RetailWeek CONNECT WHITE PAPER

In association with Klarna.

NEXT-GEN PAYMENTS: WHAT SHOPPERS WANT

How consumers want to pay now and what they want in the future

INTRODUCTION

We live in a connected world, where everything we need is at our fingertips in seconds. As a result, online shopping and the payment process need to be simple, convenient and suited to an always distracted consumer's needs. Couple this with security breaches such as the one that befell Equifax in September this year – making internet users more cautious – and you have a situation in which retailers are compelled to make paying for goods online as safe as handing over cash at a till point.

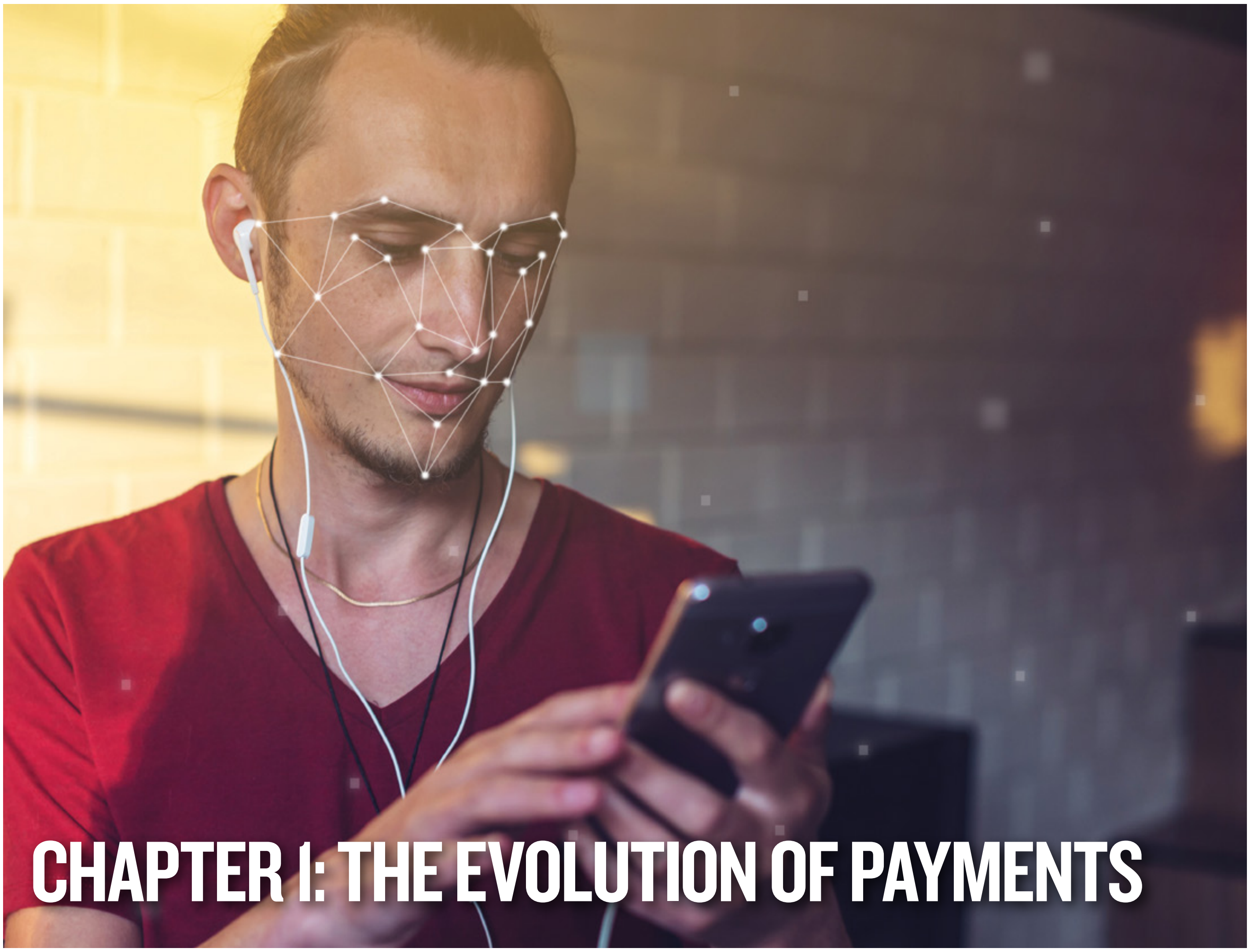
This report by Retail Week in association with payments provider Klarna examines how consumers feel about financing their purchases, including insight from 2,000 online shoppers.

Our survey delved into how consumers want to pay, which technologies they are most responsive to, how they feel about pay later and consumer finance options, what they want from payments in an ideal world and how they see themselves paying for goods in the future.

With commentary from top UK retailers and sector experts, this is a must read for anyone seeking to stay at the cutting edge of payments to ensure they are giving shoppers what they want.

METHODOLOGY

This report centres on a comprehensive analysis of consumer behaviour surrounding payments, including the results from a survey of 2,000 UK consumers conducted in August. Those surveyed were people who shop online, with a nationally representative split across gender and age.

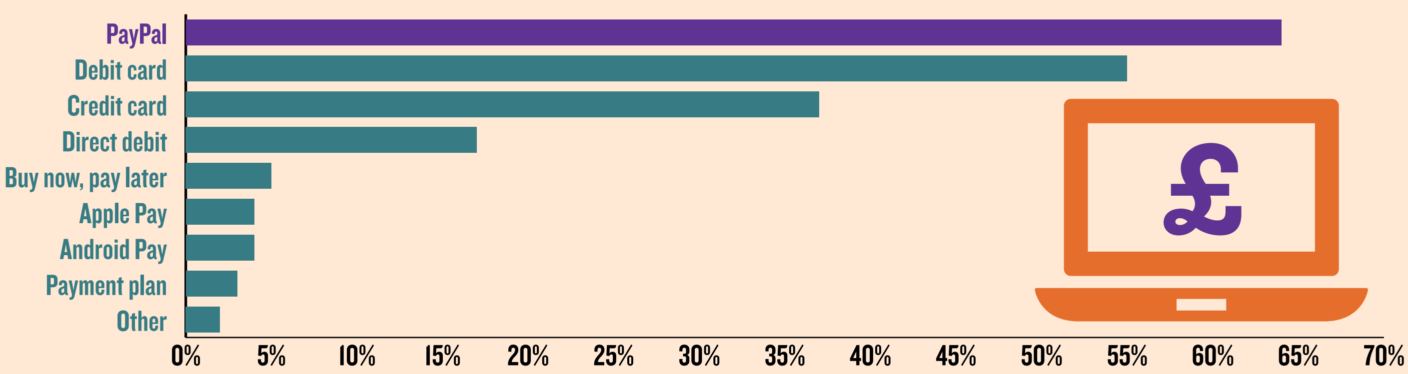


CHAPTER 1: THE EVOLUTION OF PAYMENTS

In July, for the first time ever, the British Retail Consortium (BRC) revealed that more payments were being made by card than by all other methods combined, driven by a surge in contactless transactions, which now account for around a third of all purchases. It was a landmark moment. It was the news retailers had been waiting for: contactless had finally been adopted on a mass scale. The investment had paid off.

Contactless hasn't been the only big payment investment for retailers. While that particular method of payment has been establishing itself with customers, others have been emerging. The arrival of a whole new generation of payment methods – some just for physical payment, some exclusively for online and others for both – has forced retailers to make big decisions about their systems and processes, and how much they are willing to invest to keep

WHICH PAYMENT METHOD DO YOU USE MOST OFTEN ONLINE?



up. But as Karen Pepper, head of UK for Amazon Pay, explains, there are also major benefits to the new host of technologies emerging – not least when it comes to serving customers' needs.

She says: "The shift to digitisation and increasing connectivity has opened up significant potential when it comes to the future of digital shopping and the adoption of connected devices for ecommerce.

"As the payments space continues to evolve at a significant pace, so too do demands for how people access and pay for products and services in an online age."

Contactless adoption

The adoption of contactless payments has been relatively straightforward. After all, debit and credit cards are not anything new. And with the ability to now make micro-payments for even the smallest of purchases, the convenience of being cash-free is irresistible to shoppers.

But what about the other payment technologies emerging today? Will the BRC one day announce that smartphones have overtaken contactless as the preferred payment method for UK consumers?

What about more innovative technologies, such as Mastercard's 'selfie pay' authentication system, Amazon's checkout-less CCTV and sensor-based payments offering, or Klarna's invoice-based pay later option?

A survey conducted in August 2017 by Retail Week in association with Klarna asked customers to predict how they will be making payments in the future. It revealed three methods that are barely in use today: fingerprint scanning, iris scanning and voice recognition. Yet this world could become a reality.

"As the payment space continues to evolve, so too do demands for how people access and pay for products"
Karen Pepper, Amazon Pay

499 million
payments were made using alternative payment methods such as Android Pay and Apple Pay in the UK last year

Rise of alternatives

In its 2017 annual market summary, trade association UK Finance identified alternative payment methods, such as Apple Pay and Android Pay, as accounting for 499 million payments

in the UK last year, and predicted a 66% increase in their usage over the next decade.

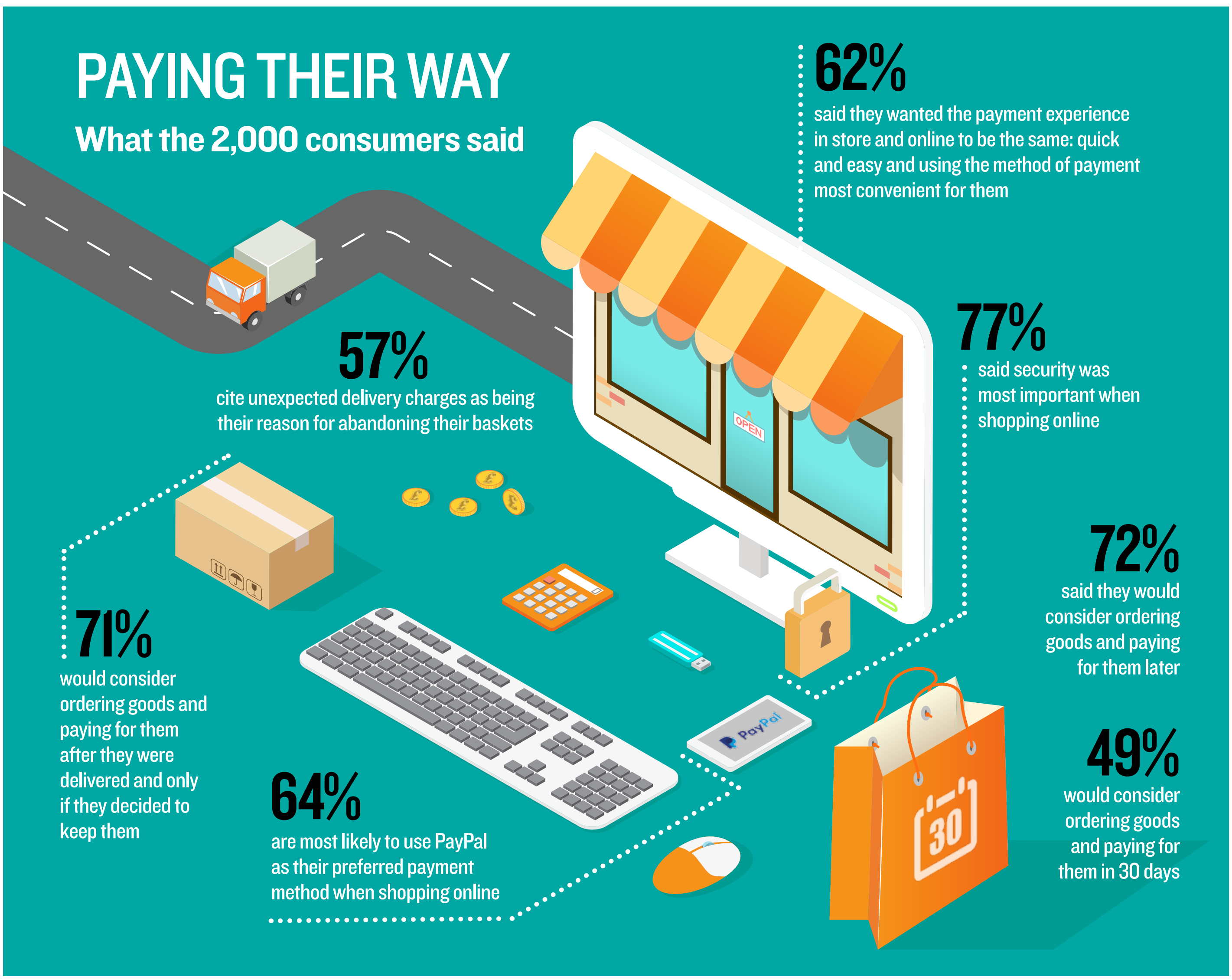
The organisation also revealed growing popularity for remote banking-based systems, such as the Faster Payments Service.

The Retail Week and Klarna survey revealed how fragmented the payments landscape has become. When consumers were asked which methods they used most online, unsurprisingly credit cards and debit cards featured highly, used by 37% and 55% respectively.

But the survey revealed a diverse spread of other methods in use – PayPal, Apple Pay, Android Pay, pay later and consumer finance all got a mention.

This diversity in alternative payment methods has happened at a remarkable rate, leaving consumers and retailers racing to catch up. Despite all the wizardry on offer in retail, the fundamental principle that you must give customers what they want still prevails.

Will the BRC one day announce that smartphones have overtaken contactless as the preferred payment method for UK consumers?



CHAPTER 2: WHAT DO CONSUMERS WANT?

The 2,000 customers surveyed for this report were asked how important it was to have a variety of payment methods – and the results were very telling.

Three-quarters say having a wide range of options would "positively affect" their experience of shopping with a retailer.

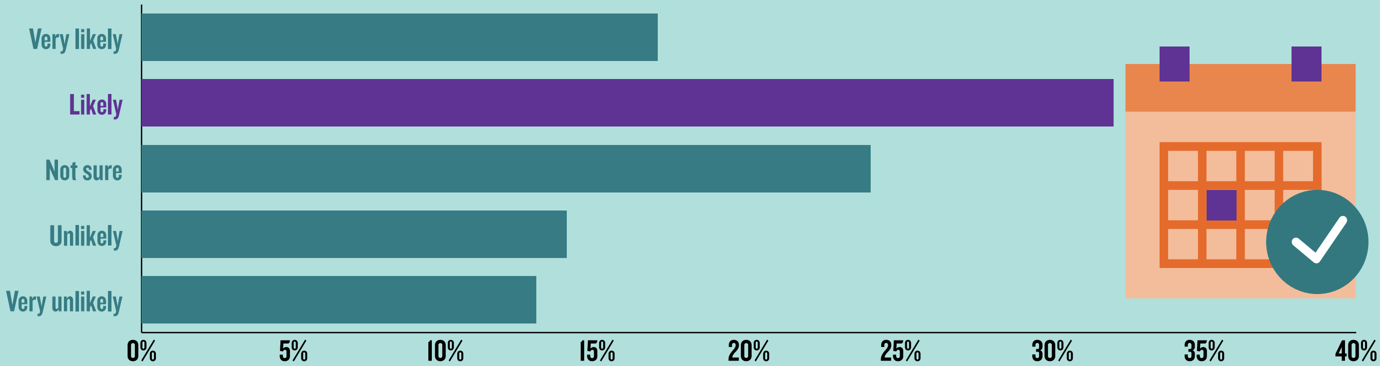
When asked whether a quick, efficient experience would make them more likely to shop with that retailer again in the future, this figure rose to 80%.

The requirement for retailers to provide a range of options, and to deliver them with ease and speed, has presented pressures – and opportunities – like never before.

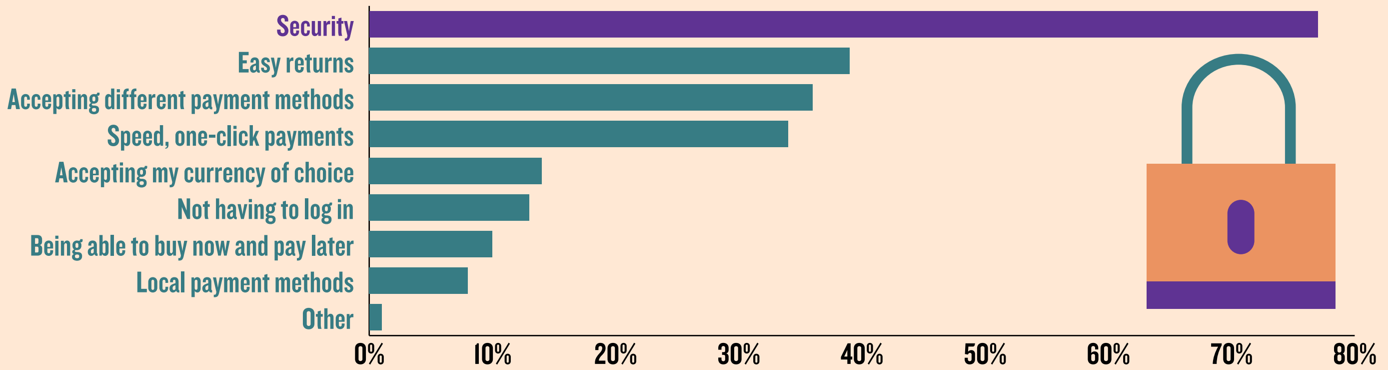
High expectations

Tom Jennings, managing director of prepaid card issuer Wirecard Card Solutions, agrees: "In an internet age where shopping is – for the most part – online, the expectation for greater speed and convenience is at the highest it's ever been.

WHEN SHOPPING ONLINE, HOW LIKELY WOULD YOU BE TO CONSIDER AN OPTION WHERE YOU COULD ORDER AN ITEM NOW AND PAY FOR IT IN 30 DAYS?



WHAT IS MOST IMPORTANT TO YOU WHEN MAKING A PAYMENT ONLINE?



"Customers now see as a basic prerequisite payments processes that are fast and integrated into their online behaviours"
Tom Jennings, Wirecard Card Solutions

"Customers now see as a basic prerequisite payments processes that are fast and integrated into their own online behaviours, all the while offering the most secure method available. It's the ability to cater to these evolving standards and customer demands that retailers also now look for in a payments provider."

Exciting new payment methods are attractive in terms of the tech available, but customers are also looking for new ways to manage the burden of shopping.

The use of credit and finance in shopping is not new today, but there are more options emerging, including Klarna's optimised pay later and consumer finance solutions.

The survey showed that such options would be welcomed by consumers. Just under half say they would consider an option where they could pay for an item in 30 days, and 72% say they would consider some form of deferred payment option, despite 47% having never shopped this way before. This is particularly relevant given the squeeze in income shoppers have felt over the past decade – and, in many cases, continue to feel.

Paul Lyon, IT director at electricals brand Ebuyer, says the company has seen a sharp increase in shoppers looking to buy products on finance, even in the past year. "It's become our second biggest asset within the payments offer," he says. "It's part of our consumer make-up.

"There's been a shift as a result of austerity. People want the latest technology, but can't necessarily afford to pay for it in one go. If we didn't offer finance, a large percentage of our business would drop off."

Security concerns

When asked what was the most important thing when it came to online shopping, the most common response – from 77% of people – was security. Security, flexibility and ease of access may be obvious talking points, but they can be difficult to put in place. Not least because retailers have been obliged to make big investments already and face more – and stricter – requirements.

"There's been a shift as a result of austerity. If we didn't offer finance, a large percentage of our business would drop off"
Paul Lyon, Ebuyer

Mark Latham, director at card payment terminal provider Handepay, says: "From retailers' perspectives, particularly for SMEs, there's been a big change in the last few years in terms of pricing structures, as well as legislation around card payments.

"Things have become more complicated with the new Payment Card Industry Data Security Standard (PCI DSS) in place; these have brought in extra costs."

CHAPTER 3: CUSTOMER EXPERIENCE COUNTS

If payments were ever considered an afterthought – or, at least, an established and unchanging part of retail business – that time has come to an end. One of the principle shifts in the past decade is that payments are not simply a means to an end, but a way to engage with shoppers. And nowhere is this more obvious than at the online checkout.

Asked how retailers fall down at this crucial point, our survey of 2,000 shoppers revealed a litany of potential errors.

Checkout frustrations

For example, 18% of respondents are put off by the absence of a method they wanted to use, while 33% have been deterred by extra fees for using their preferred payment. Poor security was also a major factor, cited by 29% of people surveyed.

Mike Jackson, director of financial services at John Lewis, says this goes to the core of the link between online and offline, and between payments and experience. He says: “Payment can be laborious at times and that can leave a bad feeling with customers. We want them to be happy to come back. Very few people are doing great things in that area at the moment. It needs to be effortless and it needs to save time; that’s where you want to aspire to be.”

Seamless shopping

Our survey also revealed that the raising of standards in ecommerce may, in turn, have lifted customers’ expectations about the in-store experience.

When asked what they expect from making payments online compared with offline, the majority responded that it should be a seamless experience, with no difference in quality between the two.

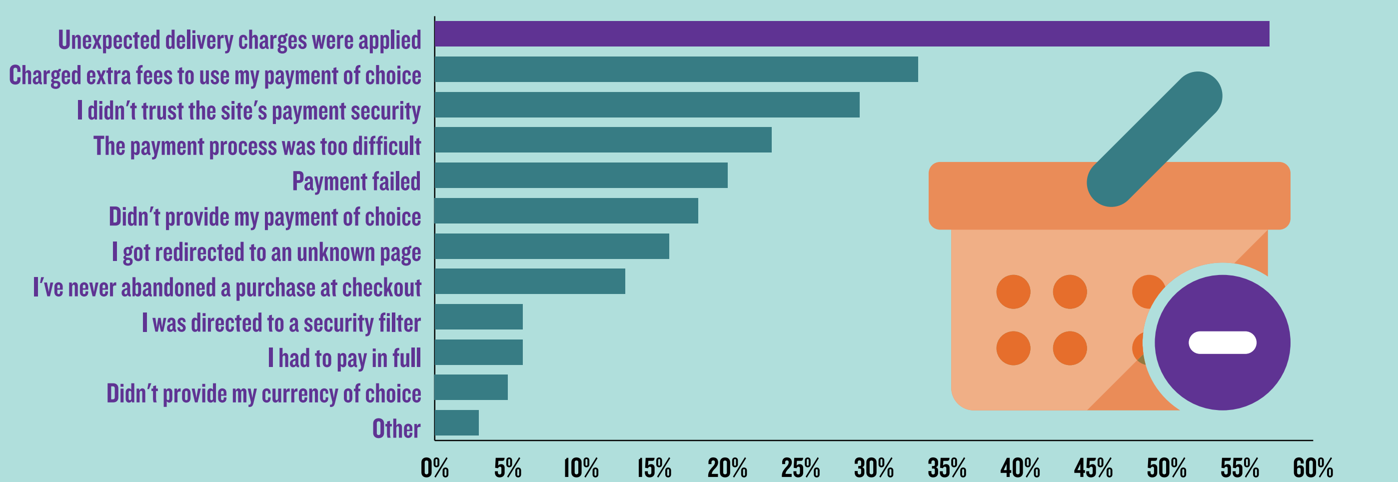
Evidently, mindsets and habits have cross-hatched between channels. Some 12% say they would like retailers to remember their payment details whether they shop online or in store with them. In addition, 15% would like the option to make contactless payments at home, while 13% said they would choose to pay via a smartphone at home as well as in store.

> **“Payment needs to be effortless and it needs to save time”**
> **Mike Jackson, John Lewis**

Gerald Dawson, finance director at pet food retailer Forthglade, says a key rule when it comes to payments is to understand customer needs – what works for one “tribe” will not be popular with another.

He says: “Depending on which tribe you’re selling to, certain payment methods either work or they don’t. Some payment methods are only suitable for certain shoppers but some retailers will want every payment method going.”

IF YOU HAVE EVER LEFT THE CHECKOUT PAGE BEFORE COMPLETING A PURCHASE, WHAT WAS YOUR REASON FOR DOING SO?



CHAPTER 4: LEADING TECH CHANGE IN RETAIL

Retailers have had major decisions on their hands for some time, and this is not about to change.

Jackson says the current climate presents both major opportunities and challenges for a huge multichannel business like John Lewis with a wide, diverse customer base.

"If you are a retailer of huge scale, you're going to have to attract a very broad range of shoppers," he says. "Not all customers are 'digital first'. A lot of older customers will keep using plastic over digital for many years to come. There is a decision to be made."

Tipping point

One of these decisions, says Jackson, is whether a retailer would define themselves as a leader or a follower. "We are a fast follower," he says. "We are cautious about being first to market. There is usually a tipping point when methods such as contactless are adopted by customers, banks and merchants. Timing is important to invest in flexible infrastructure to be able to move when you reach that tipping point."

Dawson at Forthglade says that, because of the amount of investment retailers need to make in new payment tech, it is essential to match this offering to the customer.

"Anything that streamlines the checkout is welcome," he says. "But there are costs involved and margins have been dropping for so long. If you're Aldi, your margins are around 1%; if you're Amazon, they're even lower. Some people see the charges in payment methods as non-controllable costs, such as VAT, but for others a 2% payment fee can cause a lot of problems. And the cost of setting up is high; you don't want to do that if nobody is going to use it."

Customer retention

Despite this cost, if customers are asking for new methods to buy goods, retailers have to listen. And the returns can be huge.

Pepper at Amazon Pay says: "The advantages of a faster, easier and more secure transaction at checkout are essential in helping online businesses increase retention by reducing cart abandonment rates and increasing consumer trust.

"Our merchants tell us constantly that a more optimised process is generating significant value in terms of increasing sales conversions."

CHAPTER 5: THE FUTURE OF PAYMENTS

If you had told a retailer 20 years ago that shoppers would one day be able to authorise a purchase with a selfie (after explaining what a selfie was), or be able to pick up an item and walk straight out of a store to be billed remotely, they would have struggled. But what once sounded like wild speculation is now becoming a reality.

Mastercard is well into trials with its Identity Check Mobile system, fingerprint authorisation is already well established and contactless payments are now the norm. The value of alternative currencies, chiefly Bitcoin, has risen and blockchain systems are being more widely understood.

Indeed, it is perhaps the banking sector that faces the most disruption of all.

As Forthglade's Dawson says: "Everyone is trying to get a slice of the banks' business. There are all sorts of new payment gateways and ultimately they are adding to the customer experience."

Lyon at Ebuyer says these changes are in retailers' interests. "What we'll see is a shift away from traditional banking systems," he says. "More traditional banking processes are being disrupted and the new fintech companies will show up banking."

Unbundling banking

It's what Chris Skinner – in his book *ValueWeb: How Fintech Firms are Using Mobile and Blockchain Technologies to Create the Internet of Value* – describes as the "unbundling of banking". Innovative solutions, including those that let you try goods first and pay later, are shaking up the traditional marketplace with an unprecedented level of choice.

Retail is complex and multifaceted, not least because of the variety of sectors within it. New tech has produced such a huge variety of options to retailers that not all solutions are applicable.

Our research shows that the pay later model would be more popular, for example, with electrical and tech goods (which 73% of respondents say they would consider purchasing with a system such as Klarna's) than on food (which only 12% say they might buy this way).

Today's consumer has more choice than ever before, not least when it comes to payment methods. The future is bound to hold more choice, more change and more opportunity.

> **"Traditional processes are being disrupted and the new fintech companies will show up banking"**
> **Paul Lyon, Ebuyer**

TOMORROW'S WORLD: WHAT CONSUMERS EXPECT

We asked 2,000 people how they imagine paying for goods online in the future. These were the answers they gave:

- A single sign-in for all retailers
- A 'contactless' experience for online – fast and frictionless
- Fingerprint scanners
- Eye scanners
- Voice recognition while driving
- Gadgets attached to computers

PARTNER COMMENT: EXPERIENCE MATTERS

Payments technology innovation has truly revolutionised how we shop. Consumers can now live an almost entirely cashless life and customer experience is now the major battleground of retail.

As this research shows, customers want a seamless, easy experience when paying online. This can be achieved by thinking differently about payments – eliminating needless steps in the checkout process and making it simple and straightforward for people to access new payment services. Customer experience must be a top priority for retailers.

Today's consumers expect to be able to shop in a way that works for them, whether that's on mobile, desktop, on the move or in store. Providing a smooth buying journey across all touchpoints is crucial.

With a poor online checkout clearly linked to abandoned carts, retailers need to take heed. The research lays bare the impact that a poor payment process can have on sales, so seeking expert advice is vital. Customers want the payment experience to match the shopping experience – and both need to be top notch.

Although technology has radically changed how people shop, the mission for retailers should be the same: to create a frictionless shopping experience that is customer-centric whatever the channel.

The role of payment technology providers like Klarna is to help retail evolve to meet customer needs and ultimately alter the face of shopping.

FIVE TAKEAWAYS

- **Invest in your customer experience to ensure shoppers don't drop out of the purchase process due to frustration. Klarna helps by simplifying checkout flow and access to consumer finance.**
- **Remove barriers to purchase. Klarna enables shoppers to try goods first and pay later and to spread the cost of purchases over time. These options were shown to be gaining in popularity and are a route to winning over shoppers.**
- **Ensure there is no disparity between the shopping experience and the payment experience. Live up to customer expectations.**
- **Give shoppers flexibility and choice to complete transactions in a way that works for them, with pay later and consumer finance options.**
- **Make checkout smooth. Customers want convenience, so investing in mobile-optimised technology such as Klarna's will ensure customers complete purchases quickly and easily.**

ABOUT KLARNA

It's all about 'smoooth' (yes, with three 'o's). Klarna is Europe's leading payments provider and a newly licensed bank, which wants to revolutionise the payment experience for shoppers and merchants alike. Founded in Stockholm, Sweden, in 2005, the fintech unicorn gives online consumers the option to pay now, pay later or over time – offering a trusted, frictionless and 'smoooth' checkout experience. Klarna now works with 70,000 merchants to offer payment solutions to more than 60 million users in Europe and North America. Klarna has 1,500 employees and is active in 18 countries.

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