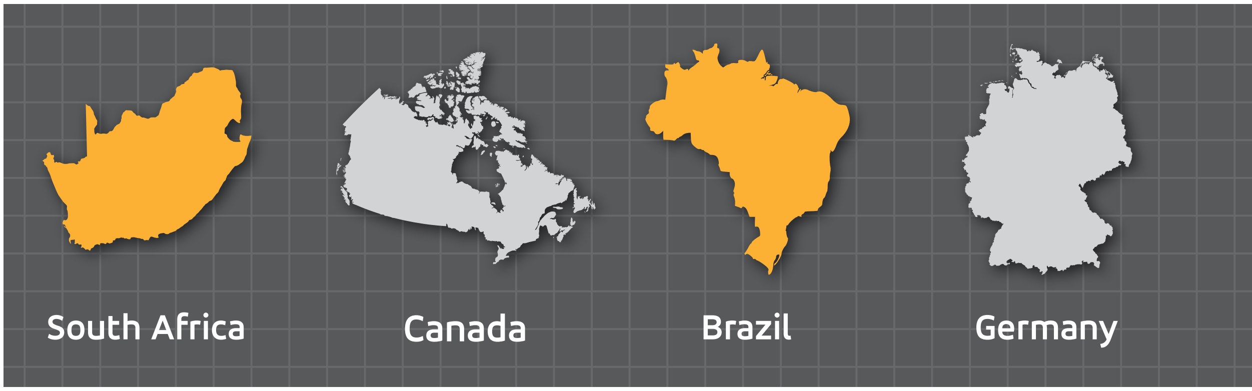
SMALL TO MID-SIZED MERCHANTS SEEK COMPETITIVE TECHNOLOGY IN OMNI-CHANNEL WORLD

A Technology and Business Audit of Small to Mid-Sized Merchants in Four Markets:



Executive Summary

- To better understand the attitudes of small and mid-sized merchants toward new technology solutions and how they incorporate it into their businesses, Global Insights completed the Merchant Scope project with qualitative and quantitative research across four countries: Brazil, Canada, Germany and South Africa.
- The research uncovered a dramatic difference between smaller and larger merchants in their abilities to have an online presence and an online business. It also showed regional differences in technology inclusion, as well as an inhibiting factor based on employee size.
- The survey identified the two biggest barriers to adopting new technology: cost (46 percent) and a lack of know-how (31 percent). While other barriers such as data security and privacy worries are also concerns (27 percent), the issues of cost and lack of understanding loom largest.
- The gap between smaller-scale merchants and the domination of mega-retailers presents challenges for technology providers, banks and governments who work with smaller merchants. But in identifying common goals and cooperation, these partners can develop solutions for smaller merchants to help them close that gap.

Introduction

The rise of the mega-retailer has changed everything about the competitive environment for merchants of all sizes. Large, vertically integrated merchants have revolutionized supply-chain and inventory management, taking technology in those areas to a level that enables them to cut pricing and improve the customer experience. They have exploded across continents, with technology channels creating the "omni-channel" reality of global shopping. According to information published by the National Retail Federation, the top 250 retailers control $4.3 trillion in revenue; 63 percent of them are global.[i] They have exploited their scale and technology resources to present customers with a unitary, integrated shopping experience that inexorably is moving to an individually customized marketing model. That model has not only shifted competition among merchants, it has also effectively up-ended the traditional merchant/consumer relationship, empowering the consumer to the point where customer experience and online agility have been increasingly important as a growth driver among top global online merchants.

The picture for the mega-retailer is clear. But for small and medium-sized merchants, it's not. The ability of large, often global merchants to dominate retailing creates an arena where small to medium-sized merchants may feel they cannot compete. The ability of large merchants to leverage technology both on the macro level outlined above, as well as in-store, presents a daunting competitive environment for small and mid-sized merchants. Part of that technology will inhibit small and mid-sized merchants' ability to upgrade payment technology that can improve customer experience.

Examples abound. Consider U.S. local pizza restaurants that find it hard to compete with national chains, not because of the quality of the food they offer, but because of the ability of the national chains to employ mobile applications that allow for online ordering. These apps, together with additional technology implemented in the restaurants, allow customers to follow the preparation, completion and delivery of their food.[ii] And this phenomenon highlights an issue that merchants around the world, not just in the U.S., are dealing with. This is spreading to other classes of the food services trade and other types of merchants, emerging as a potential competitive advantage for more savvy merchants who can exploit the technology.[iii]

To better understand this fundamentally new dynamic, MasterCard conducted a global study, employing both qualitative and quantitative research, to discover how small and mid-sized merchants view their competitive environment. Global Insights went beyond the global expansion and viewed their entire technology footprint: point of sale (POS), payments, marketing, accounting (payables and receivables), delivery and inventory. Our research shows that the gap in resources between the mega-retailers and smaller-scale merchants has led to a lack of commitment to develop the technology that can enable growth, restore competition and optimize the customer experience.

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Key Findings: The World Is Not Flat

Global Insights surveyed four markets: Canada, Brazil, South Africa and Germany. Key themes from this research revolve around the competitive dynamic outlined above. The pain points for small and mid-sized merchants come from lacking the scale, financial resources and skill set to exploit technology, especially as it impacts customers and prospects.

The most significant data points and findings that illustrate this divide:

1. The 90-20 Equation

Global Insights' research found that nearly 90 percent of merchants have an online presence, but only 20 percent have an eCommerce website. They lack the technology to accept payments online. Small merchants need help in understanding and meeting the evolving expectations of more informed and digitally connected consumers. These expectations center on convenience, an innovative shopping experience and personalized customer support. In the new retail environment, the consumer shopping experience starts long before entering a store, and includes the ability for the merchant to be present in different devices and channels.

2. POS Data Is Underutilized

Merchants find point-of-sale (POS) devices in large measure work as a transaction terminal. Half of the respondents globally indicated satisfaction with the payments acceptance experience. Nevertheless, Global Insights' research indicates that the data passing through POS systems are underutilized. They are leveraged for the authorization of transactions, but not as a potential window into customer behavior providing insights. Today's consumers are increasingly driven to shop by intelligent offers – perceived value over price and targeted messaging. Consumers don't just want to receive discounts; they want to be offered discounts on the products they care about. Developing ways to use consumer purchase behavior data, in line with prevailing data laws, to offer them the things they really need can only happen when the data flowing through the POS is utilized.

Key Findings: The World Is Not Flat

3. Adoption Rates Differ by Trade

Small across all verticals industries confirmed the importance of technology in helping them manage their business. However, adoption varies greatly, with Hospitality and Restaurants investing a larger portion of their revenue on consumer-facing and back-office technologies — on average 8.1 percent and 11.8 percent, respectively. Hospitality businesses are the most likely to have an eCommerce website to attract travelers, at 33 percent. Hospitality businesses are also more likely to utilize digital marketing — 61 percent of Hospitality businesses use email marketing, compared to an average of 50 percent for all merchants, and only 44 percent of Service merchants. Fifty-eight percent of Restaurants and 53 percent of Hospitality merchants use software to manage their accounts receivable, compared to a 49 percent average for all merchants. Fifty-one percent of Restaurants are using software for inventory management, compared to a 47 percent average across merchants and only 36 percent of Hospitality merchants.

4. Technology Perception Differs by Geography

Geography is an important determinant in how retailers globally leverage technology. However, the qualitative phase of the research showed that it is not the matter of developed versus developing markets, but rather individual and unique market forces that drive differences in perception of the importance of technology. For example, 92 percent of Brazilian merchants consider technology vital to running their businesses, compared to less than half of German merchants (46 percent) agreeing with the sentiment.

Methodology

To know what merchants think about technology and how they incorporate it into their business, Global Insights first needed to define what is meant by small businesses as a group, and what categories exist within them.

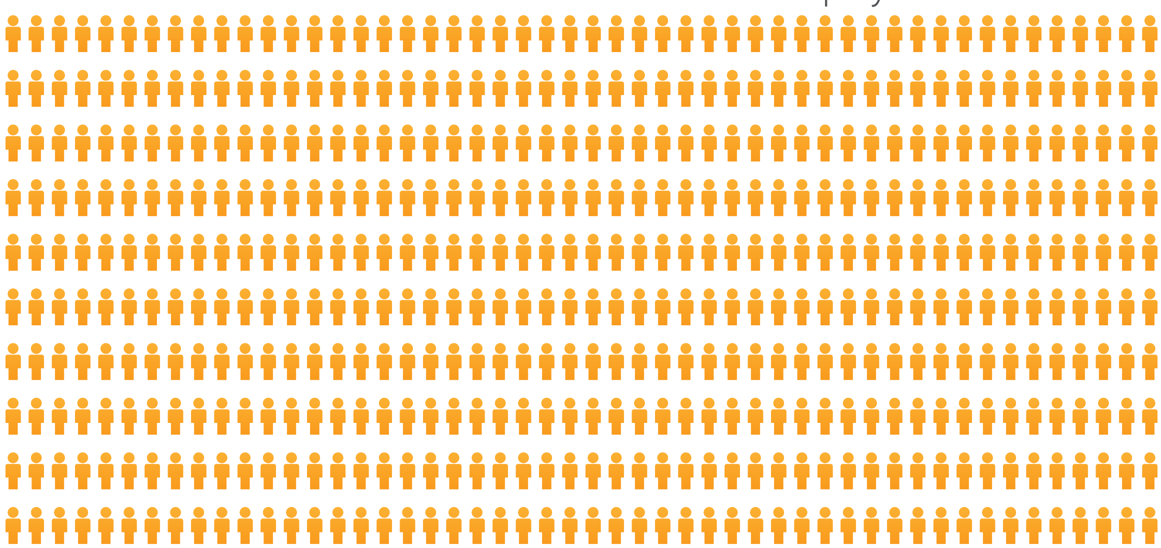
Size Matters: Employee Base Impacts Technology

Merchants of different sizes face different challenges in adopting new technology, but in a global study using revenue to categorize business size is difficult because the relative sizes of individual economies can mischaracterize the results. Instead, MasterCard divided small merchants according to three sizes:

Micro businesses: Businesses with **one to nine** employees

Small businesses: Businesses with **10 to 49** employees

Medium businesses: Businesses with **50 to 500** employees



This sizing allowed Global Insights to explore how merchants deal with barriers as a result of their employee base. Micro and small businesses are less able to spend money and time on technology than medium-sized businesses, putting smaller enterprises at a competitive disadvantage. When micro or small merchants are evaluating a piece of technology, they also have to consider if they can afford to have one of their few employees dedicated to the task to setting up the technology. This is a considerable disadvantage for micro and small merchants, and inhibits their ability to adopt potentially useful technology. Medium businesses are able to use their comparative resource advantage to use more variety of software and automation to run their businesses. This difference is found in marketing/promotion software being used more by medium-sized business. Micro and small businesses are also lagging in using software to manage their accounts receivable, payables and inventory management. Medium businesses have more integration between back-office and front-office technologies. Understanding how business size impacts small merchants is key to proving the best answers to merchants' needs.

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The Shops: Four Merchant Categories

Global Insights began the Merchant Scope project with innovative qualitative research. In Brazil and Germany, Insights conducted research with business owners and technology decision makers of micro, small and medium businesses.

For this study, MasterCard defined the relevant merchants as one of four basic types:

RETAIL

Examples of these merchants include clothing stores, sporting goods, housewares and grocery stores.

PERSONAL SERVICES

These include pharmacies, dry cleaning, auto repair shops and barber shops or salons.

RESTAURANTS

These include a wide range of food service establishments and cafes.

HOSPITALITY

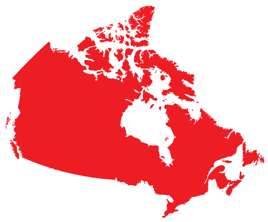
Examples include hotel and lodging businesses, including travel agencies.

Global Insights prioritized ways they thought about technology, not just in how they used it for their business operations, but also for how they thought about it impacting their customers' shopping experience.

In addition to providing the foundational knowledge of small merchants, the findings from the qualitative research formed the basis for the quantitative research. The research included surveying 270 merchants per market — 90 each of micro, small and medium businesses. The questions, refined from the qualitative research, focus on a few key areas — how merchants feel about technology, what technologies they are currently using, and what the barriers are precluding these merchants from using new technologies. By thoroughly investigating the state of technology use among a robust sample of small merchants, Global Insights assembled the proper recommendations to help small merchants and their partners improve their businesses.

Global Relevance: The Group of Four

The Merchant Scope research is globally relevant, while accounting for particulars of each market. The choice of Canada, Brazil, Germany and South Africa was aimed at calling out the characteristics than can be used to understand unique challenges faced by merchants around the world.

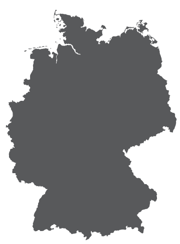


Canada

Mirrors many of the merchant dynamics found in markets such as the U.S. or UK, but with U.S. merchants getting ready to widely accept EMV cards, Canada provides almost a future state for the U.S. — a large and sophisticated economy with high card use by consumers. Canadian merchants in the survey report 59 percent of their customers are using cards. Merchant landscape is equipped to handle EMV (chip-enabled card) payments, where surveyed merchants report 33 percent of their customers use EMV enabled cards.

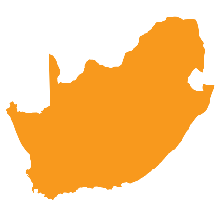
Brazil

A large and regionally important South American economy with a consumer payment landscape in flux. Small merchant dynamics here are similar to other emerging markets with large economically dominant urban centers and a technologically connected population. Fully 91 percent of surveyed Brazilian merchants view technology as important for their business, and 65 percent of Brazilian merchants view themselves as tech-savvy — they enjoy learning about and using technology.



Germany

High level of technological access for both consumers and merchants alike. German merchants surveyed reported that 40 percent of their customer payments come in cash, higher than the four-country average of 30.5 percent. This high use of cash makes Germany an interesting market to study how advancing consumer use of personal technology changes payments technology behaviors. Fully 58 percent of surveyed German merchants view their customers as tech-savvy — even higher than the 54 percent at which merchants rate themselves. This gap may drive German merchants to expand services in the future.



South Africa

High mobile penetration. Nevertheless, cash usage among consumers remains high, with surveyed merchants reporting 34 percent of customer payments made in cash, higher than the four-country average of 30.5 percent. Fewer South African businesses have online presences, and 27 percent of businesses there have no online presence at all. Likely a function of the online activity in their market being driven by mobile Internet usage, this relatively high percentage of offline merchants can become a competitive disadvantage in the future. Technology is used mostly to improve back-office operations, and less so for customer marketing and relationship building.

Customer Strategy Defines Technology Challenges

Regardless of the merchant's size and geography, the most cited challenges (on average 41 percent of merchant respondents) revolve around identifying and targeting new customers. More than 32 percent cited internet marketing and promotion, and 28 percent cited offering loyalty benefits to customers. Today, as more and more data is generated about customers' shopping behaviors and preferences, there's opportunity to use that data to tailor customer experiences, working with existing laws on data usage. Smaller merchants are starting to see the challenge and look for competitive solutions.

The marketing challenges stem from general lack of know-how and cost/availability concerns in some markets. For example, lack of know-how for merchants in Brazil ranked lower as a barrier compared to other countries; instead, Brazilian merchants regard the cost factor as the highest obstacle. Developing solutions that fit each unique market is imperative to the success of small businesses.

Other major differences break along geographic lines and device lines. The latest innovations in devices (tablets and mobile phones) also have inventory and operations applications. Among the markets surveyed, businesses in Canada are most likely to use software for automation in both the back office and customer-facing activities, in contrast to Brazilian and South African merchants, who tend to use software primarily for back-office operations. In Germany, software usage is centered around electronic payments acceptance, but not in other parts of the business. On average, 56 percent of Canadian and Brazilian merchants use smartphones to assist in running their businesses; meanwhile, only about 31.5 percent of German and South African merchants pick smartphones to aid their stores' operations.

Despite these regional differences, small merchants (with the exception of Germany), indicate that they would invest in a technology if it seems beneficial to their business (77 percent average across all countries). Primarily, merchants look for solutions that will aid them in attracting new customers and promoting loyalty among existing clientele.

Marketing, according to the research, is still traditional: newspaper clippings, direct mail and radio. These methods have virtually no individual targeting. In Brazil, merchants are experimenting with heavy use of social networking to reach dedicated customers, while Canadian businesses are leveraging both new and traditional methods of reaching consumers. In Germany and South Africa, merchants rely almost solely on print media to attract attention. Evidence suggests that merchants using these marketing methods are far from being satisfied with their performance.

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Measuring The Innovation and Integration Gap

As the 90-20 equation showed, there is a huge gap between being online (90 percent) and being able to execute payments online. The missing piece of technology lies at the foundation of merchant psychology. What are small businesses thinking when they confront technology barriers and decide how to implement online payment? In talking to business owners and decision makers, MasterCard learned that some of the barriers to adopting technology have roots in local attitudes. For example, when asked about implementing mobile payments, German business owners noted they were concerned about how their customers would feel about their privacy. In Brazil, the idea was seen as tempting, but concerns about the reliability of the infrastructure meant Brazilian merchants were unlikely to invest in the near future.

The qualitative research showed that although all businesses are using some type of technology in the back office, medium-sized businesses are using more sophisticated technologies and are more fully integrating that technology than micro and small businesses. Merchants report that wider internet use is streamlining many processes such as purchasing, inventory management and bill pay. But this can lead to a "one-size-fits-all" nature of many business software offerings. The lack of customized solutions means that business owners must enter data manually and transfer it across applications — losing the efficiency that comes from automating business processes. The lack of integrated technology means that small businesses are at a disadvantage when compared to larger merchants; fixing this integration gap is critical to small businesses' future business health.

By and large, accepting electronic payments at the point of sale is working. Small merchants need help using technology for marketing to prospects and customers, as well as rewarding customers. In Insights' research, accepting electronic payments was cited as one of the most challenging activities by an average of only 23 percent of all merchants, making it the second least challenging out of 13 business activities small merchants could choose from. Even when comparing businesses by size and by region, accepting electronic payments ranks low on the list of challenges — the most challenged country in accepting electronic payments is Brazil at 32 percent, and across business sizes the highest was among micro businesses, with only 25 percent citing it as challenging.

So what is preventing merchants from using the technology to solve these challenges? When surveyed about the barriers to adopting new technology, the two most identifiable barriers were cost of technology (46 percent) and a lack of know-how (31 percent). While other barriers such as data security and privacy worries are concerns (27 percent), the issues of cost and lack of understanding loom largest. When technology that can help the business is priced out of reach, planning and integrating correctly for maximum benefits become more difficult. When implementing technology requires expertise and special skills small merchants don't have, it becomes too daunting to consider and too difficult to use. It's critical for everyone involved in expansion and promotion of small businesses globally to understand these barriers. The technology to help small merchants solve key challenges such as identifying new customers and offering loyalty benefits to their existing customers already exists. The barriers of cost and a lack of expertise are holding back small merchants from unlocking their true business potential, and the findings of Insights' research have applications for different constituents of the payments value chain — and beyond.

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Implications: What Does it Mean?

I. Small Merchants

a. **Prioritize Resources for Marketing.** When examining what can be spent on digital marketing, asking key questions can help determine if an investment is worth it: Is this the key to stepping a merchant's business up to the next level? Is the merchant able to use sales data to effectively build marketing propositions? Is the merchant losing out on sales because you can't identify and target your customers? What can merchants invest in now to make this pay off and run their business better?

b. **Integration.** Consider technology in the context of how it works together. The sales data that come through a well-developed eCommerce and inventory system, working with data usage laws, can become the fuel for developing strategies regarding what products to promote and how to offer customers the goods and services they want most.

II. Financial and Technology Providers

a. **Financial Services Institutions.** Small merchants rely on banks and other service providers for their information security needs as well as to look out for their money. They are key constituents of the global economy — according to the World Bank's International Finance Corporation, small and medium enterprises account for 90 percent of businesses and 50 percent of employment worldwide.[iv] They use banks' position to help merchants roll together the solutions they need in a way that runs their business better, and thereby make them better customers. For example, Quicken and Intuit package themselves and use that approach to make it easy for small merchants to understand what's needed for them to upgrade their technology. Similar approaches make banks stand out from competition and position them as real partners in business growth.

b. **Technology Providers.** Small merchants rely on technology providers to make technology work and make their lives easier. Small merchants are focused on running and growing their businesses, and they're not professional experts in technology. This means that it's crucial for providers to position offerings as simple means for merchants to improve their business. "Lite" versions of technology to introduce product concept and functionality to merchants who find technology daunting can extend reach and utility.

III. Governments

For governments at every level, from the national to the regional and municipal, one of the most powerful ways to help small merchants is by promoting eCommerce. Investing public resources into technology infrastructure, like the plan in New York City to transform old payphones into wi-fi hotspots,[v] is a way to integrate small merchants into a larger push to foster technology as a social and economic benefit. By fostering a supportive technology climate for small merchants, governments will make it easier for these merchants to see the value of investing resources in building eCommerce websites.

Conclusions

The gap in technology resources between global retailers and smaller-scale merchants is glaring, and can be closed with the coordination and participation of banks, governments and merchants. The downside is further exclusion of smaller retailers and their customers from the advantages of a cashless economy. The upside is huge. Improving the technology use and business operations of small merchants globally allows the businesses who supply technology to better match the needs of their small merchant customers. It helps governments support employment and entrepreneurship locally, provides consumers with a wider variety of options when making purchasing decisions, and enables merchants to be more successful and better engines of economic growth. By understanding the current state of the small merchant technology landscape, all these players can come together to pursue their own goals, simultaneously building the infrastructure to benefit the global marketplace for decades to come.

Learn more at merchantscope.mastercard.com

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