



In the Face of Disruption:

Evolving the retail payment
partnership

Authors:

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The U.S. retail industry is in the midst of a seismic shift. Storefronts across the country that were once built to provide consumer goods are in oversupply. To protect profitability and manage industry expectations, dozens of major retailers have closed stores and launched restructurings this year, and the rate of these announcements continues to accelerate.

Diminished role of brick and mortar

While the broader U.S. retail market has grown by 3.9 percent so far in 2017, traditional retail sales have risen by only a quarter of a percent during the same period.¹ The shift towards digital channels is expected to continue through the holiday season according to Deloitte's 2017 Holiday Retail Survey.² Physical stores saw customer traffic decrease by 4.5 percent on Black Friday³ while Cyber Monday sales grew 16.8 percent year-over-year.⁴

Sluggish growth for store-based retail has had substantial ramifications on retailers of all sizes. Among the 35 largest publicly-traded U.S. retailers, 37 percent reported declines in global sales during the first half of 2017 compared to the same period in 2016.⁵ Analysts estimate that 8,600 stores will have closed nationwide by the end of the year, a figure that would exceed the number of store closings during the financial crisis.⁶ Among top U.S. retailers, 82 percent offer shoppers store-branded credit cards,⁷ which should serve as an ominous sign for the payment industry.

Increased reliance on store cards

Many retailers have elected to offset declining sales from traditional channels by aggressively expanding their store card businesses. The increased profits from store cards have enabled many retailers to temporarily stay afloat, making large U.S. retailers more reliant on store card profits than ever before.⁸

Retailers' reliance on store cards coincides with a period in which issuers are seeing their highest delinquency rates in years.⁹ This is particularly true for store cards, which typically charge higher interest rates than branded and general purpose credit cards. If consumer defaults continue to increase, issuers should consider imposing stricter underwriting requirements on borrowers, which would curtail future retail card growth.

This leads to an interesting dilemma: how can issuers, payment providers and banks evolve with the continued retail channel disruption and build out growth paths for their retail industry businesses? There are both near and long-term strategies that players should consider.

“Every retailer, retail partner, and card issuer in the value chain should assume that their business model will change. Card issuers with significant exposure to the retail industry should prepare for continued industry evolution by identifying and building growth paths, both near and long-term, that enable the fulfillment of the end-customer experience.”

**Max Bercum, Principal,
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1. Optimize your current business portfolio

In the near term, issuers should identify the right set of retailers with whom to form new relationships, and build partnership portfolios that are positioned to deliver sustained success. “Traditionally, selecting the right retailer was largely about scale,” says Deloitte’s Bercum. “However, as the retail and technology industries converge, issuers should consider forgoing scale in favor of a differentiated customer value proposition and company-owned store models.”

Retailers with company-owned stores, digital or physical, have more autonomy over in-store brand messaging, which allows them to maintain a consistent message across in-store, digital, mobile, and social channels. As a result, company-owned models typically exhibit stronger engagement and higher customer satisfaction than traditional models. In this new retail environment, these players can better maintain customer loyalty, enabling them to thrive.

2. Become invaluable for your partners by driving their success

In the long-term, issuers should develop differentiating capabilities that support the customer experience. As retail continues to shift online, optimizing the in-store experience will become critical to retailers to maintaining store traffic and overall growth.

Financial institutions can support customer experience fulfillment by equipping retail partners with targeted data analytics. Issuers and payment providers that can effectively combine and enrich customer data with their own transactional data will enable retailers to better tailor their offerings to consumers in real-time. Together with state of the art in-store technology that enhances the shopping experience

(e.g., mirrors with augmented reality, artificial intelligence that creates an individual store experience for every consumer), issuers will be able to help drive success for their partners.

Succeeding in this new environment will require continued investment and agile technological development. Acquiring or partnering with technology players will be critical to working toward sustained success in the long term.

Lastly, with lower volumes of customers shopping at physical stores,¹⁰ payment companies should rethink their engagement model for originating and servicing store cards. As consumers become more accustomed to an efficient experience, the shift to mobile payment applications will likely accelerate. “Issuers should identify gaps in their capabilities and operating model and look for opportunities to acquire and partner with fintech companies rather than rely on building these capabilities in house,” says Bercum.

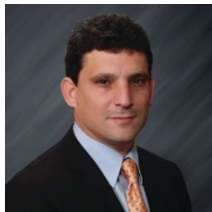
Opportunities in an evolving industry

We are in the midst of a significant restructuring of the retail industry, which means traditional operating and business models are being disrupted. This disruption extends to all stakeholders within the value chain.

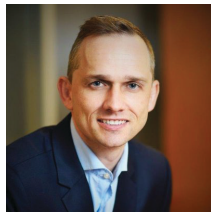
These industry challenges should be met with bold and decisive actions. Retail card issuers should rapidly recalibrate their \$125 billion retail portfolio¹¹ to successfully position themselves to take advantage of the projected credit revenue growth of 2.7 percent annually over the next five years.¹² Additionally, building increased customer experience capabilities can drive increased customer engagement, loyalty, and volume to help retail partners, and especially issuers, thrive in the new environment.



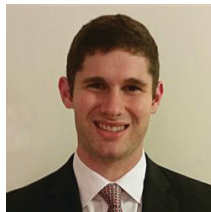
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1. Source: U.S. Census Bureau, July 2017 Monthly Retail Trade Report, <https://www.census.gov/retail/index.html>
Note: Traditional retail sales refers to stores classified in the following NAICS codes: 442, 443, 448, 451, 452, and 4532.
2. Source: Deloitte 2017 Holiday Retail Survey, <https://www2.deloitte.com/us/en/pages/consumer-business/articles/holiday-retail-sales-consumer-survey.html>
3. Source: RetailNext via USA Today, Retailers rejoice – and Cyber Monday sales record,
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4. Source: Adobe, <http://news.adobe.com/press-release/experience-cloud/adobe-data-shows-cyber-monday-largest-online-sales-day-history-659>
5. Source: Deloitte analysis
Note: Top U.S. retailers based on STORES Magazine's July 2016 list of top 100 retailers, excluding supermarkets, restaurants, convenience stores, drug stores / pharmacies, auto parts stores, and cable and internet providers; <https://nrf.com/resources/annual-retailer-lists/top-100-retailers/stores-top-retailers-2016>
6. Credit Suisse via Fortune, Major Wall Street Firm Expects 25% of U.S. Malls to Close by 2022, <http://fortune.com/2017/05/31/malls-retail-stores-closing/>
7. Source: Deloitte analysis
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9. Source: The Wall Street Journal, A Surprise Bump in Bad Card Loans,
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10. Source: The Wall Street Journal, In-Store Declines Drag Down Traditional Retailers,
<https://www.wsj.com/articles/in-store-declines-drag-down-traditional-retailers-1483731326>
11. Note: Based on 2017 Investor Reports from Synchrony Financial, Citi Retail Services, and Alliance Data Systems
12. Source: IBISWorld, Credit Card Issuing in the US: Market Research Report, August 2017

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