OliverWyman

MAG
MERCHANT ADVISORY GROUP®

2023 VOICE OF THE MERCHANT STUDY

A business of Marsh McLennan

CONFIDENTIALITY

EXECUTIVE SUMMARY

As the payments space continues to evolve rapidly, this report explores the changes happening at each step across the payments value chain.

The typical transaction lifecycle serves as the "organizing framework" for the report

Customer
Buys goods or services from the merchant through a point-of-sale

Merchant
Sells goods or services to the customer through a point-of-sale (accepting multiple card types)

Merchant Services Provider
Processes/settles the transaction for merchants

Network
Runs the "payment rails" used to transmit transactions between acquirers and issuers

Card Issuer
Provides the card account (and credit, in some cases) to the consumer

1 — Use payment card
2 — Sales data transmitted
3 — Routes to network
4 — Switches to card issuer
5 — Issuer authorizes transaction
6 — Authorization sent to provider
7 — Authorization sent to merchant
8 — Receive goods

Key themes at each "hop"

- Consumers' willingness to use non-bank payments and financial services (FS) products is growing - prompting merchants to also diversify their offerings
- Both proprietary and third-party shopping channels continue to gain traction, with over 60% of merchants supporting three or more channels; self-checkout has the highest customer penetration

- Merchants are increasingly adopting a strategic approach to payments, expanding beyond cost- and operational-related activities to drive the business
- Payments technology and infrastructure are at the core of merchants' transformation, with orchestration and tokenization being top-of-mind

- In a bid to address some of the pain points and sources of friction (e.g., cost, outages without resiliency), half of all merchants have opted for multi-acquirer set ups
- Merchants are increasingly looking towards specialist providers for innovation and customization – only 20% expect this as the top quality while selecting their payments providers

- CNP debit routing and the Credit Card Competition Act (CCCA) are top of mind; merchants believe competition in debit and credit will be impactful to their organizations
- FedNow launched in July 2023; at this early stage of launch, only ~40% of merchants consider it to be very or somewhat impactful to their organizations

- Issuer partnerships are critical to ensure the success of merchants' proprietary card programs; changes in both the economics, and roles and responsibilities of issuers and merchants are transpiring for these offerings
- Issuers play a critical role in influencing auth declines, driving most auth declines outside of fraud pre-screening
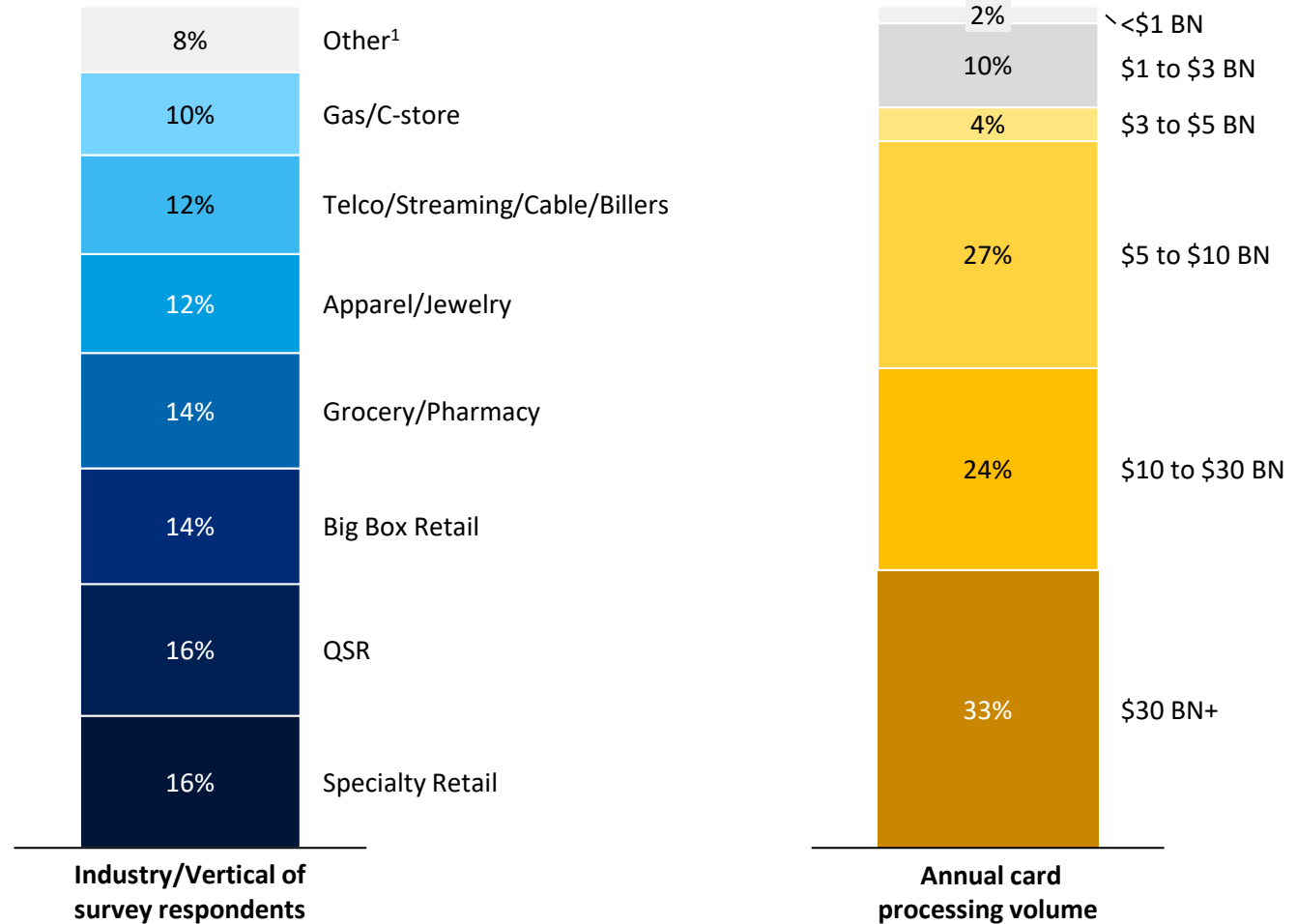
INTRODUCTION

Context

Oliver Wyman and the Merchant Advisory Group (MAG) jointly sponsored the 2023 "Voice of the Merchant" study. This is a continuation of the 2022 study to examine how leading merchants are transforming their payments ecosystems to meet customers' evolving shopping expectations.

The study included a survey of 50+ enterprise merchants, followed by targeted interviews covering the following topics:

- Payments Strategy
- Recent Regulatory Changes
- Payments Technology and Infrastructure
- Partnership Approaches
- Payments Organizational Structure

Source: OW – MAG Voice of the Merchant Survey 2023
1: includes travel, professional services, and other retailers
Note: totals may not sum to 100% due to rounding

Demographics of Merchant Survey respondents

Industry/Vertical of survey respondents	
8%	Other[1]
10%	Gas/C-store
12%	Telco/Streaming/Cable/Billers
12%	Apparel/Jewelry
14%	Grocery/Pharmacy
14%	Big Box Retail
16%	QSR
16%	Specialty Retail

Industry/Vertical of survey respondents

Annual card processing volume	
2%	<$1 BN
10%	$1 to $3 BN
4%	$3 to $5 BN
27%	$5 to $10 BN
24%	$10 to $30 BN
33%	$30 BN+

Annual card processing volume

SURVEYED TOPICS

1   **2**   **3**   **4**   **5**

Payments strategy

- What type of activities do merchant payments teams spend the most time on?
- What are the largest payments-related pain points today?
- How are merchants actively managing their form of payment mix?
- What are the primary performance metrics used to measure success for the payments and financial services products that organizations offer?

Recent regulatory changes

- What level of impact do merchants anticipate for forthcoming/potential payments industry developments?
- How prepared are merchants to implement/capitalize on these developments that are driven by regulators and card networks?

Payments technology and infrastructure

- What is the customer penetration for first-party and third-party shopping channels?
- What tokenization technologies are merchants using for their payments data?
- How many merchants have or envision having omnichannel tokenization solutions?

Partnership approaches

- How are merchants procuring various operational payment services today?
- What qualities are merchants looking for when partnering with an organization for these payments-related services?
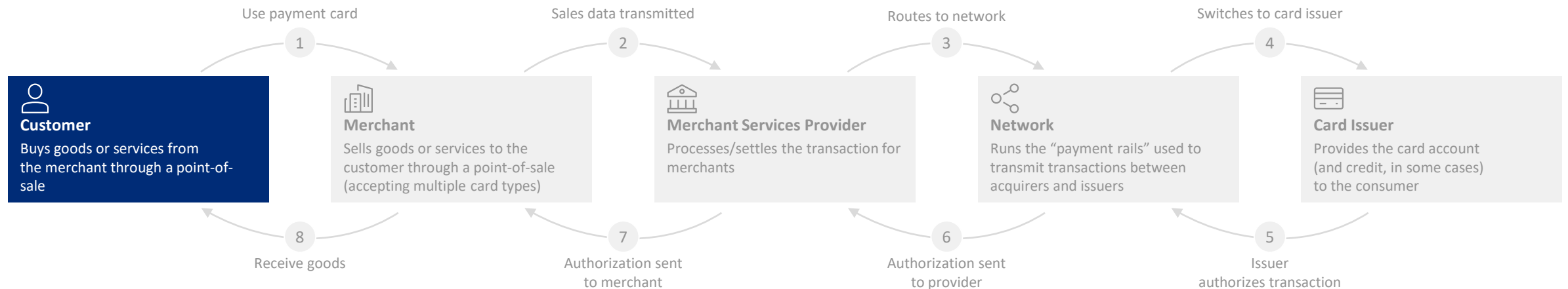
Payments organizational structure

- How have payments team sizes been changing?
- What are the primary reporting structures for payments teams and how do reporting structures influence payments priorities?

CUSTOMER

Step	Label	Entity	Description
1	Use payment card		
2	Sales data transmitted		
3	Routes to network		
4	Switches to card issuer		

Customer — Buys goods or services from the merchant through a point-of-sale

Merchant — Sells goods or services to the customer through a point-of-sale (accepting multiple card types)

Merchant Services Provider — Processes/settles the transaction for merchants

Network — Runs the "payment rails" used to transmit transactions between acquirers and issuers

Card Issuer — Provides the card account (and credit, in some cases) to the consumer

8 — Receive goods
7 — Authorization sent to merchant
6 — Authorization sent to provider
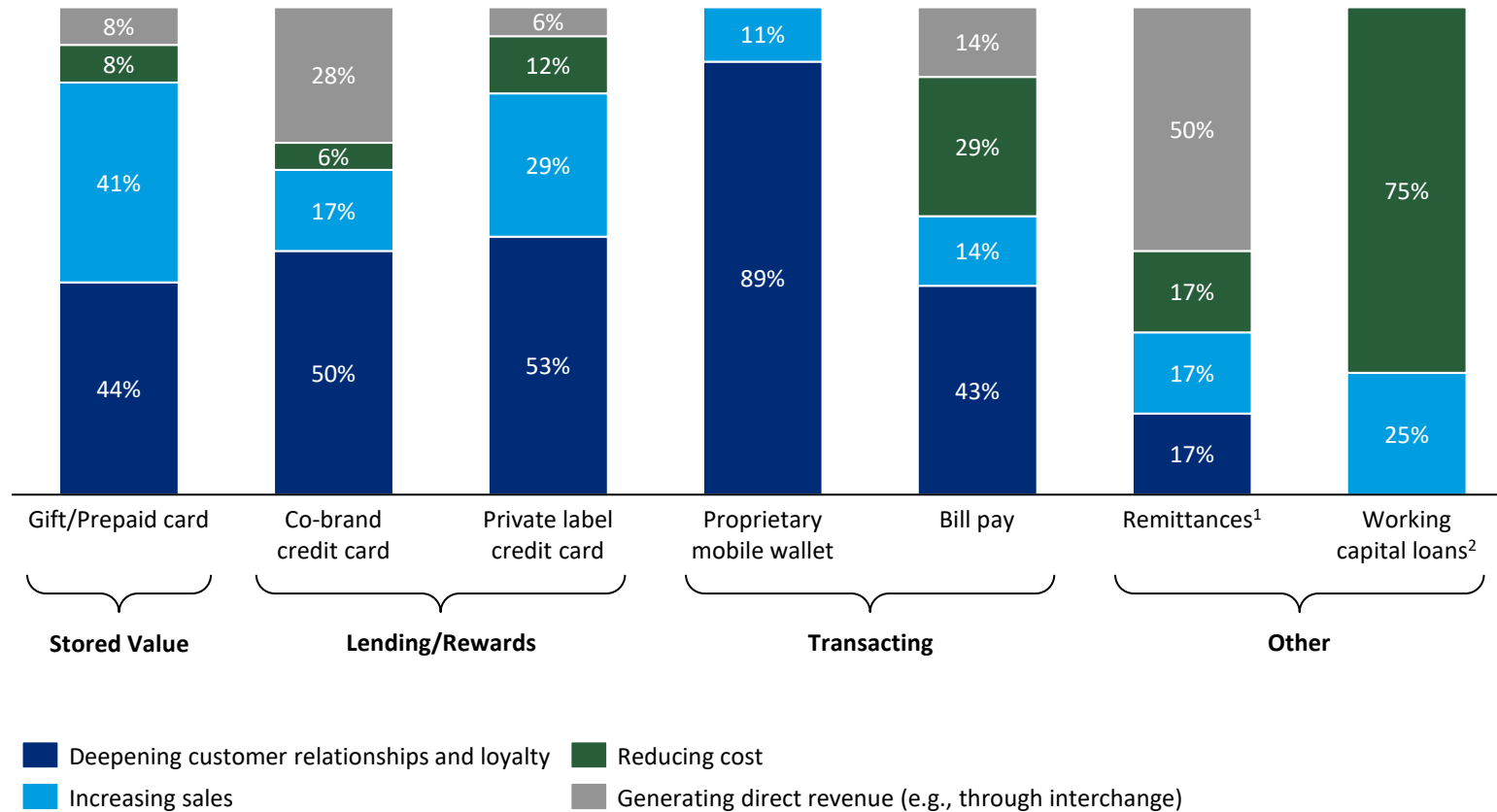5 — Issuer authorizes transaction

Key takeaways

- **Success Metrics:** Most merchants see deepening customer relationships as the primary measure of success for payments and FS offerings, and non-financial digital experiences are raising the bar for what "good" looks like

- **Evolving Customer Preferences:** More than a third of merchants support proprietary card and mobile wallet offerings, reflecting growing customer propensity to adopt non-bank payments and FS services

- **Shopping Channels:** Both proprietary and third-party shopping channels continue to gain traction, with over 60% of merchants supporting three or more channels for their customers

- **Self-checkout Penetration:** Self-checkout has the highest customer penetration, particularly in non-discretionary 'everyday spend' verticals like gas/convenience stores and grocery/pharmacy stores, with half of these merchants reporting >25% customer penetration for the service

- **Merchant Implications:** To stay abreast of the changing landscape of customer needs and preferences, merchants must adopt a comprehensive approach across payments mix, technology, operations, and stakeholder management

TAKING A CUSTOMER-FIRST VIEW, MOST MERCHANTS SEE DEEPENING CUSTOMER RELATIONSHIPS AS THE PRIMARY MEASURE OF SUCCESS FOR PAYMENTS AND FS PRODUCTS

We asked merchants about how they measure the success of their payments and FS products

Stored Value: Gift/Prepaid card — 8%, 8%, 41%, 44%

Lending/Rewards: Co-brand credit card — 28%, 6%, 17%, 50%; Private label credit card — 6%, 12%, 29%, 53%

Transacting: Proprietary mobile wallet — 11%, 89%; Bill pay — 14%, 29%, 14%, 43%

Other: Remittances[1] — 50%, 17%, 17%, 17%; Working capital loans[2] — 75%, 25%

Legend:
- Deepening customer relationships and loyalty (dark blue)
- Increasing sales (light blue)
- Reducing cost (green)
- Generating direct revenue (e.g., through interchange) (grey)

Question: For each of the below financial service products that your organization offers, please indicate the primary performance metric you use for measuring its success.
Note: totals may not sum to 100% due to rounding. 1. Includes cross-border money transfers via physical or digital channels. 2. Includes loans to marketplace sellers to finance inventory
Source: OW – MAG Voice of the Merchant Survey 2023

Commentary

- Deepening customer relationships is the primary performance metric used by merchants to gauge the success of their payments and FS offerings; increasing customer lifetime value based on customer satisfaction, loyalty, and referrals directly drives long-term business sustainability

- Increasing sales is an additional key metric often associated with gift cards and private label credit cards, where these products are often used to facilitate on-us volumes via more frequent and/or higher value purchases; and it also serve as a means for merchants to extend their customer base to include a wider demographic of customers – some of whom traditional financial institutions (FIs) may not approve

- Cost is used to assess the attractiveness of working capital loans and bill pay - likely due to its direct impact on profitability
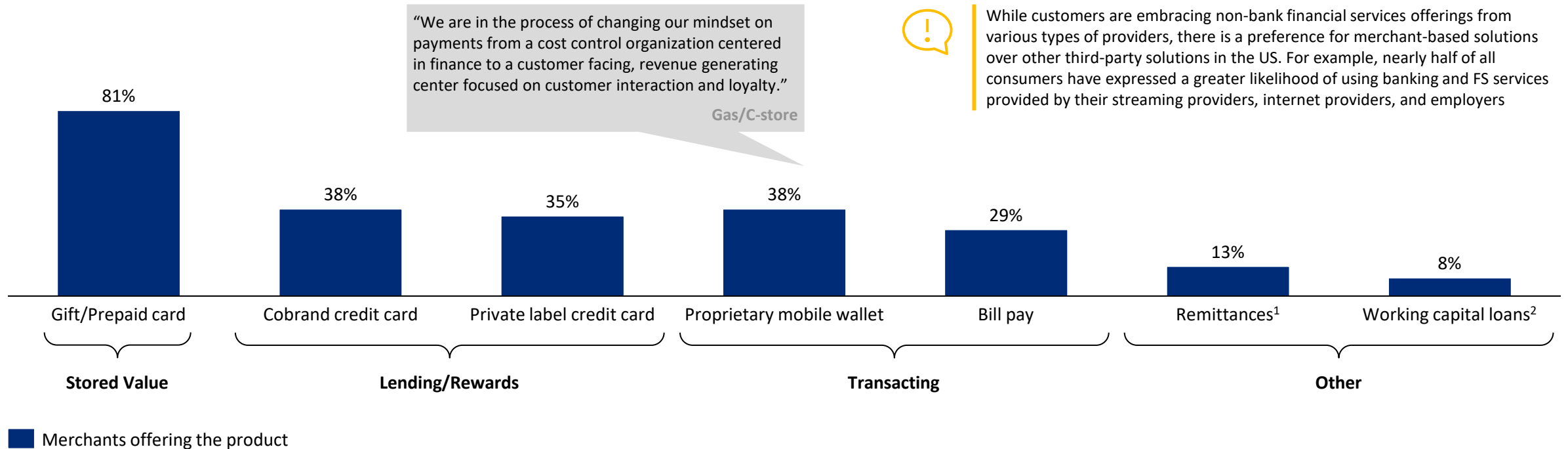
"

We are trying to understand customer insights around Gen Z and how that might impact the customer experience we want to deliver; we care a lot about how Gen Z thinks about banking, money movement, and how they think about card brands.

QSR

MORE THAN A THIRD OF MERCHANTS SUPPORT PROPRIETARY CARDS AND MOBILE WALLETS, REFLECTING CUSTOMER PROPENSITY TO ADOPT NON-BANK PAYMENTS AND FS OFFERINGS

We asked merchants about the financial services products their organization offers (2023)

"We are in the process of changing our mindset on payments from a cost control organization centered in finance to a customer facing, revenue generating center focused on customer interaction and loyalty."

Gas/C-store

While customers are embracing non-bank financial services offerings from various types of providers, there is a preference for merchant-based solutions over other third-party solutions in the US. For example, nearly half of all consumers have expressed a greater likelihood of using banking and FS services provided by their streaming providers, internet providers, and employers

Gift/Prepaid card	Cobrand credit card	Private label credit card	Proprietary mobile wallet	Bill pay	Remittances[1]	Working capital loans[2]
81%	38%	35%	38%	29%	13%	8%

Stored Value   **Lending/Rewards**   **Transacting**   **Other**

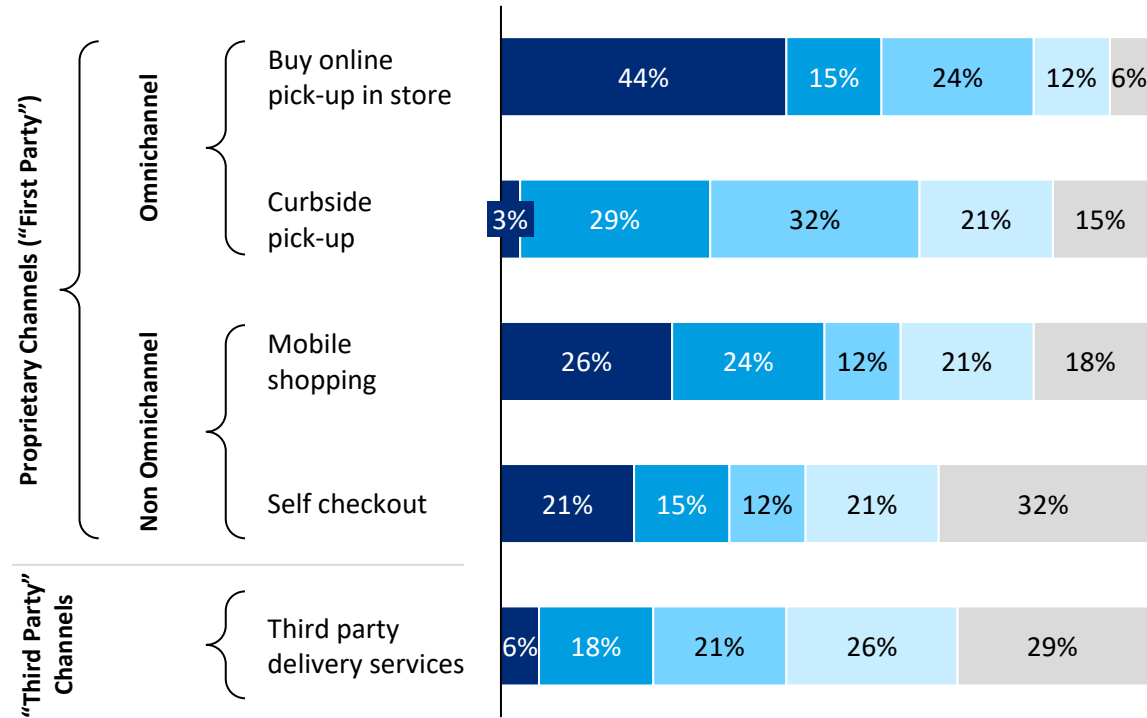■ Merchants offering the product

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Merchants are responding to the evolving customer preferences by expanding into various payments and FS products; this includes a focus on stored value, lending, and rewards programs, as well as transactional products
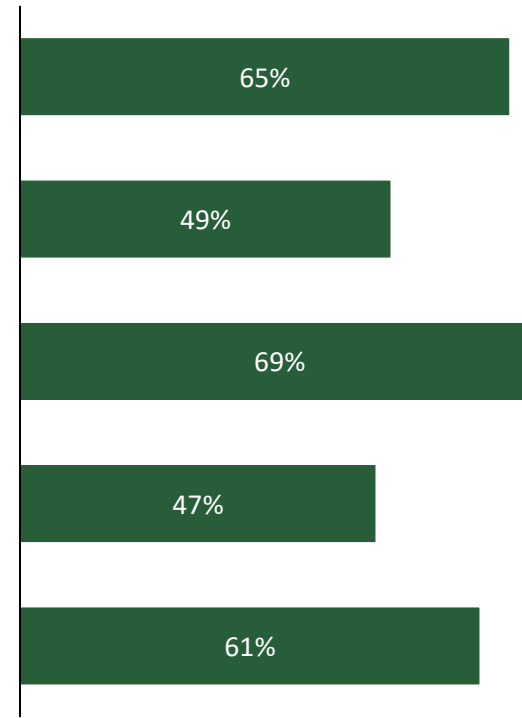

BOTH PROPRIETARY AND THIRD-PARTY SHOPPING CHANNELS CONTINUE TO GAIN TRACTION, WITH OVER 60% OF MERCHANTS SUPPORTING THREE OR MORE CHANNELS FOR CUSTOMERS

Last year we asked merchants to rank the below shopping trends by importance[1] (2022)

This year we asked merchants about the shopping channels their organization offers[2] (2023)

- Despite varying degrees of importance in 2022, nearly all channels have ~50+% adoption across merchants in 2023

- The majority of merchants (61%) support three or more channels to offer greater customer convenience

"

We want payments to be an enabler for the strategy, and support whatever the business wants to do. We have aggressive goals towards many of these channels.
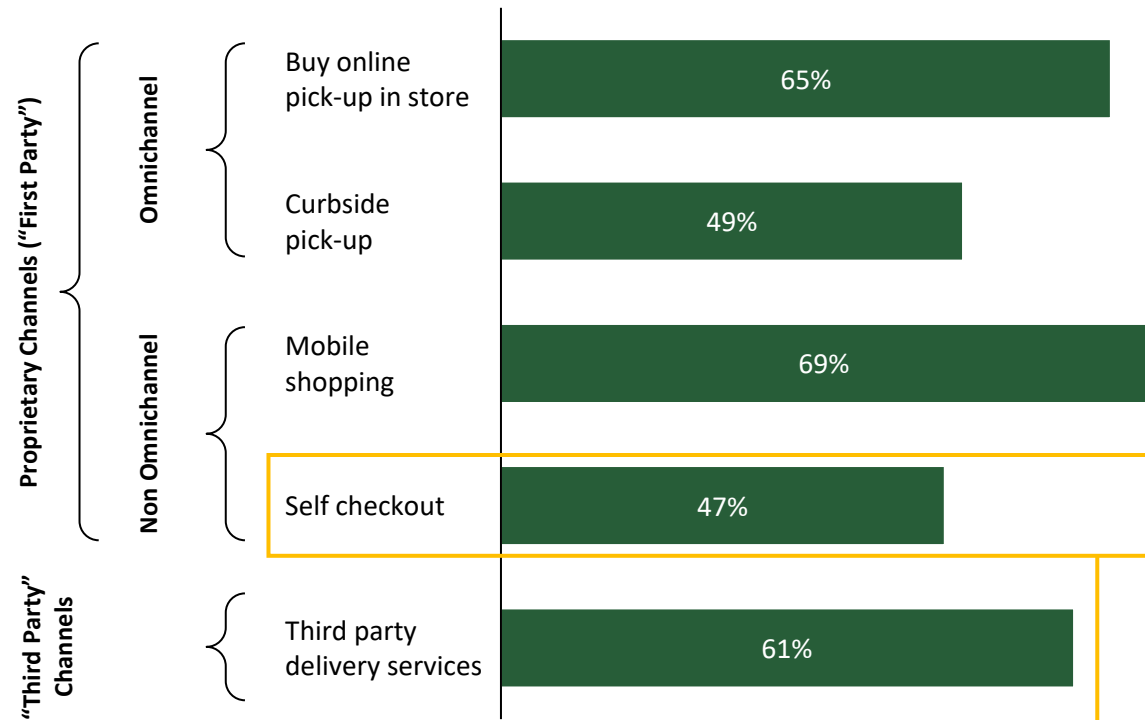
QSR

Legend (left chart): 5 (least important) | 4 | 3 | 2 | 1 (Most Important)

Legend (right chart): Merchants offering the service

WHILE ONLY ABOUT HALF OF ALL MERCHANTS OFFER SELF-CHECKOUT, 70% OF THEM HAVE STRONG USAGE OF THE SERVICE

This year we asked merchants about the shopping channels their organization offers (2023)

We asked merchants to rank the different shopping channels based on customer penetration (2023)

Proprietary Channels ("First Party")

Omnichannel

Buy online pick-up in store — 65%
3% | 12% | 6% | 79%

Curbside pick-up — 49%
12% | 88%

Non Omnichannel

Mobile shopping — 69%
3% | 9% | 9% | 23% | 57%

Self checkout — 47%
8% | 8% | 29% | 25% | 29%

"Third Party" Channels

Third party delivery services — 61%
3% | 3% | 16% | 77%

■ Merchants offering the service
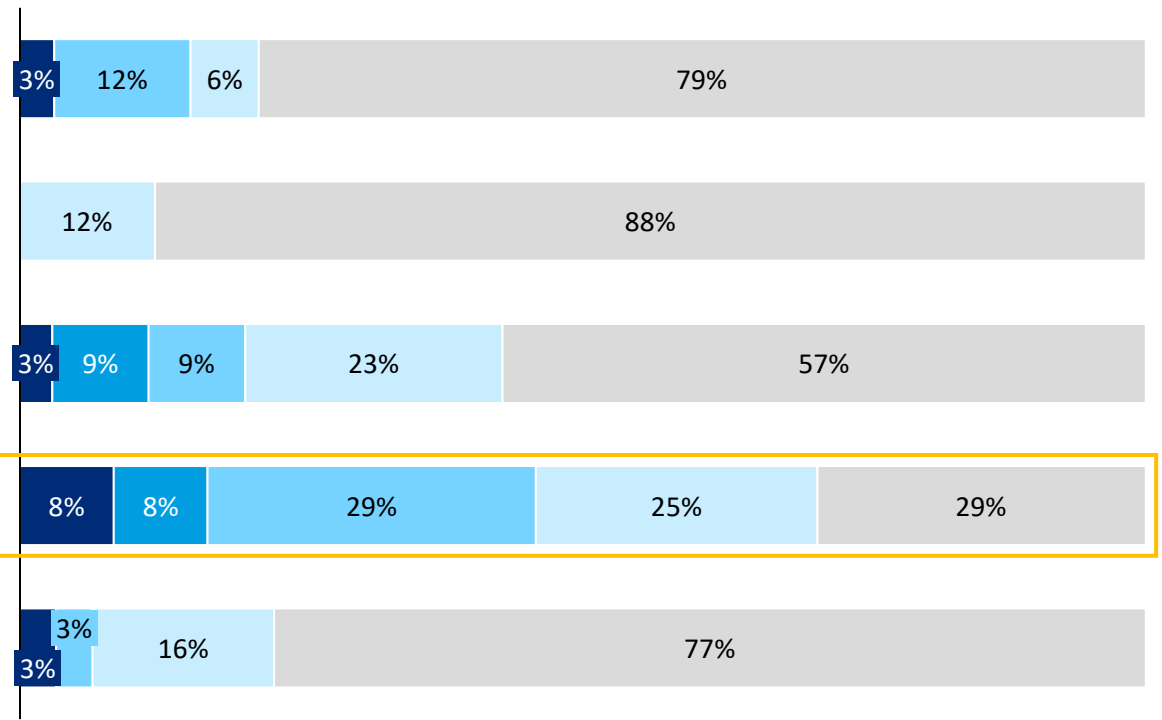
The greater adoption for self-checkout likely reflects the return to in-store shopping where customers value convenience and speed at checkout

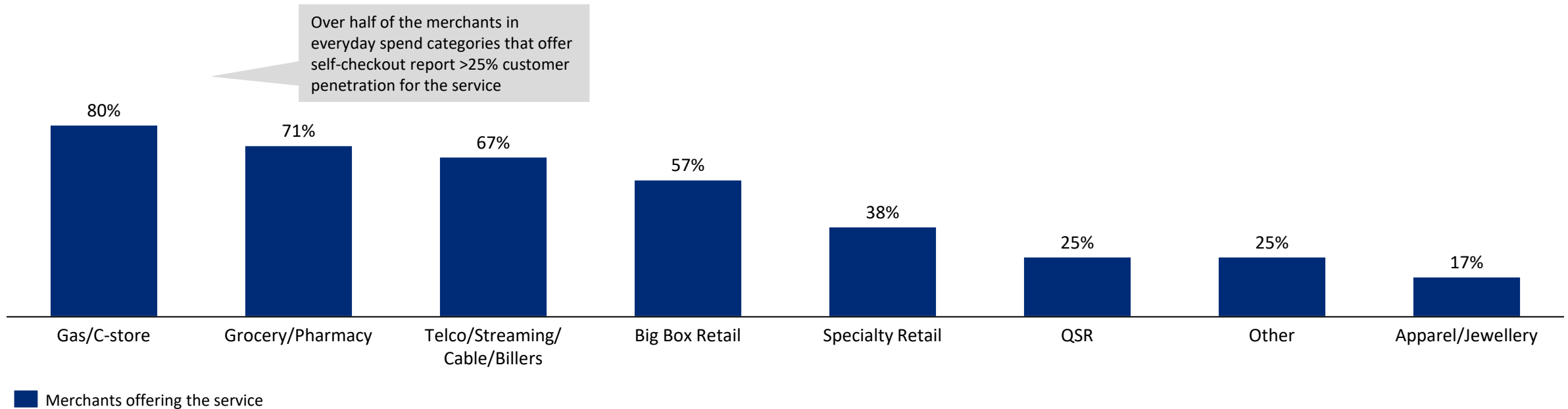■ 75+% ■ 51-75% ■ 26-50% ■ 11-25% ■ 0-10%

Question: Approximately what % of your customers used each of these services at least once in 2022?
Note: totals may not sum to 100% due to rounding
Source: OW – MAG Voice of the Merchant Survey 2023

SELF-CHECKOUT IS MORE COMMONLY OFFERED BY 'EVERYDAY SPEND' RETAILERS, WITH 70+% OF GROCERY/PHARMACY/GAS/C-STORES OFFERING THIS SERVICE

This year we asked merchants if their organization offers self-checkout[2] (2023)

Over half of the merchants in everyday spend categories that offer self-checkout report >25% customer penetration for the service

Category	%
Gas/C-store	80%
Grocery/Pharmacy	71%
Telco/Streaming/Cable/Billers	67%
Big Box Retail	57%
Specialty Retail	38%
QSR	25%
Other	25%
Apparel/Jewellery	17%

■ Merchants offering the service

Verticals with high "everyday spend", such as gas/convenience stores and grocery/pharmacy stores are more likely to offer self-checkout compared to other industry verticals due to the volume of transactions they handle, and the strong alignment with customer preferences for convenience and speed in these places

Question: Approximately what % of your customers used each of these services at least once in 2022?
Note: totals may not sum to 100% due to rounding
Source: OW – MAG Voice of the Merchant Survey 2023

MERCHANTS NEED TO EMBRACE A COMPREHENSIVE APPROACH ACROSS PAYMENTS MIX, TECH, OPS, AND STAKEHOLDER MANAGEMENT TO MEET THE CHANGING NEEDS OF CUSTOMERS

Considerations for merchants to stay ahead of the curve as it applies to changing customer needs

Maintain consistency in payments mix across channels	**Leverage omnichannel tokens**	**Facilitate seamless payments operations**	**Manage internal and external stakeholders**
• With customers looking to engage across various channels, maintaining a diverse yet consistent set of payments options becomes essential • Offering a seamless payment experience regardless of the channel helps drive repeat usage and stickiness	• Omnichannel tokenization solutions can enhance customer convenience and enable cross-channel shopping, while also facilitating the tracking of customer behavior and transaction history across different channels	• As customer interactions span multiple channels, it is imperative for merchants to develop seamless processes for operational activities such as returns, refunds, and chargebacks	• The evolving payments landscape brings increased complexity, necessitating more frequent and streamlined coordination between different internal teams and external partners (e.g., acquirers and fraud vendors)

> " Technology is a key enabler for our payment strategy and operational goals.
>
> **Telco/Streaming/Cable/Billers**

> " Currently there are limitations on how tokens impact routing and customer lifecycle management.
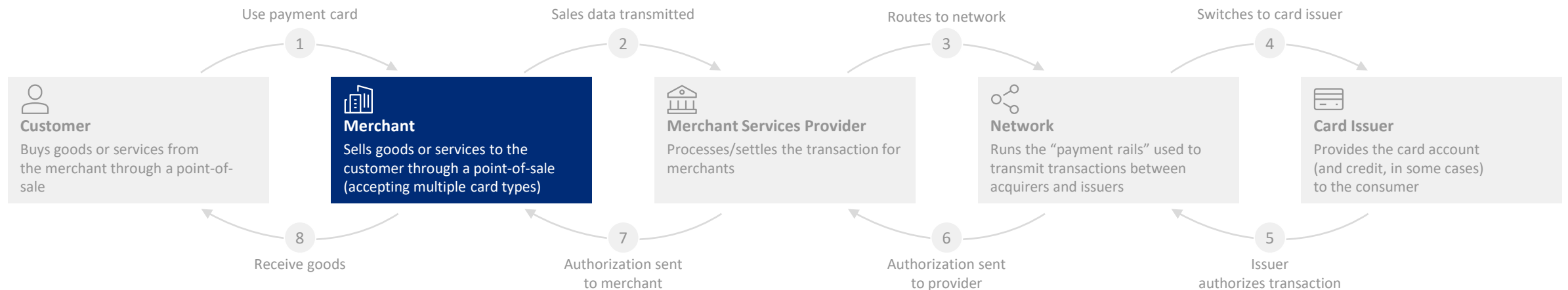>
> **QSR**

> " We have an increased focus [and continued investment] in back-end infrastructure and capabilities; as we expand, we need to maintain our payments capabilities.
>
> **QSR**

Source: OW – MAG Voice of the Merchant Survey 2023, OW Analysis

MERCHANT

	Use payment card		Sales data transmitted		Routes to network		Switches to card issuer

① Use payment card → ② Sales data transmitted → ③ Routes to network → ④ Switches to card issuer

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Card Issuer
Provides the card account (and credit, in some cases) to the consumer

⑧ Receive goods ⑦ Authorization sent to merchant ⑥ Authorization sent to provider ⑤ Issuer authorizes transaction
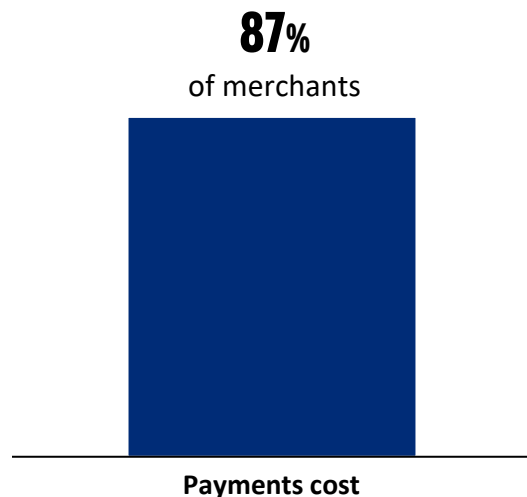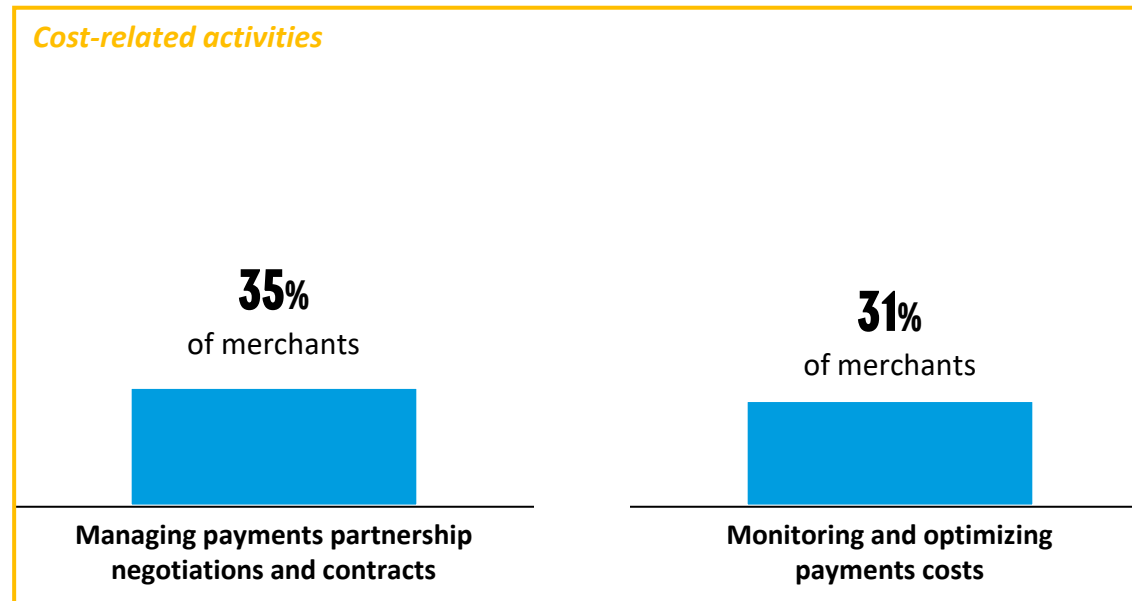
Key takeaways

- **Focus on Cost***: There is a shift in focus away from cost as the primary payments priority; last year ~90% prioritized cost (ranked in the top two for most important payments activities), whereas this year 66% ranked cost-focused activities in the top two based on where their payments teams spend the most time

- **Shift towards Strategic Mindset:** 60% of merchants are now actively involved in managing their form of payment (FOP) mix, and ~28% ranked "developing payments strategy, including alternative forms of payment" or "enhancing omnichannel customer experiences" in their top two areas where their payments team spends the most time

- **Technology Partnerships:** While technology underpins much of what merchants do in payments, the use of specialized providers (i.e., outside of acquirers) appears to be growing - highlighting how merchants' partnership ecosystem is transforming

- **Omnichannel Tokenization:** ~40% of merchants have already implemented or are in the process of implementing omnichannel tokenization – which is key to meeting customer needs

- **Payments Orchestration**: 40% of merchants have adopted some form of payments orchestration – reflecting another area where merchants' needs are rapidly evolving

- **Team Size:** Team size expansion is occurring for merchants of all sizes, driven by the shift to a strategic mindset and merchants' evolving, more sophisticated technology needs

- **Reporting Structures:** ~60% of merchants' payments teams primarily report to treasury/finance, with the rest reporting to marketing, ops, or digital/IT; cross-functional collaboration is increasing

MERCHANTS ARE SHIFTING THEIR FOCUS AWAY FROM COST AS THE PRIMARY PAYMENTS PRIORITY; LAST YEAR NEARLY 90% PRIORITIZED COST, WHILE THIS YEAR IT WAS 66%

Importance of payments activities[1] (2022)

87%
of merchants

Payments cost

Time spent by payment activity[2] (2023)

Cost-related activities

35%
of merchants

Managing payments partnership negotiations and contracts

31%
of merchants

Monitoring and optimizing payments costs

Of the merchants that participated in the 2022 study as well as this year's study, the change is even starker; while 96% of merchants that participated in both years ranked payments cost in their top two most important payments priorities for 2022, this year only 61% of merchants reported that they spent the most time on cost-related activities

- Last year, managing the total cost of payments was the top priority for most of the retailers in this study with nearly 90% of respondents ranking payments cost in their top two most important payments priorities

- This year, only about ~66% of merchants noted payments cost in their top two activities based on where their payments teams spend the most time

- Additionally, 28% ranked "developing payment strategy, including alternative forms of payment" or "enhancing omnichannel customer experiences" in their top two

~60% OF MERCHANTS ARE ENGAGED IN ACTIVELY MANAGING THEIR FORM OF PAYMENT (FOP) MIX, EMPLOYING AT LEAST ONE METHOD OR ACTIVITY TO DO SO

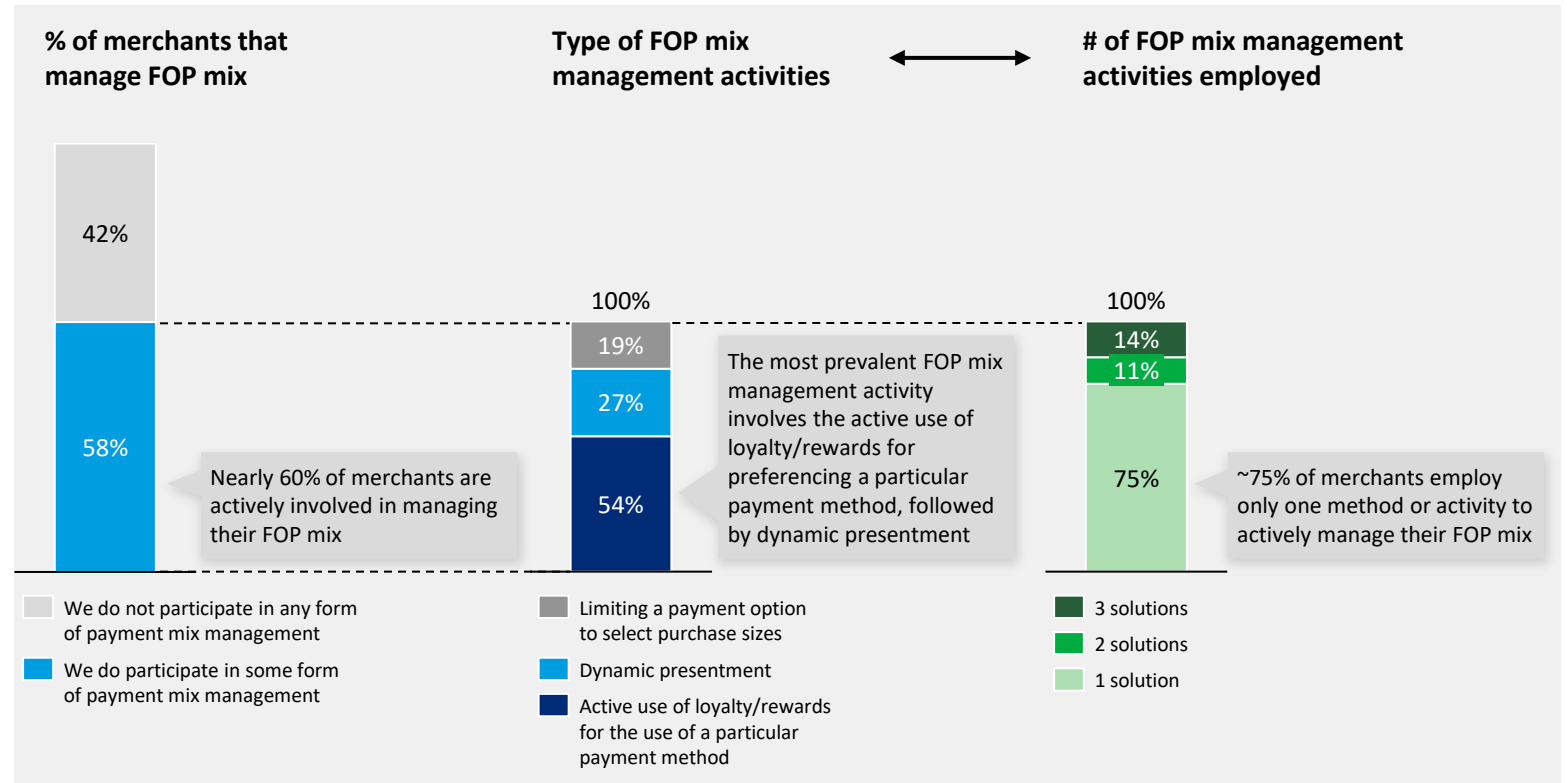## Overview of FOP mix management

- FOP mix management (aka steering) refers to the strategies employed by merchants to influence and encourage customers to choose specific payment methods that are likely more advantageous to merchants in terms of optimizing revenues and costs (e.g., encouraging the use of lower cost non-card payment methods such as ACH)

- Merchants can influence customer payments choice in various ways, including:
  - Limiting payment options based on purchase size
  - Employing loyalty or rewards incentives for using a specific payment method
  - Dynamic presentment (e.g., presenting certain payment methods to specific customers)
  - Offering price discounts on certain payment methods
  - Imposing price surcharges on certain payment methods

"

In terms of FOP mix, we try and push people towards private label as much as possible.

Big Box Retailer

We asked merchants if they actively manage FOP mix, and if so, how? (2023)

% of merchants that manage FOP mix

42%

58%

Nearly 60% of merchants are actively involved in managing their FOP mix

Type of FOP mix management activities

100%

19%

27%

54%

The most prevalent FOP mix management activity involves the active use of loyalty/rewards for preferencing a particular payment method, followed by dynamic presentment

# of FOP mix management activities employed

100%

14%

11%

75%

~75% of merchants employ only one method or activity to actively manage their FOP mix

Legend (column 1):
- ☐ We do not participate in any form of payment mix management
- ☐ We do participate in some form of payment mix management

Legend (column 2):
- ☐ Limiting a payment option to select purchase sizes
- ☐ Dynamic presentment
- ☐ Active use of loyalty/rewards for the use of a particular payment method

Legend (column 3):
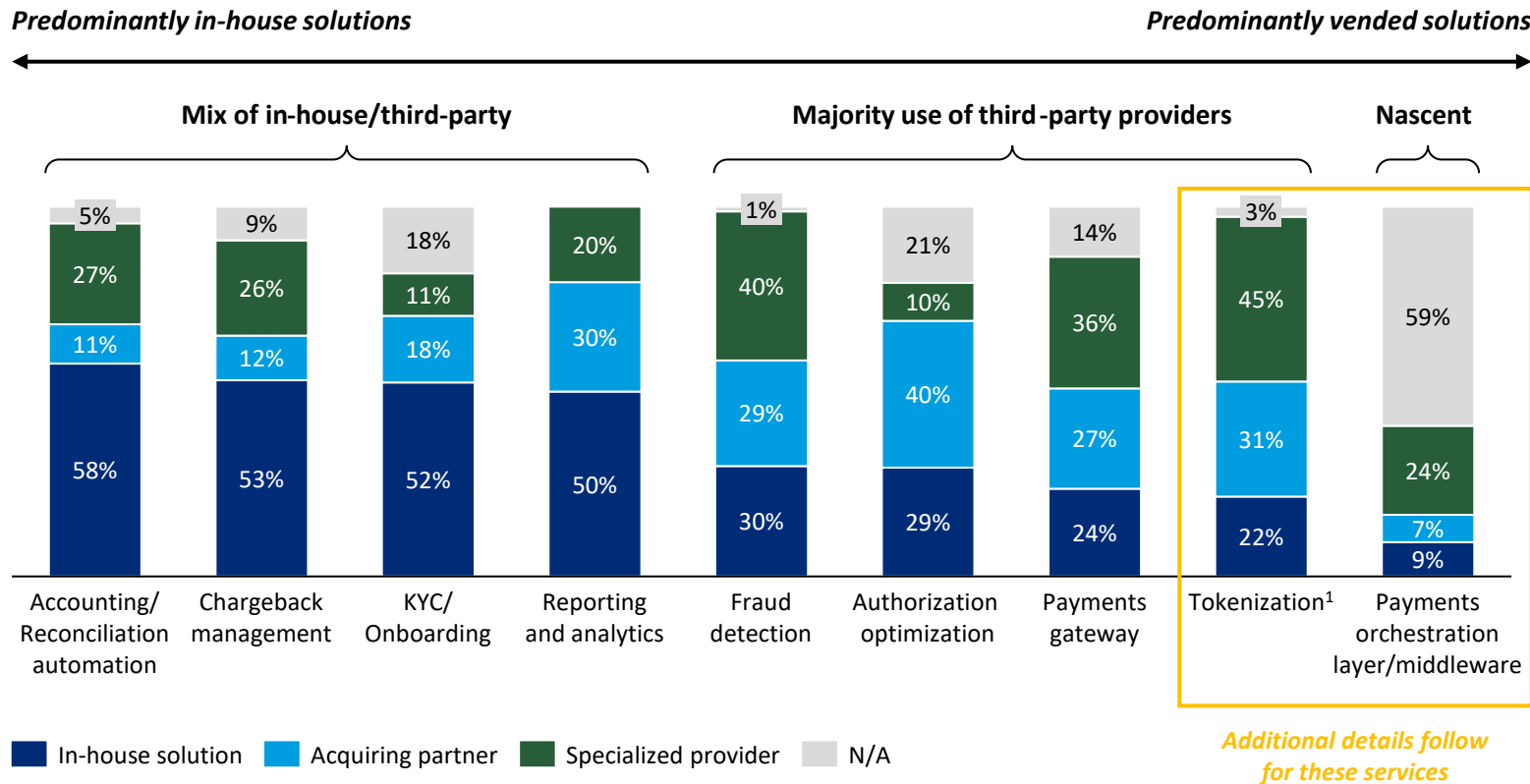- ☐ 3 solutions
- ☐ 2 solutions
- ☐ 1 solution

Question: To manage form of payment mix does your company engage in any of the below activities? (Select all that apply)
Note: totals may not sum to 100% due to rounding
Source: OW – MAG Voice of the Merchant Survey 2022, OW – MAG Voice of the Merchant Survey 2023

IN TERMS OF VENDED TECH OUTSIDE OF CORE ACQUIRING, MERCHANTS ARE FOCUSED ON TOKENIZATION AND ORCHESTRATION SOLUTIONS WITH SPECIALIZED PROVIDERS

Merchants' procurement of various payments services
Percentage mix of payments services across merchants based on how each solution is procured

Predominantly in-house solutions ← → *Predominantly vended solutions*

Mix of in-house/third-party — **Majority use of third-party providers** — **Nascent**

	Accounting/ Reconciliation automation	Chargeback management	KYC/ Onboarding	Reporting and analytics	Fraud detection	Authorization optimization	Payments gateway	Tokenization[1]	Payments orchestration layer/middleware
N/A	5%	9%	18%		1%	21%	14%	3%	
Specialized provider	27%	26%	11%	20%	40%	10%	36%	45%	59%
Acquiring partner	11%	12%	18%	30%	29%	40%	27%	31%	24%
In-house solution	58%	53%	52%	50%	30%	29%	24%	22%	7%
									9%

■ In-house solution   ■ Acquiring partner   ■ Specialized provider   ▨ N/A

Additional details follow for these services

Key takeaways

- Payments services and technologies used in day-to-day business activities vary in degree of complexity

- While many merchants leverage in-house solutions for business-as-usual (BAU) services such as reporting, reconciliation, and KYC/onboarding among others, others tend to use vended solutions (or in conjunction with their in-house tools)

- Tokenization and orchestration have the lowest penetration of in-house solutions, suggesting a higher level of sophistication/complexity and a greater need for external support in these areas
  - In the same vein, for both tokenization and orchestration, the number of merchants relying on specialized providers is far greater than those relying on their acquirers for these services, highlighting another area where merchants' partnership ecosystem is transforming

Question: Please indicate how you receive each of the below services today. If you have multiple providers for a service, select all that apply.
1. Network tokens are included under 'Specialized Provider' Note: totals may not sum to 100% due to rounding
Source: OW – MAG Voice of the Merchant Survey 2023

TOKENIZATION: TOKENIZATION HAS WITNESSED A SURGE IN IMPORTANCE, BECOMING A VITAL COMPONENT OF MERCHANTS' PAYMENTS STRATEGIES

Considerations for merchants to stay ahead of the curve as it applies to changing customer needs
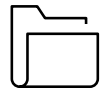
Context

- Merchants typically use various token solutions (acquirer, network, specialized provider) to mask stored card data in order to protect against cyber risk and reduce PCI scope (e.g., card-on-file)

- The role of tokens is evolving from being a commodity to becoming more strategic (e.g., by using a single token for each customer across different channels, merchants are gaining insight into customer behavior across channels)

Key benefits

- Use cases and benefits of payment tokenization technology vary based on the type of token

- Generally, payment tokenization is used to:
  - Enhance security
  - Simplify transactions
  - Enable convenient digital wallets
  - Support recurring payments
  - Improve cross-channel consistency
  - Prevent fraud

Key challenges merchants face

- Having multiple token providers, often used for different capabilities across token types, complicates the token management process

- Different capabilities across token types (acquirer-provided vs. network-provided vs. specialist-provided) impact payments operations, including routability across networks, portability between acquirers, auth rates, etc.

Sample providers
(non-exhaustive)

Networks

DISCOVER | mastercard

AMERICAN EXPRESS | VISA

Merchant Acquirers/PSPs

adyen | FIS worldpay

stripe | fiserv.

Third-Party Providers

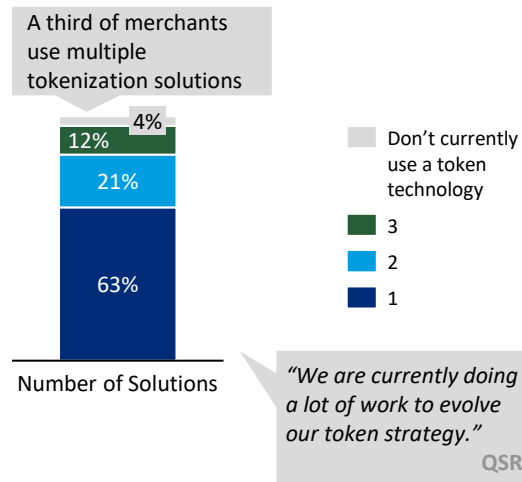cybersource
A Visa Solution | Braintree
A PayPal Service

spreedly

Source: OW – MAG Voice of the Merchant Survey 2023, OW Analysis

TOKENIZATION: ~40% OF MERCHANTS HAVE ALREADY IMPLEMENTED OR ARE CURRENTLY IMPLEMENTING OMNICHANNEL TOKENIZATION
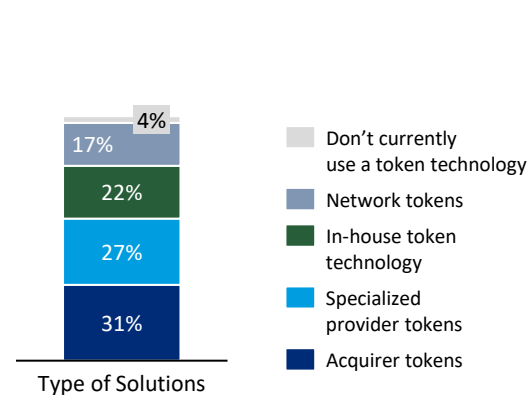
Omnichannel tokenization pertains to the usage of tokens to replace sensitive payments data across various commerce channels (in-store, online, mobile), thereby ensuring transaction security and a consistent customer experience, regardless of the channel. This is critical for merchants to build a single customer view based on their engagement across the different channels (unlike card-on-file/merchant tokens which are typically designed for a single channel and/or use case)

Number of tokenization solutions used by merchants[1]

A third of merchants use multiple tokenization solutions

- 4%
- 12%
- 21%
- 63%

Number of Solutions

Legend:
- Don't currently use a token technology
- 3
- 2
- 1

"We are currently doing a lot of work to evolve our token strategy."
QSR

- While nearly all merchants (96%) employ some form of tokenization technology, about 60% of merchants have only one tokenization solution

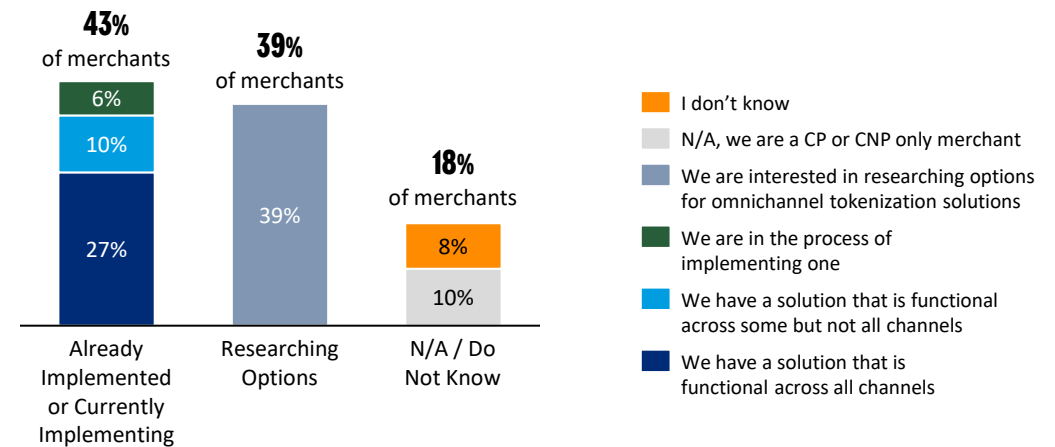### Types of tokenization solutions used by merchants[1]

- 4%
- 17%
- 22%
- 27%
- 31%

Type of Solutions

Legend:
- Don't currently use a token technology
- Network tokens
- In-house token technology
- Specialized provider tokens
- Acquirer tokens

- Acquirer tokens and specialized provider tokens were widely adopted following high-profile card data breaches ten plus years ago
- In recent years network tokens have risen with 17% of merchants reporting using them
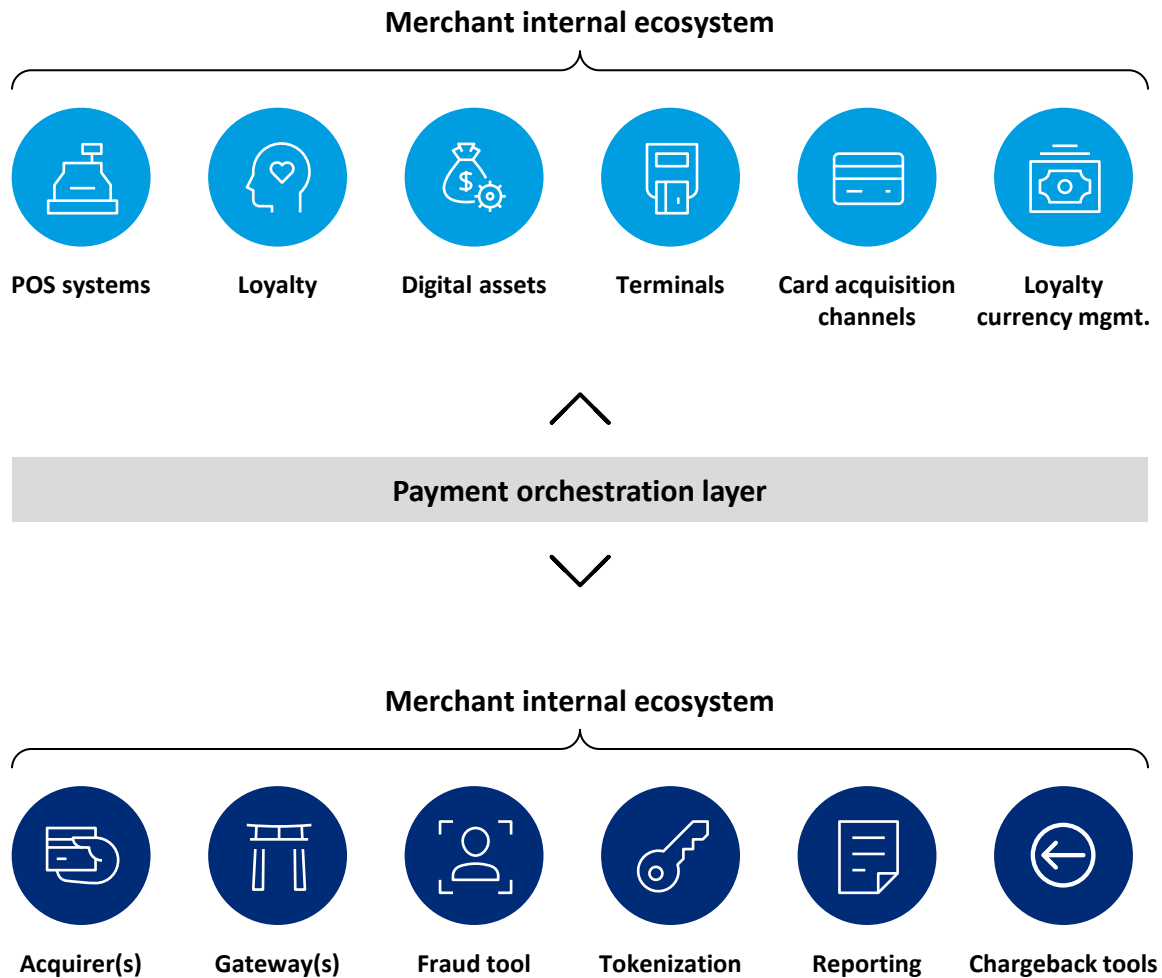
Usage of omnichannel tokens by merchants[2]

Percentage of merchants that have or envision having an omnichannel tokenization solution

43% of merchants
- 6%
- 10%
- 27%

Already Implemented or Currently Implementing

39% of merchants
- 39%

Researching Options

18% of merchants
- 8%
- 10%

N/A / Do Not Know

Legend:
- I don't know
- N/A, we are a CP or CNP only merchant
- We are interested in researching options for omnichannel tokenization solutions
- We are in the process of implementing one
- We have a solution that is functional across some but not all channels
- We have a solution that is functional across all channels

- ~40% of merchants have already implemented or are planning to implement an omnichannel tokenization solution
- For the other merchants, roughly half (~10%) are not omnichannel (i.e., CP or CNP only) and hence do not need omnichannel tokens; the rest (~8%) are undecided

1. Question: What tokenization technology do you use for your payments data? If you use multiple tokenization solutions, select all that apply. | 2. Question: Do you have or do you envision having an omnichannel tokenization solution? |Note: totals may not sum to 100% due to rounding . | Source: OW – MAG Voice of the Merchant Survey 2023

ORCHESTRATION: PAYMENTS ORCHESTRATION IS DESIGNED TO SIMPLIFY THE INTERPLAY BETWEEN A MERCHANT'S INTERNAL SYSTEMS AND ITS EXTERNAL PARTNERS

Merchant internal ecosystem

| POS systems | Loyalty | Digital assets | Terminals | Card acquisition channels | Loyalty currency mgmt. |

Payment orchestration layer

Merchant internal ecosystem

| Acquirer(s) | Gateway(s) | Fraud tool | Tokenization | Reporting | Chargeback tools |

A Payments Orchestration Layer is a middleware layer that interfaces with a merchant's internal systems and applications to create a **streamlined single point of integration** for external payments partners.

It provides a centralized hub for payments processing by enabling easy integration of Payment Service Providers (PSPs) while simplifying back-end payment processes.

As merchants adopt orchestration layers, they can more seamlessly route transactions to multiple acquirers.
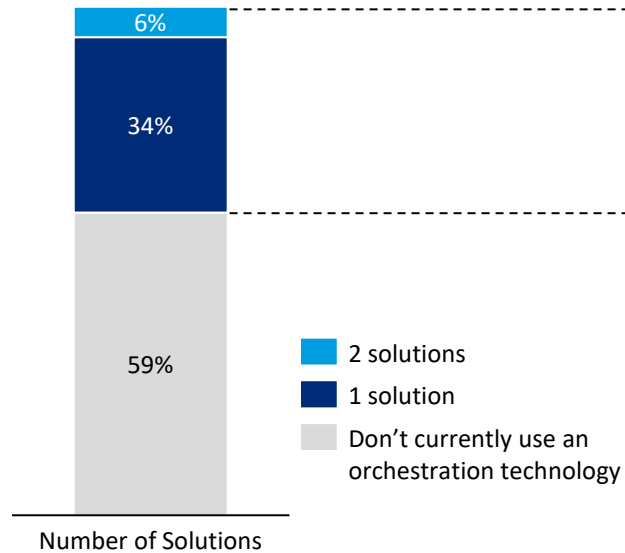
Payments orchestration pros/cons

👍

- Enables merchants to easily partner with specialty providers
- Abstracts complexity away from customers for a seamless experience
- Reduces technology development, support costs, and complexity
- Increases speed-to-market for integration
- Enables standardization
- Supports SLAs for key infrastructure components
- Reduces operational overhead (e.g., reconciliation, chargebacks)
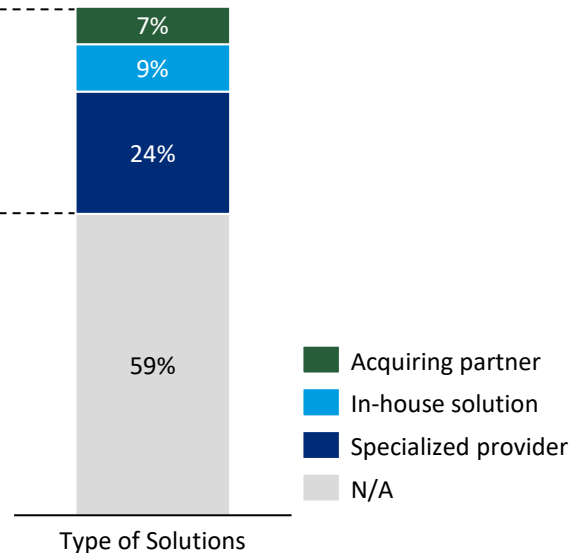
👎

- Requires upfront investment
- Integration complexity with acquirers that have tightly coupled verticalized tech stacks
- If procuring from third party:
  - Potential for vendor lock-in
  - May not meet all requirements
  - Reliant on vendor for changes

Source: OW Analysis

ORCHESTRATION: 40% OF MERCHANTS HAVE ADOPTED PAYMENTS ORCHESTRATION, WITH THE MOST COMMON APPROACH BEING A VENDED SOLUTION FROM SPECIALIZED PROVIDERS

Number of orchestration solutions used by merchants

6%

34%

59%

Number of Solutions

- 2 solutions
- 1 solution
- Don't currently use an orchestration technology

Types of orchestration solutions used by merchants

7%

9%

24%

59%

Type of Solutions

- Acquiring partner
- In-house solution
- Specialized provider
- N/A

Merchants are looking for more sophisticated, enterprise-grade orchestration solutions

" We want to get to a point of doing payments orchestration where we can find one platform to plug and play. This is because we only want to do this once and integrate quickly.

Specialty Retail

" On orchestration, we have different channels, customers, selling systems, etc. Some third-party solutions are good, but a lot of our systems are homegrown, and it makes it difficult to settle and reconcile when going with a third-party solution. Most third-party providers focus more on e-Com and smaller/mid-size merchants.

Big Box Retail

" We are in the midst of looking at different orchestration providers. We really don't want to build a home-grown system and can't seem to find anyone that has a full-service offering for our vertical.

Specialty Retail

~40% of merchants have an orchestration solution and most rely on a single solution because it reduces complexity, ensures consistency, and promotes cost efficiency

The majority of merchants with orchestration solutions primarily rely on specialized third-party providers, likely due to the complexity (e.g., cost, expertise, scalability, and evolving payment landscape) involved with developing an in-house solution

~80% of merchants with in-house orchestration solutions process >$30 BN in annual payments volume; these larger merchants have the necessary resources that make an in-house solution more feasible and advantageous for their operations

Question: Please indicate how you receive each of the below services today. If you have multiple providers for a service, select all that apply.
Note: totals may not sum to 100% due to rounding
Source: OW – MAG Voice of the Merchant Survey 2023

TEAM SIZE EXPANSION IS OCCURRING FOR MERCHANTS OF ALL SIZES, DESPITE A MORE CHALLENGING ECONOMIC ENVIRONMENT

Payments team size (2023)
Percentage of merchants with various payment team sizes

27%
20%
22%
31%
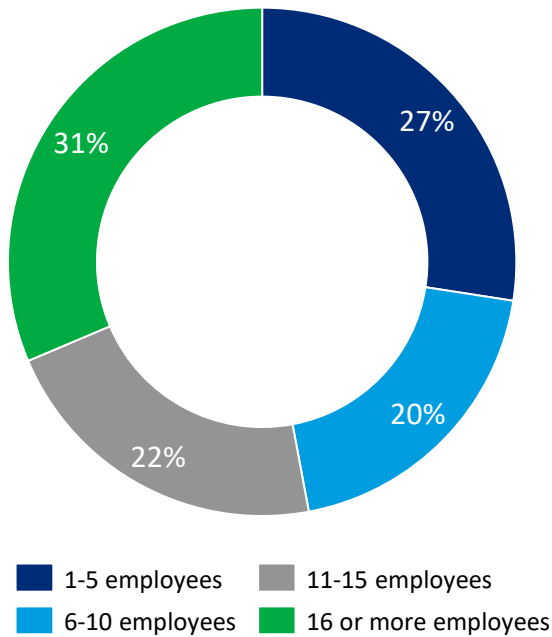
Team size expansion is happening broadly across the board

- ■ 1-5 employees
- ■ 6-10 employees
- ■ 11-15 employees
- ■ 16 or more employees

Change in payments team size for merchants that participated in both 2022 and 2023 survey

	Payments team size	Vertical		Change from 2022
1	1-5	Specialty Retail	—	Same Tier
2	1-5	Gas/C-store	—	Same Tier
3	1-5	Grocery/Pharmacy	—	Same Tier
4	1-5	QSR	—	Same Tier
5	6-10	Gas/C-store	↑	Increase
6	6-10	Grocery/Pharmacy	—	Same Tier
7	11-15	Apparel/Jewelry	—	Same Tier
8	11-15	QSR	—	Same Tier
9	11-15	Big Box Retail	↑	Increase
10	11-15	Specialty Retail	—	Same Tier

	Payments team size	Vertical		Change from 2022
11	16+	Telco/Streaming/Cable/Billers	—	Same Tier
12	16+	Big Box Retail	↑	Increase
13	16+	Telco/Streaming/Cable/Billers	—	Same Tier
14	16+	Big Box Retail	—	Same Tier
15	16+	Big Box Retail	—	Same Tier
16	16+	Specialty Retail	↑	Increase
17	16+	Other	—	Same Tier
18	16+	QSR	—	Same Tier
19	16+	Telco/Streaming/Cable/Billers	—	Same Tier
20	16+	Telco/Streaming/Cable/Billers	—	Same Tier

The growth in merchants' payments team sizes has been driven by the shift to a strategic mindset and merchants' evolving, more sophisticated technology needs

Question: How large is your payments team?; Note: totals may not sum to 100% due to rounding
Source: OW – MAG Voice of the Merchant Survey 2023, OW – MAG Voice of the Merchant Survey 2022

WHILE ~60% OF MERCHANTS HAVE PAYMENTS REPORTING INTO TREASURY, THE REPORTING STRUCTURE DOES NOT SIGNIFICANTLY INFLUENCE THEIR PRIORITIES

Primary reporting structure for payments
Percentage of merchants for each reporting structure

Percentage	Structure
59%	Treasury / Finance
16%	Marketing
16%	Digital / IT / Other
8%	Operations

Reporting structure and payments priorities by vertical
Merchants ranked activities based on time spent by payments team on a specific activity

Activity ranked in top three priority

Reporting structure	Vertical	Cost	Strategy	Operations
Treasury/Finance	Grocery/Pharmacy	47%	-	53%
	Specialty Retail	33%	17%	50%
	Big Box Retail	22%	22%	56%
	Gas/C-store	56%	-	33%
	Telco/Streaming/Cable/Billers	22%	11%	67%
	Apparel/Jewelry	-	33%	67%
	Other	33%	22%	44%
Marketing	Grocery/Pharmacy	-	33%	67%
	Specialty Retail	33%	-	67%
	Telco/Streaming/Cable/Billers	33%	33%	33%
	Apparel/Jewelry	-	33%	67%
	Other	67%	-	33%
Digital/IT/Other	QSR	50%	-	50%
	Specialty Retail	50%	17%	17%
	Big Box Retail	67%	33%	-
	Gas/C-store	33%	33%	33%
Operations	QSR	33%	67%	-
	Big Box Retail	33%	33%	33%
	Telco/Streaming/Cable/Billers	33%	-	67%

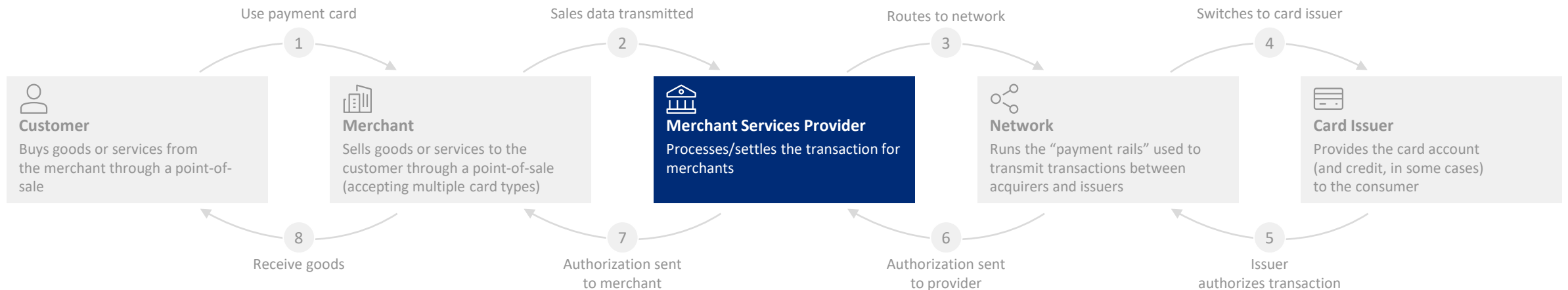| Category	Activities
Cost	Monitoring and optimizing payments costs
	Managing partnership negotiations and contracts
Strategy	Enhancing omnichannel customer experiences
	Developing payment strategy
Operations	Managing fraud and chargebacks
	Overseeing payments operations

Question: What is the primary reporting structure for the payments team in your company?
Note: totals may not sum to 100% due to rounding
Source: OW – MAG Voice of the Merchant Survey 2023

MERCHANT SERVICES PROVIDER

Use payment card

1

Sales data transmitted

2

Routes to network

3

Switches to card issuer

4

Customer
Buys goods or services from the merchant through a point-of-sale

Merchant
Sells goods or services to the customer through a point-of-sale (accepting multiple card types)

Merchant Services Provider
Processes/settles the transaction for merchants

Network
Runs the "payment rails" used to transmit transactions between acquirers and issuers

Card Issuer
Provides the card account (and credit, in some cases) to the consumer

8

Receive goods

7

Authorization sent to merchant

6

Authorization sent to provider

5

Issuer authorizes transaction

Key takeaways

- **Merchant Pain Points:** ~70% of merchants list the business-as-usual operational and cost activities where their teams spend the most time as also being their biggest pain points

- **Value-added Services:** Even as priorities shift, ~80% of merchants leverage at least one solution (in house or vended) for operational needs beyond core payments processing, with merchants often having two or more solutions for reporting and fraud detection

- **Multi-acquirer Setups:** In a bid to address some of the pain points and sources of friction (e.g., cost, outages without resiliency), half of all merchants have opted for multi-acquirer set ups

- **Partnerships:** Merchants are increasingly looking towards specialist providers for innovation and customization – only 20% expect this as the top quality among their PSPs
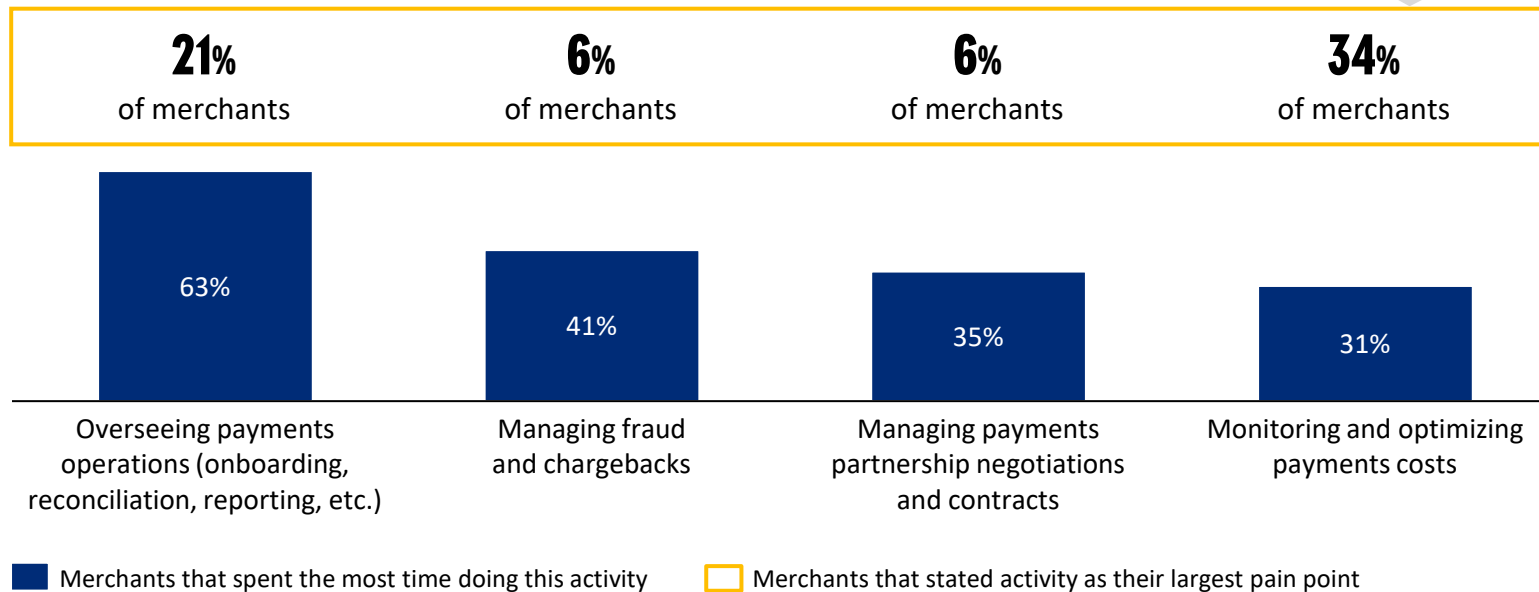
PAYMENTS TEAMS SPEND MOST OF THEIR TIME ON OPERATIONS AND COST, WITH ~70% OF MERCHANTS ALSO CONSIDERING THEM PAIN POINTS

Time spent by payment activity and merchant key pain points

Percentage of merchants that ranked an activity in their top two areas where most time is spent[1],
Percentage of merchants that stated this type of activity as their largest pain point[2]

32% of merchants had other areas they found concerning, with 17% listing keeping up with changes in regulations/network requirements as their largest pain point

21% of merchants	**6%** of merchants	**6%** of merchants	**34%** of merchants

QSR

63%	41%	35%	31%
Overseeing payments operations (onboarding, reconciliation, reporting, etc.)	Managing fraud and chargebacks	Managing payments partnership negotiations and contracts	Monitoring and optimizing payments costs

■ Merchants that spent the most time doing this activity   ▢ Merchants that stated activity as their largest pain point

Key takeaways

Despite payments cost being a significant pain point, it is unlikely to remain a top priority for merchants, as many have already made meaningful optimizations in recent years

"

Given the current contracts, cost cannot be meaningfully improved today. Longer term, fraud and cost will be flipped as priorities.

1. Question: How much time does your payments team spend on the following activities? (1 = most time consuming) | 2. Question: What is your largest payments-related pain point today and how does it impact your business?
Note: totals may not sum to 100% due to rounding
Source: OW – MAG Voice of the Merchant Survey 2023

EVEN AS PRIORITIES SHIFT, 80% OF MERCHANTS LEVERAGE AT LEAST ONE SOLUTION FOR OPERATIONAL NEEDS BEYOND CORE PAYMENTS PROCESSING

Common suite of payments services that merchants seek beyond core processing

Fraud and Risk

Advanced fraud detection tools (e.g., machine learning), including smart authentication, chargeback management, data security, and regulatory compliance support

Payment Optimization

Services to streamline operations and improve financial performance, including authorization rate optimization, smart transaction routing, and other strategies
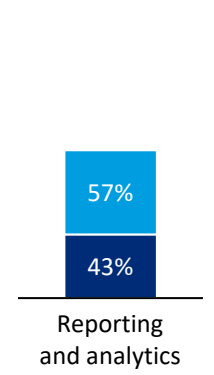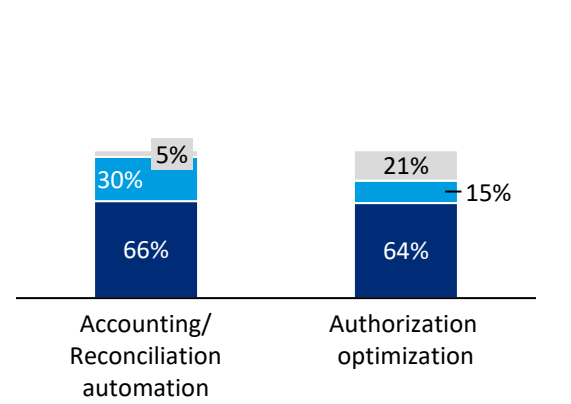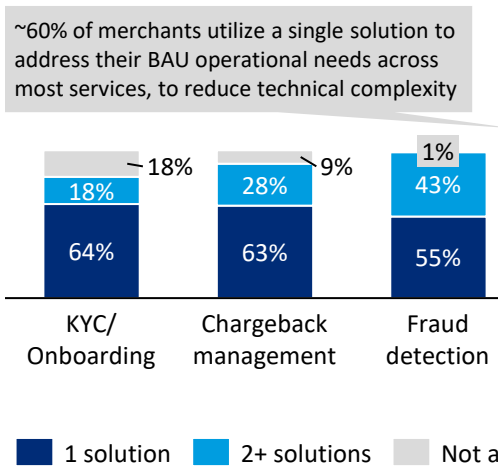
Reporting/Insights

Comprehensive information and data analytics (e.g., dashboards and customizable reports) about customer and transactions data to enhance transparency, and facilitate better decision-making

Other

Other value-added services including banking, cards, loyalty, working capital, alternative payments, recurring billing management, etc.

Penetration of various payments services across merchants

Percentage of merchants utilizing no providers, a single solution, or multiple solutions (including in -house tools)

~60% of merchants utilize a single solution to address their BAU operational needs across most services, to reduce technical complexity

	1 solution	2+ solutions	Not applicable/No solution
KYC/Onboarding	64%	18%	18%
Chargeback management	63%	28%	9%
Fraud detection	55%	43%	1%
Accounting/Reconciliation automation	66%	30%	5%
Authorization optimization	64%	15%	21%
Reporting and analytics	43%	57%	

Legend: ■ 1 solution ■ 2+ solutions ▢ Not applicable/No solution

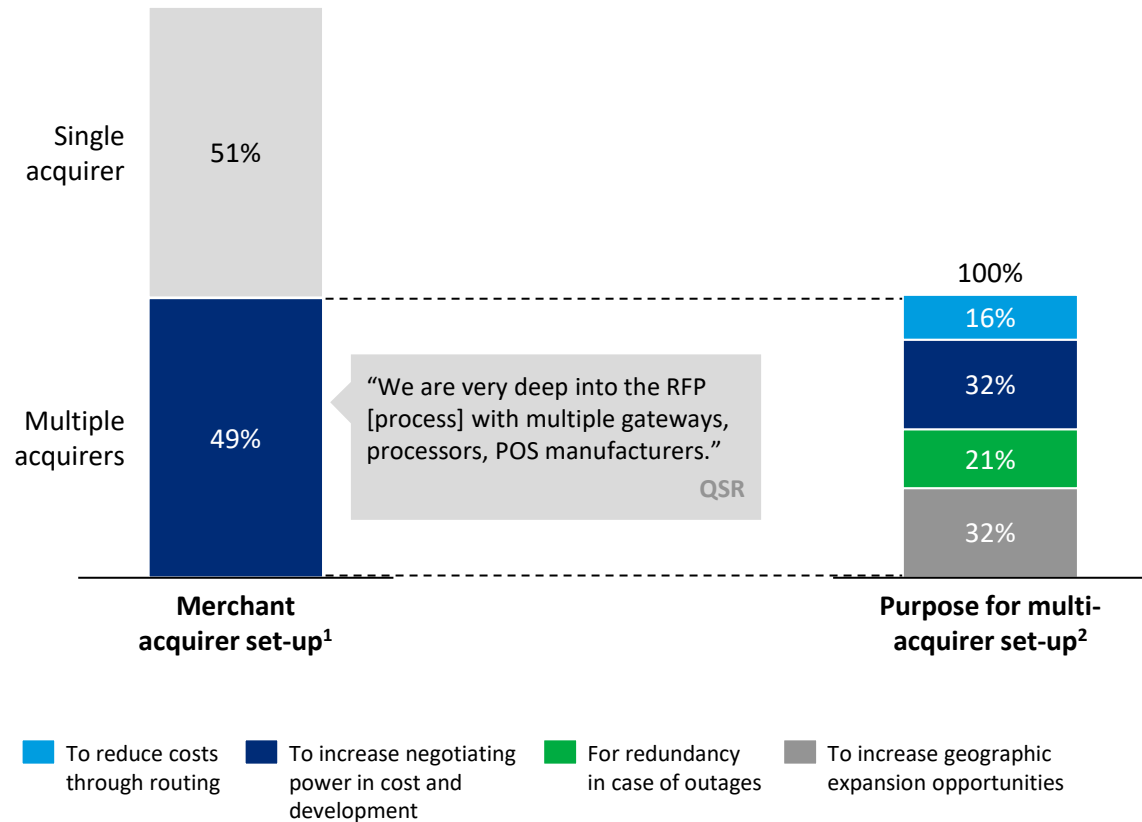It is common for merchants to have two or more solutions for reporting and fraud detection

" Fraud has become an increasingly prominent issue for us. Fraudsters have been finding deficiencies in the payments infrastructure resulting in a whack-a- mole approach to fraud.
Grocery/Pharmacy

" We have good visibility in aggregate from our acquirer, but tying the payments data to the customer and customer behavior is still challenging
Grocery/Pharmacy

Question: Please indicate how you receive each of the below services today. If you have multiple providers for a service, select all that apply.
Note: totals may not sum to 100% due to rounding
Source: OW – MAG Voice of the Merchant Survey 2023

IN A BID TO ALLEVIATE SOME OF THE PAIN POINTS AND SOURCES OF FRICTION (AMONG OTHER STRATEGIC REASONS), ~50% OF ALL MERCHANTS HAVE OPTED FOR MULTI-ACQUIRER SET UPS

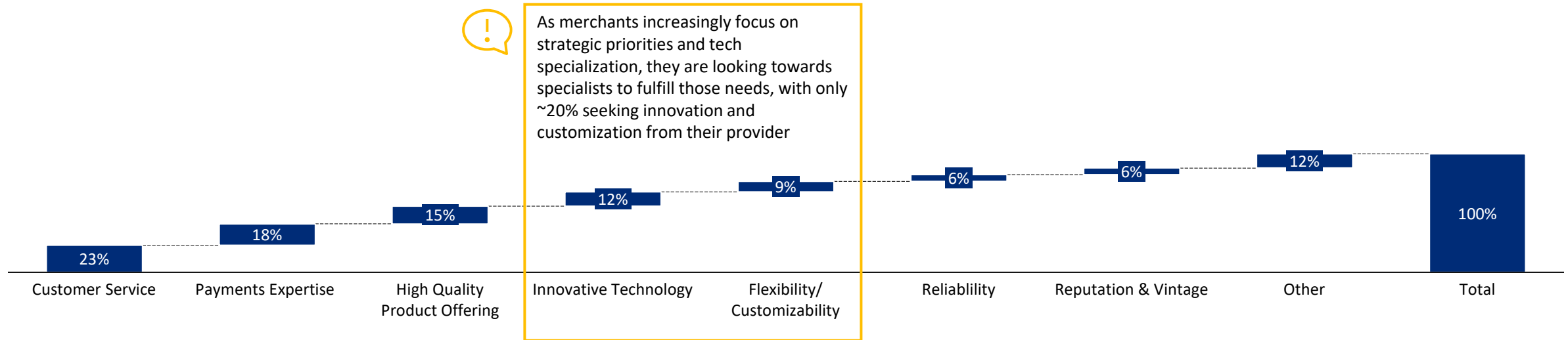## Merchant usage for multi-acquirer routing (2022)

Single acquirer — 51%

Multiple acquirers — 49%

"We are very deep into the RFP [process] with multiple gateways, processors, POS manufacturers."
QSR

Merchant acquirer set-up[1]

100%
- 16%
- 32%
- 21%
- 32%

Purpose for multi-acquirer set-up[2]

Legend:
- To reduce costs through routing
- To increase negotiating power in cost and development
- For redundancy in case of outages
- To increase geographic expansion opportunities

Common rationales for multi-acquirer routing (2023)

Type	Description
Reduce cost/increase leverage	All-in costs include direct processing fees as well as indirect costs like reserve collateral requirements; a multi-acquirer model creates ongoing transparency and provides leverage
Increase operational redundancy	Following a string of high-profile processor outages as well as unexpected, onerous requirements imposed by acquirers on some industries during the pandemic, many merchants have moved to a multi-acquirer model
Increase geographic expansion	Local acquiring is key, as otherwise the transaction is processed as cross-border (higher cost, lower acceptance rate, and risk of latency); some merchants may adopt only one processor per geo
Improved acceptance rates	Maximizing merchant revenue by increasing authorization approval by data management, tokenization, local acquiring, and/or network routing
Local payment methods	Flexibility to accept different types of payment methods - especially important for emerging markets
Local expertise	The 'market' is a key criteria used to route transactions, take advantage of an acquirer's local know-how, and comply with local rules and requirements

Industry-wide Applicability

↓

Applicable to Specific verticals

MERCHANTS ARE INCREASINGLY LOOKING TOWARDS SPECIALIST PROVIDERS FOR INNOVATION AND CUSTOMIZATION – ONLY 20% EXPECT THIS AS THE TOP QUALITY AMONG THEIR PSPS

We asked merchants the top quality they look for when partnering with an organization for payments-related services

As merchants increasingly focus on strategic priorities and tech specialization, they are looking towards specialists to fulfill those needs, with only ~20% seeking innovation and customization from their provider

Customer Service	Payments Expertise	High Quality Product Offering	Innovative Technology	Flexibility/ Customizability	Reliablility	Reputation & Vintage	Other	Total
23%	18%	15%	12%	9%	6%	6%	12%	100%

> " We adopted a long-term approach to partnerships and keep asking for more from partners, both for cost and revenue generating initiatives. Generally, we have a bias towards putting more burden on our incumbent partners and would like to limit costly net new integration."
>
> **Grocery/Pharmacy**

> " [We are looking for] relevant experience with other merchants, specialized/hyper-focus on payments, understanding of [our industry] and its nuances, as well as an understanding of our current hardware and software providers and associated challenges.
>
> **Apparel/Jewelry**

> " Resources are still hard to unlock and there is still a 'do more with less' attitude.
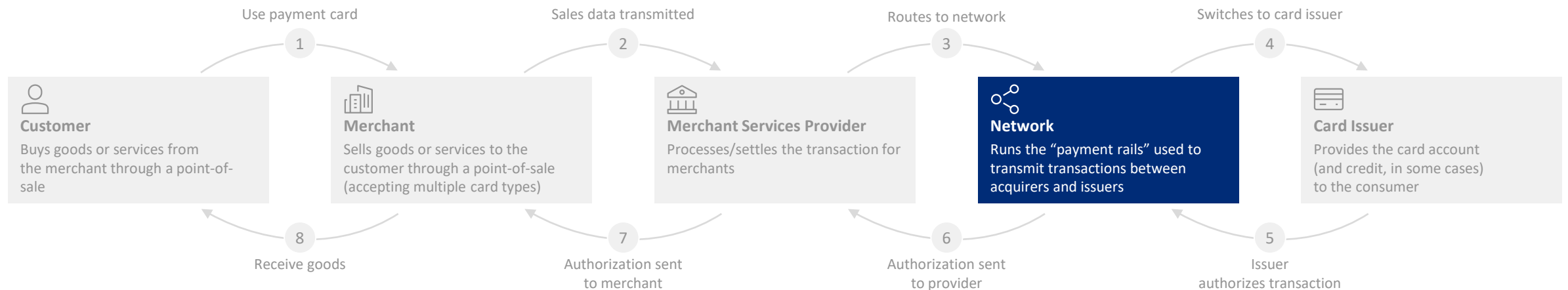>
> **Grocery/Pharmacy**

Question: Excluding cost, what qualities do you look for when partnering with an organization for payments-related services?
Note: totals may not sum to 100% due to rounding
Source: OW – MAG Voice of the Merchant Survey 2023

NETWORK

Use payment card **1**	Sales data transmitted **2**	Routes to network **3**	Switches to card issuer **4**	

Customer
Buys goods or services from the merchant through a point-of-sale

Merchant
Sells goods or services to the customer through a point-of-sale (accepting multiple card types)

Merchant Services Provider
Processes/settles the transaction for merchants

Network
Runs the "payment rails" used to transmit transactions between acquirers and issuers

Card Issuer
Provides the card account (and credit, in some cases) to the consumer

Receive goods **8**	Authorization sent to merchant **7**	Authorization sent to provider **6**	Issuer authorizes transaction **5**	

Key takeaways

- **Payment Industry Developments:** There are several key payments industry developments that have further advanced over the last year - including CNP debit routing, the Credit Card Competition Act (CCCA), enhancements to friendly fraud programs by the card schemes, real-time consumer payments use cases, and enhanced regulatory scrutiny for BNPL

- **Most Impactful Developments:** Of the above developments, CNP debit routing, and the CCCA are top of mind; merchants believe competition in debit and credit will be impactful to their organizations

- **Variance Across Verticals:** More than 80% of merchants in 'everyday spend' categories expect the CNP Debit routing ruling to be impactful for their business

- **CNP Debit Routing:** Half of all merchants expect to implement smart CNP debit routing by the end of 2023; nearly 20% of merchants do not plan to implement it at all

- **Real-time Payments:** FedNow launched in July 2023; at this early stage of launch, only ~40% of merchants consider it to be very or somewhat impactful to their organizations

FIVE KEY PAYMENTS INDUSTRY DEVELOPMENTS HAVE ADVANCED OVER THE LAST YEAR CREATING MORE COMPETITION...AND COMPLEXITY
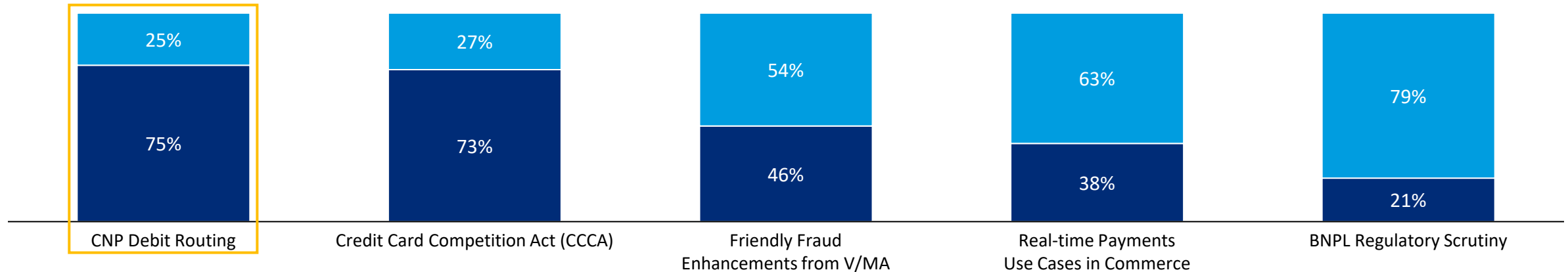
	CNP Debit Routing	Credit Card Competition Act (CCCA)	Friendly Fraud Enhancements	Real-time Payments Use Cases	BNPL Regulatory Scrutiny
Relevant entity	The Federal Reserve	U.S. Congress	Visa and Mastercard	The Federal Reserve	The CFPB
Overview	• The Fed has clarified that Regulation II which requires issuers to support two or more unaffiliated networks for debit routing, also applies to CNP transactions • This will place routing control for CNP debit transactions in the hands of merchants	• Bill aimed to increase competition in credit card routing • Like debit routing, this would require issuers to enable an unaffiliated network on credit cards, offering merchants routing choice on credit transactions	• As CNP transactions continue to rise since the pandemic, there has been an increase in first-party misuse (friendly fraud) • V/MA have changed their dispute programs to enable merchants to provide additional data or evidence to challenge disputes	• The Federal Reserve launched FedNow, a national real-time rail, to facilitate instant payments • Currently supports Account-to-Account (A2A) transfers and Consumer-to-Business (C2B) use cases	• The CFPB issued a market-monitoring inquiry into the business practices of five leading BNPL providers • The objective was to analyze trends and consumer impacts accompanying the rapid growth in BNPL products
Timing	Effective July 1, 2023	Bill reintroduced in June 2023	Effective April 2023	Launched in July 2023	CFPB reports published Sept. 2022 and March 2023
Implications for merchants	• Reduced cost of acceptance • Increased control over transaction routing • Infrastructure investments required to enable CNP routing	Impact depends on the enactment of legislation, but may include: • Reduced cost of acceptance • Increased control over transaction routing • Investment in intelligent routing capabilities may be needed • Major payments contract renegotiations may be needed	• Decreased financial burden in first-party misuse transactions • Improves protection for small businesses and merchants	Impact depends on the rate of adoption: • Slow adoption may have limited impact on POS payments mix • Accelerated adoption may result in material cost savings and reductions in returns, chargebacks, and fraud	Impact depends on final CFPB action, but may include: • Opportunities for merchant-friendly installment solutions • Greater innovation and appeal for merchant–developed financing options • Potential increase in overheads/losses • Reduced sales in case of greater friction in cust. journey

Source: Federal Reserve Board, Congress.gov, CFPB, Visa, Mastercard

CNP DEBIT ROUTING AND THE CCCA ARE TOP OF MIND, WITH MERCHANTS ANTICIPATING COMPETITION IN DEBIT AND CREDIT TO BE IMPACTFUL TO THEIR ORGANIZATIONS

We asked merchants what level of impact they anticipate forthcoming/potential payments industry developments to have on their business

Additional details in subsequent slides

	CNP Debit Routing	Credit Card Competition Act (CCCA)	Friendly Fraud Enhancements from V/MA	Real-time Payments Use Cases in Commerce	BNPL Regulatory Scrutiny
Uncertain impact	25%	27%	54%	63%	79%
Very/Somewhat impactful	75%	73%	46%	38%	21%

❝
Regulatory changes and the need to develop support for them is one of our largest pain points today.

Grocery/Pharmacy

❝
Given debit routing is more "real" with the regulatory change, it is a top priority. A close second is RTP and irrevocable payments – I think there is huge potential. Keen to see how FedNow is architected and what key considerations exist for a merchant like us.

Big Box Retail

■ Uncertain impact/I'm not familiar with this development   ■ Very/Somewhat impactful

Question: For the below forthcoming/potential payments industry developments, please indicate the level of impact you anticipate each to have on your business.
Note: totals may not sum to 100% due to rounding
Source: OW – MAG Voice of the Merchant Survey 2023

CNP DEBIT ROUTING: THE FED'S AMENDMENTS TO REG II PROVIDES MERCHANTS ADDITIONAL LOWER COST ROUTING OPTIONS FOR CNP TRANSACTIONS

## Previous state of debit card routing

- Regulation II requires that all issuers allow merchants/acquirers to have the choice between two or more unaffiliated networks for debit routing – Visa/Mastercard on front of card, and a single-message PIN network(s) (e.g., Maestro, PULSE, Interlink, STAR, NYCE, Accel) on back of card

- As a result, many merchants have two transaction routing choices for debit transactions, allowing them to select the lowest-cost option and creating more competition

- However, hitherto not all cards had two unaffiliated network routing options for CNP transactions as either issuers chose a network that did not enable or not effectively enable card-not-present, or had opted out of card-not-present functionality

- CNP debit transactions were more complicated to dynamically route than CP transactions due to the inability to capture a PIN at the CNP checkout, necessitating the transaction to become 'PINless', with alternate rules and requirements

- Overall, about half of debit volume came from issuers enabled for CNP PINless routing
  - Some top issuer clients of regional networks (e.g., STAR, Accel) opted out of PINless CNP
  - Many other issuers were not enabled for PINless given their debit cards had Visa/Maestro or Mastercard/Interlink configurations

Current changes to Reg II rule

- On October 3, 2022, the Federal Reserve amended the Reg II ruling to clarify that issuers must enable at least two unaffiliated payment card networks, without restrictions based on geographic area, specific merchant, or type of debit transaction

- The amended rule went into effect on July 1, 2023, with participants given 9 months to comply

- This increases competition for CNP transaction routing and provides an additional, lower-cost routing option on CNP transactions

- Based on the clarification of this rule, issuers are now required to enable two networks for CNP transactions, providing merchants with the choice in routing (e.g., merchants can choose to enable and route to the lowest cost network, merchants can choose to have exclusivity with one network, etc.)

- There are two other clarifications in the rule, including language on updating the applicable form factors to include e-wallets and other digital debit transactions, and adding biometrics as an applicable authentication method in addition to PIN and signature

- As of June 30, 2023, it is reported that all the existing debit networks, including Interlink and Maestro, enable routing for both CP and CNP transactions

Source: Vixio – 'An Easy Switch': US Fed Dual-Routing Set To Take Effect, Interlink, Oliver Wyman analysis

CNP DEBIT ROUTING: IN 2021, ONLY ~5% OF CNP DEBIT TRANSACTIONS WERE PROCESSED VIA PIN NETWORKS

**US Debit Volumes: Breakdown of Signature vs. PIN
2021, ($TN)**

Avg. interchange by network and issuer type (in ¢)
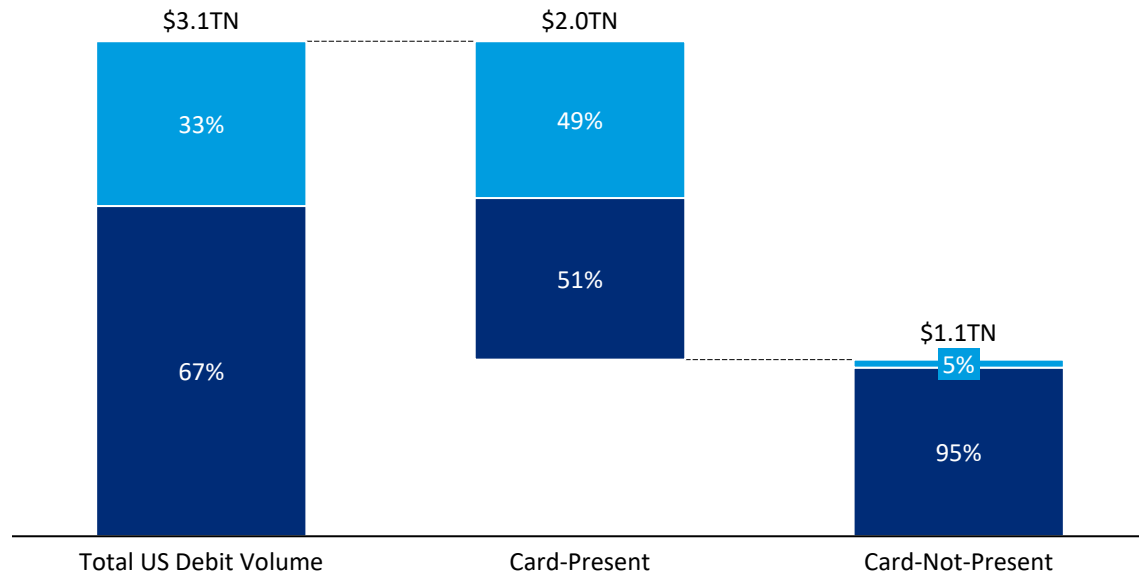
In a CP environment, merchants have the ability to determine which network a transaction is routed to, resulting in an approximately equal distribution between PIN-based and signature-based transactions
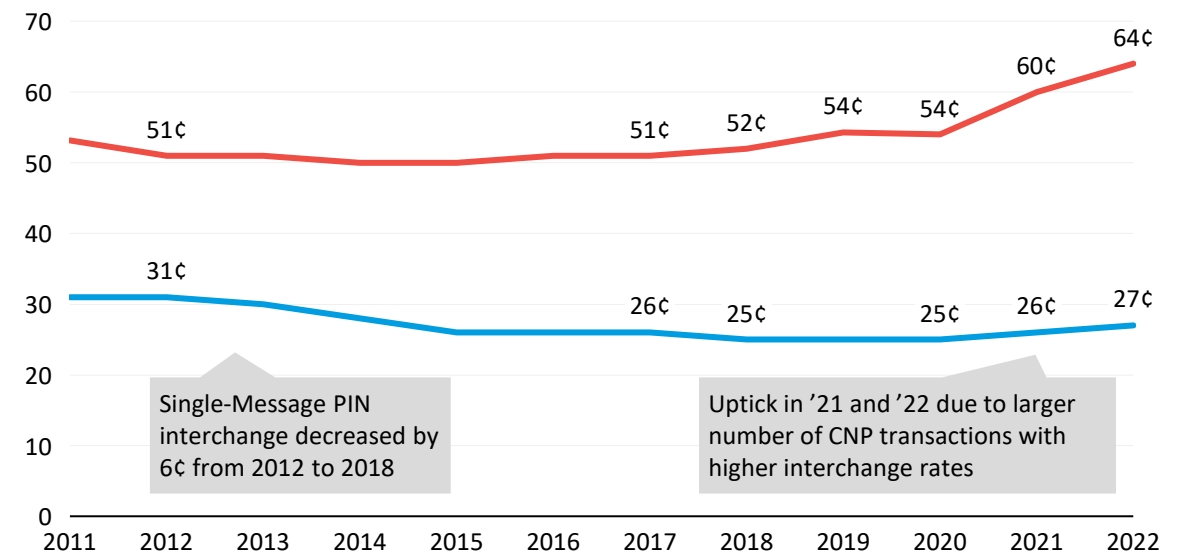
Merchants benefit from the lower interchange costs associated with single-message (PIN) debit transactions

■ Single-Message (PIN) ■ Dual-Message (Signature)

── Dual-Message: Exempt ── Single-Message: Exempt

Source: Jefferies, Federal Reserve – Regulation II (Debit Interchange Fees and Routing), Oliver Wyman analysis

CNP DEBIT ROUTING: MORE THAN 80% OF MERCHANTS IN 'EVERYDAY SPEND' CATEGORIES EXPECT THE CNP DEBIT ROUTING RULING TO BE IMPACTFUL FOR THEIR BUSINESS...

Perceptions of impact from Fed's ruling clarifying debit routing ability on CNP transactions
Merchants that expressed that the ruling would be very or somewhat impactful on their business

Overall	Grocery/Pharmacy	Big Box Retail	Telco/Streaming/ Cable/Billers	QSR	Other	Specialty Retail	Apparel/Jewellery	Gas/C-store
75%	83%	83%	83%	75%	75%	75%	60%	60%
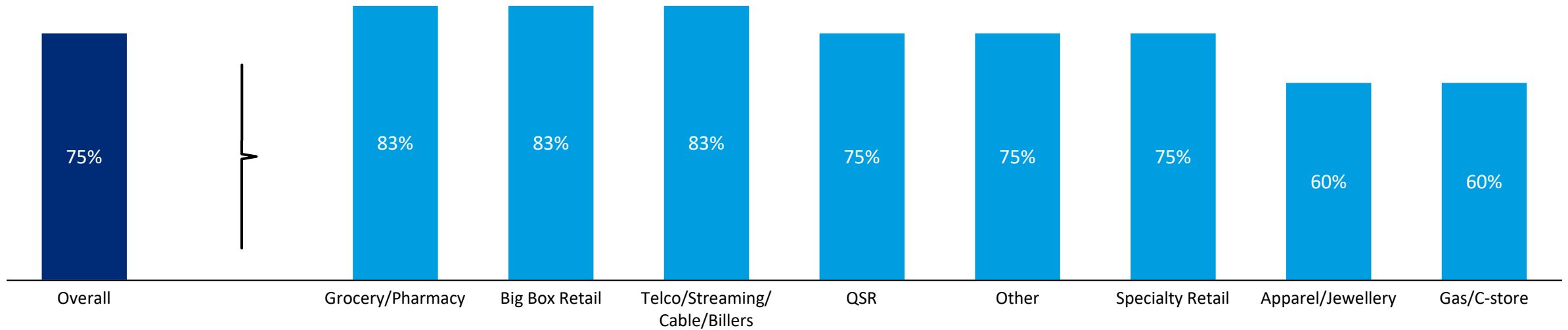
> We have done a lot of work in implementing CNP debit routing over the past year and believe others may not be as advanced on CNP routing. It's a bit of a wild west.
>
> QSR

Question: For the below forthcoming/potential payments industry developments, please indicate the level of impact you anticipate each to have on your business. "Recent or upcoming changes; The Fed's ruling clarifying debit routing ability on card not present transactions" respondents. | Note: totals may not sum to 100% due to rounding | Source: OW – MAG Voice of the Merchant Survey 2023

CNP DEBIT ROUTING: ...BUT ONLY 50% OF MERCHANTS EXPECT TO HAVE IMPLEMENTED CNP DEBIT ROUTING BY YEAR-END 2023

Timing of CNP Debit Routing
(Percentage of merchants)

Fed ruling go-live date occurred on 7/1/2023

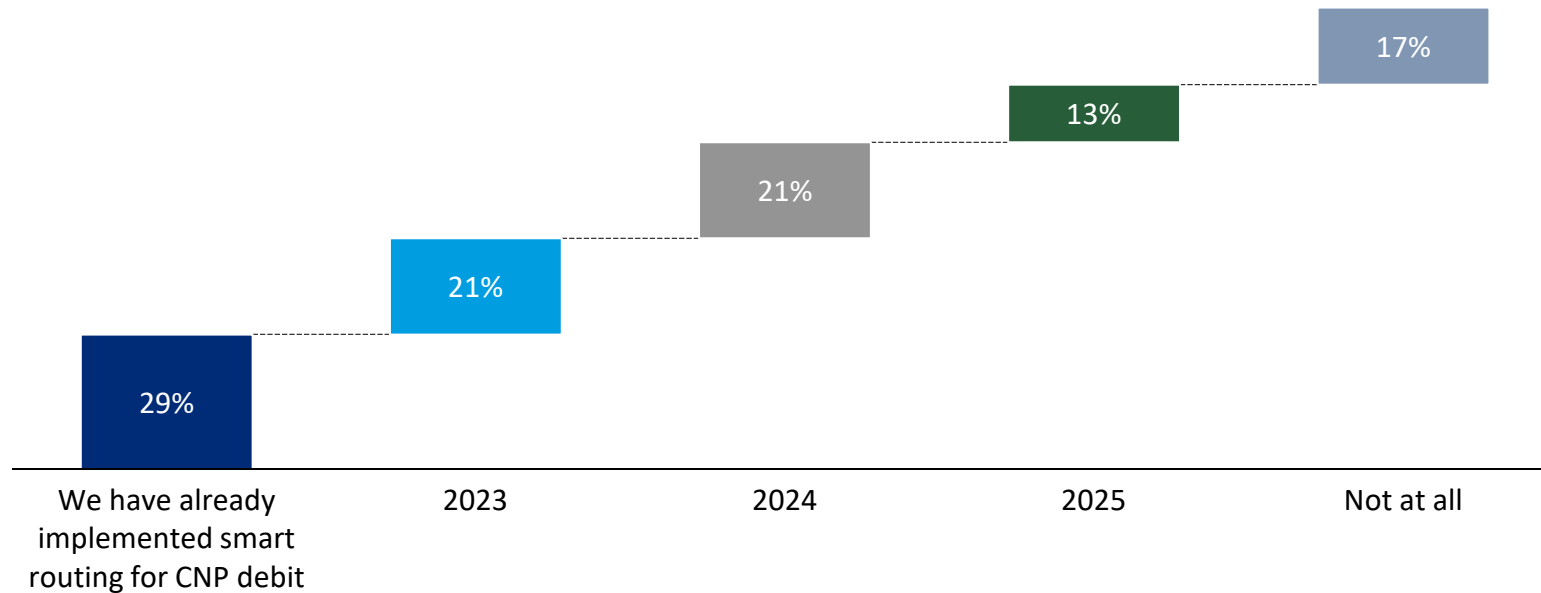| We have already implemented smart routing for CNP debit	2023	2024	2025	Not at all
29%	21%	21%	13%	17%

Key takeaways

- While merchants are not required to enable the debit routing capability, the majority of merchants surveyed (80+%) have already implemented CNP debit routing or have plans to do so by 2025

- Enterprise merchants using interchange-plus pricing models are very likely to expand the use of least cost routing for CNP, potentially including merchant service provider value-added services (VAS) related to authorization optimization

- The majority of merchants not planning to implement smart routing for CNP debit perceive the ruling to have little to no impact on their organization, which includes 40% of apparel/jewelry merchants and 25% of QSRs; this is likely due to having low PIN volume and/or small-ticket interchange pricing which mutes the impact

"

The two processors with PIN debit networks will benefit the most. Given our [transaction] routing strategy, the impact on our business would not be very high though."

QSR

Question: When will your organization be ready to capitalize on the Fed's ruling requiring at least two network options for routing card not present (CNP) debit transactions?
Note: totals may not sum to 100% due to rounding
Source: OW – MAG Voice of the Merchant Survey 2023

CARD ISSUER

Customer	Merchant	Merchant Services Provider	Network	Card Issuer
Buys goods or services from the merchant through a point-of-sale	Sells goods or services to the customer through a point-of-sale (accepting multiple card types)	Processes/settles the transaction for merchants	Runs the "payment rails" used to transmit transactions between acquirers and issuers	Provides the card account (and credit, in some cases) to the consumer

Flow steps:
1. Use payment card
2. Sales data transmitted
3. Routes to network
4. Switches to card issuer
5. Issuer authorizes transaction
6. Authorization sent to provider
7. Authorization sent to merchant
8. Receive goods

Key takeaways

- **Issuer Role:** Issuer partnerships are critical for merchants to ensure the success of their proprietary card programs; changes in both the economics, and roles and responsibilities of issuers and merchants are transpiring for these card offerings

- **Authorization Rates:** While various factors influence auth rates throughout the transaction flow, issuers play a critical role in influencing auth declines, driving most auth declines outside of fraud pre-screening

ABOUT HALF OF ALL MERCHANTS OFFER SOME FORM OF PROPRIETARY CARD PROGRAMS – BE IT PRIVATE LABEL OR CO-BRAND CARDS

We asked merchants if they offer private label or co-brand cards
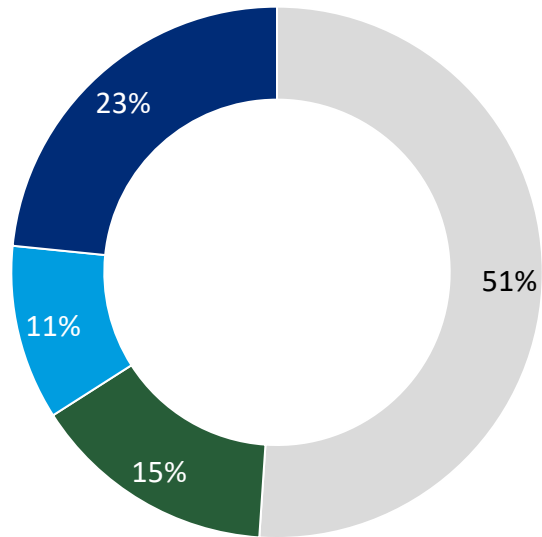
- Both co-brand and private label cards
- Private label credit card only
- Co-brand credit card only
- No proprietary cards

23%
11%
15%
51%

Merchants offering co-brand credit cards

38%
23% Both co-brand and private label
15% Co-brand credit card only

Overall	Big Box Retail	Apparel/ Jewellery	Gas/C-store	Specialty Retail	Telco/ Streaming/ Cable/Billers	Other	Grocery/ Pharmacy	QSR
	83%	80%	40%	38%	33%	25%	17%	

> Over 80% of big box retailers offer both co-brand and private label programs; QSRs typically don't support either program

Merchants offering private label credit cards

35%
23% Both co-brand and private label
12% Private label credit card only

Overall	Big Box Retail	Apparel/ Jewellery	Gas/C-store	Specialty Retail	Telco/ Streaming/ Cable/Billers	Other	Grocery/ Pharmacy	QSR
	83%	80%	100%	13%		25%	17%	

Question: For each of the below financial service products that your organization offers, please indicate the primary performance metric you use for measuring its success.
Note: totals may not sum to 100% due to rounding.
Source: OW – MAG Voice of the Merchant Survey 2023

KEY OBJECTIVES FOR MERCHANTS OFFERING THESE PROGRAMS INCLUDE GREATER CUSTOMER LOYALTY, SPEND, AND RETENTION, AMONG OTHER BENEFITS

How merchants measure the success of their proprietary cards

Private label/ Co-brand credit cards

- 10%
- 15%
- 26%
- 49%

■ Deepening customer relationships and loyalty

■ Increasing sales

■ Generating direct revenue (e.g., through interchange)

□ Reducing cost
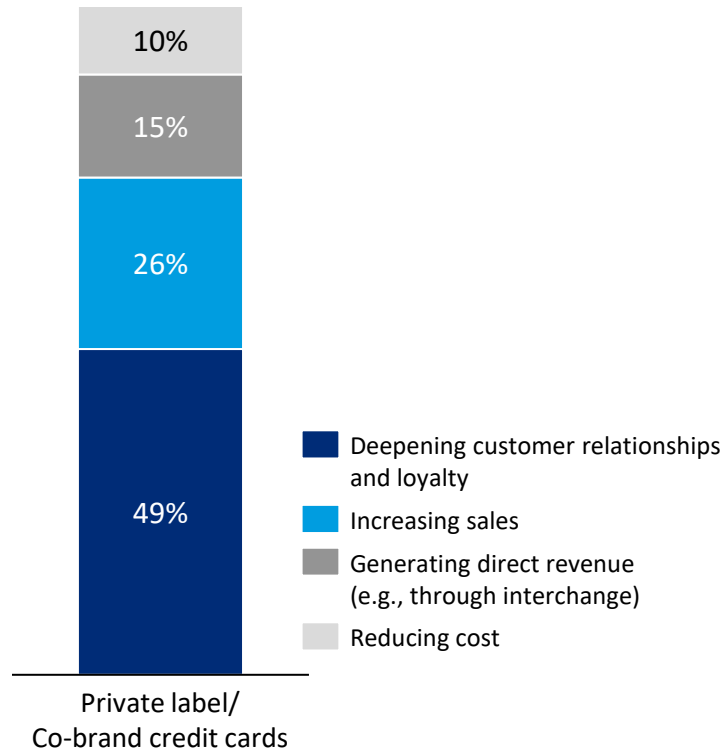
Key benefits of co-brand and private label ranked from a merchant's perspective

Applicable Benefits

Higher

1. Loyalty, customer engagement, and customer value multiplier

Co-brand and private label build a merchant's ability to offer added value and exclusive benefits to the best customers, driving brand loyalty, spending, and retention

2. Retailer Share Agreements (RSA) and acceptance cost savings

Additional revenue from royalties and gain share, additional funding pools, and lowered cost of payment acceptance (i.e., interchange fees)

3. Heightened brand awareness, interaction, and differentiation

Direct interaction with the brand (e.g., holding a branded card, speaking with a salesperson about the loyalty program in the store, receiving branded marketing material) increases by co-brand/private label offerings; these interactions can be enhanced through unique experiential benefits (e.g., VIP access to product launches, exclusive events, cut-the-queue experiences)

4. Marketing and sales support

Financial and operational support from issuers, particularly for retail-oriented programs that rely on activation at POS, issuer sales activation tactics enhance not only card sales but also product sales

5. Access to cardholder data

Incremental data on consumers available to merchants from issuers (through contractual agreements) enables a more comprehensive view into customer analytics, especially with co-brand cards
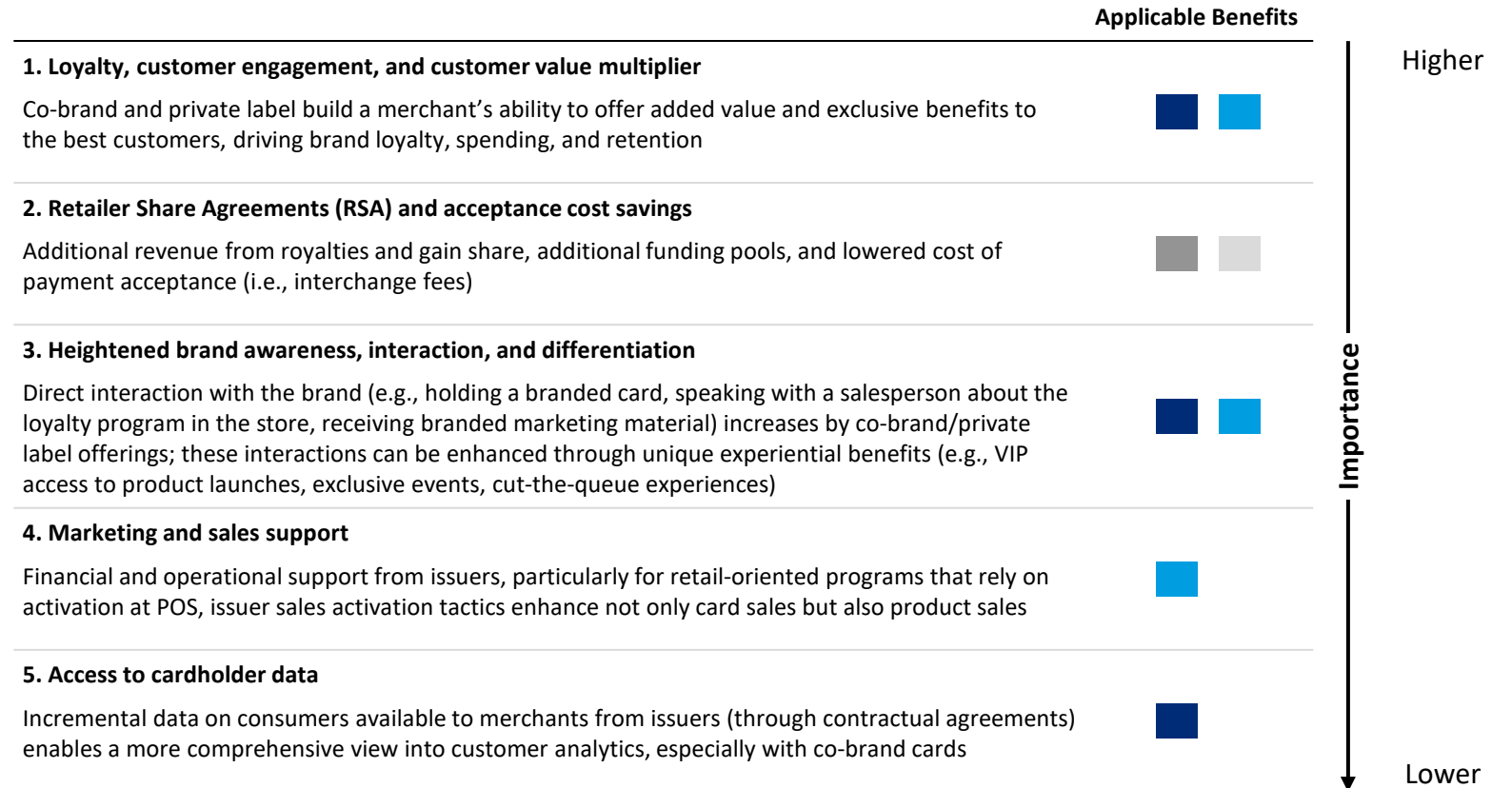
Importance

Lower

Question: For each of the below financial service products that your organization offers, please indicate the primary performance metric you use for measuring its success.
Note: totals may not sum to 100% due to rounding.
Source: OW – MAG Voice of the Merchant Survey 2023, Oliver Wyman analysis

ISSUERS ARE CRITICAL FOR THE SUCCESS OF PROPRIETARY CARDS; MERCHANTS NOW HAVE A GREATER ROLE/SHARE IN BOTH ECONOMICS AND RESPONSIBILITIES FOR THESE CARDS

Typical proprietary card economics

Who usually receives the revenue?	Merchant		Issuer
Interchange		N/A – Merchants typically get interchange relief on proprietary card spend	
Interest income			◆←
Annual fee (if applicable)		◆←	
Account fees (late fees)			◆←

Who usually bears the cost?	Merchant		Issuer
Rewards redemption		◆	
Marketing		◆→	
Capital			◆
Servicing costs			◆→
Other card benefits		◆←	
Innovation funding/test-and-learn shop			◆→

← **Indicates direction of travel** →

Illustrative proprietary card program roles and responsibilities for merchants and issuers

Function	Merchant	Issuer
Acquisition channel	Primary	Secondary
Branding	Primary	Secondary
Loyalty program and rewards currency	Primary	Secondary
Experiential benefits (e.g., free delivery)	Primary	Primary
Funding of loans	No responsibility	Primary
Program operations (e.g., service, collections)	No responsibility	Primary
Loss absorption	Secondary	Primary
Marketing	Primary	Primary
Program governance	Primary	Primary

Primary party responsible   Secondary responsibility or sometimes responsible   No responsibility

SIMILARLY, ISSUERS ARE KEY FOR DELIVERING AUTH RATE IMPROVEMENTS TO MERCHANTS, AS THEY DRIVE MOST AUTH DECLINES OUTSIDE OF FRAUD PRE-SCREENING

Factors that influence auth rates across the transaction chain
(not exhaustive)

Transaction origination   *Transmission*   *Transmission*   *Transmission*   *Transmission*

Merchant underwriting, onboarding, and monitoring	Customer authentication		Merchant	Gateway	Processor	Network	Issuer	
	Customer onboarding	Payment credentials					Policy rules	Fraud rules
• **Underwriting model and policies**—risk level of goods/services, countries operated, etc. • **Risk monitoring models**—based on cash flow, chargebacks, etc.	• **Authentication data and policies**—e.g., fraud scoring only at checkout vs along the journey • **Fraud models**—complexity of data ingestion e.g., IP address, geolocation, behavioral data, etc. • **Dynamic decline response**—notify customers on taking action upon decline (esp. for debit NSFs) • **Card on file updaters**		• **Merchant's POS**—e.g., EMV compliance, contactless • **Data sharing**—e.g., CVV sharing • **Reporting and tracking** • **Fraud models**	• **Form of payment support** • **Transmission protocol** • **Fraud models**	• **Processor model**—local processing, cross-border • **Data passing rules** • **Debit routing** • **Fraud models**	• **Network rules** • **Fraud models**	• **Transaction data requirements transmitted**—e.g., insufficient funds, data mismatches • **Other policies**—e.g., daily limits	• **Decision engines**—outlier auth rate declines driven by pre-auth, data field sharing, FOP type • **Use of bank and merchant data**—e.g., AVS checks

• **Connectivity between parties**—transmission issues (e.g., incorrect communication of data between parties), connectivity with each market in which the merchant operates

• **Data issues**—e.g., data format

• **Systems failures**

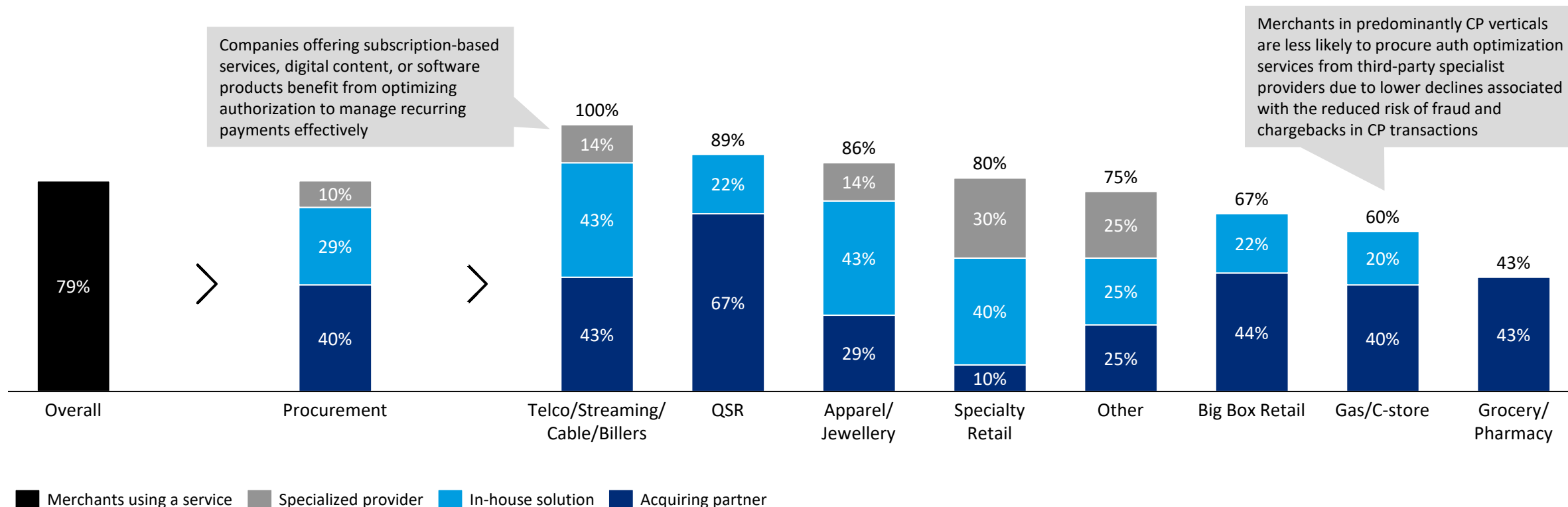• **Regulatory/rules management**—e.g., managing 3DS exemptions in the EU

Source: Oliver Wyman analysis

~80% OF MERCHANTS ARE USING SPECIALIST AUTHORIZATION OPTIMIZATION SOLUTIONS, ESPECIALLY THOSE WITH A GROWING E-COMMERCE PRESENCE AND RECURRING BILLING

Merchants' procurement of authorization optimization services
Percentage mix across verticals based on how auth optimization services are procured

Companies offering subscription-based services, digital content, or software products benefit from optimizing authorization to manage recurring payments effectively

Merchants in predominantly CP verticals are less likely to procure auth optimization services from third-party specialist providers due to lower declines associated with the reduced risk of fraud and chargebacks in CP transactions

Legend:
- Merchants using a service (black)
- Specialized provider (grey)
- In-house solution (light blue)
- Acquiring partner (dark blue)

Category	Total	Specialized provider	In-house solution	Acquiring partner
Overall	79%			
Procurement		10%	29%	40%
Telco/Streaming/Cable/Billers	100%	14%	43%	43%
QSR	89%		22%	67%
Apparel/Jewellery	86%	14%	43%	29%
Specialty Retail	80%	30%	40%	10%
Other	75%	25%	25%	25%
Big Box Retail	67%		22%	44%
Gas/C-store	60%		20%	40%
Grocery/Pharmacy	43%			43%

Question: Please indicate how you receive each of the below services today. If you have multiple providers for a service, select all that apply.
Note: totals may not sum to 100% due to rounding.
Source: OW – MAG Voice of the Merchant Survey 2023

THANK YOU TO THE MERCHANTS WHO PARTICIPATED IN THIS STUDY

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QUALIFICATIONS, ASSUMPTIONS, AND LIMITING CONDITIONS