged will delivering the supporting technology, need to:

- Build their own emulation models that can define the impact of customers using DPAs on the bank's existing payment products.
- Design and develop flexible pricing capability into existing payment products. To ensure that customer select the products from the bank, they will need to display adaptive pricing and rewards that reflects the location and loyalty offers available to customers across a range of payment situations.
- Develop retailer-driven loyalty solutions that ensure that the bank's payment products remain competitive. This includes establishing partnerships with third-party solution providers that support such retailer-led schemes, as well as directly with retailers themselves.
- Start planning to "open" their card payment infrastructures to enable more seamless integration with partners and third parties.

- Plan for the inclusion of nonfiat "social currencies" in the traditional payment mix. Partial or full payment by loyalty points or air miles will become a common and accepted practice for many customers.
- Only consider deployment of digital payment advisor tools into the customer markets if:
  - Their institution is able to develop a separate branded proposition and would be willing to actively recommend competitor payment products over its own.
  - The business for DPAs improves as and when second-stage trading of loyalty and social currencies starts to take hold — when revenue from currency exchange would make such an advisory tool sustainable, even when a bank was recommending that a customer uses a payment card from a rival institution.

Recommended Reading

Some documents may not be available as part of your current Gartner subscription.

"Gartner's Digital Wallet Solution Segmentation Model"

"Future of Money: Virtual Currency and Gamification Drive Financial Literacy and Revenue Opportunities"

"Future of Money: New Money Processes and Technologies for Financial Inclusion"

"Mobile Financial Services Defined"

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