

Discover finds partners in evolving mobile payments

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In a memorable episode of "Seinfeld," George suffers from back problems because of a ridiculously overstuffed wallet. His wallet later explodes. The episode mocked one of the inconveniences of the modern world, the explosion of cards. Credit cards, debit cards, gift cards, insurance cards, loyalty cards. Where to store them all?

New wallets are coming into marketplace that don't explode because, well, they are not physical pieces of leather. Welcome to the [digital wallet](#). It stores credit and checking accounts on a mobile phone or in the cloud, an Internet-based data storage center, enabling consumers to make payments via computer, tablet or mobile phone.

The digital wallet promises to transform the way consumers shop both online and offline, setting off a massive race among [financial institutions](#), retailers and technology companies to develop the best applications.

Discover Financial Services, the Riverwoods, Ill.-based credit card issuer, has gotten off to a fast start, but it so far has taken a different path than some of its credit card rivals. Instead of launching its own digital wallet, Discover has joined two of [Silicon Valley](#)'s largest and best-known companies to achieve scale and brand recognition in the emerging technology.

In the past few weeks, Discover has announced separate partnerships with [Google](#) and PayPal. Discover cardholders now can use the Google Wallet for payments. PayPal, the online-payment unit of [eBay Inc.](#), plans

to use Discover's extensive merchant network to make a big push into bricks-and-mortar stores.

The deals underscore Discover's distinctive place in the credit card world. Discover has about 50 million [cards](#) in circulation, one-sixth as many as Visa. But Discover's payment network reaches more than 7 million merchants, penetrating about 95 percent of the U.S. market.

"The size of its merchant footprint exceeds the size of its consumer footprint," said James Friedman, an analyst at Susquehanna Financial Group. "The challenge for Discover is to better utilize its network."

That's why financial analysts like the PayPal alliance. Think of Discover's payment network like a toll road. The more cars on the tollway, the more Discover collects. PayPal has more than 50 million active U.S. customers - similar in number to Discover cardholders.

PayPal has become so large in e-commerce that it has become a viable competitor with the payment networks run by Discover, Visa Inc., American Express Co. and MasterCard Inc. Customers fund their PayPal accounts with debit cards, credit cards or checking accounts.

Discover, though, has less to lose partnering with PayPal because it issues its own credit cards and has smaller market share among consumers than its credit card rivals, said Sanjay Sakhrani, an analyst at Keefe, Bruyette & Woods Inc.

"If Discover can secure a critical-mass amount of volume from PayPal, it can turn that into a revenue stream," Sakhrani said. "It's a fairly decent bet."

The PayPal deal doesn't preclude Discover from developing its own digital wallet. Visa, AmEx and MasterCard are testing digital platforms,

but Discover is more cautious as the mobile ecosystem evolves.

"As we think about our payment network, we are still looking to use a partnership approach," said Joe Hurley, Discover's head of global business development. "We are leveraging this huge infrastructure we have in place to gain further scale for our partners."

PayPal is one of many companies trying to offer payments via smartphones, eliminating the need to carry cash or credit cards. Mobile payments are still in their infancy, but surveys show growing consumer interest. Forrester Research Inc. estimates that 30 percent of American mobile phone owners would consider mobile payments at the checkout counter, based on a poll of about 7,600 adults.

But PayPal's development of a mobile-payment system was missing a key ingredient. While it has built a huge online network, consumers could not widely use PayPal's digital wallet in bricks-and-mortar stores.

"To be a leader, we have to be everywhere the consumer wants to be," said Don Kingsborough, PayPal's vice president of retail.

Starting in the second quarter of 2013, PayPal users will be able to access their accounts at Discover merchants. That kind of scale would have taken PayPal years to achieve on its own, said Denee Carrington, a Forrester analyst.

Discover has direct relationships with 1,500 large merchants and also works with entities known as "merchant acquirers" that have contracts with smaller retailers. Not all 7 million locations will be available at launch, but both sides expect a quick rollout.

"Merchants will not have to do any work to accept PayPal," said Joby Orłowsky, Discover's vice president of strategic initiatives. "It will be a

seamless integration."

But PayPal customers won't be able to simply wave their phone at the retailer's payment terminal. The technology isn't there yet.

PayPal customers will have to enter a cellphone number and personal identification number on the terminal.

Because many merchants don't have PIN-enabled payment terminals, PayPal will provide customers with another option to pay. The company will give its customers a plastic card that works much like a credit or debit card to swipe at the terminal.

A PayPal card would be at odds with the whole idea of a digital wallet, analysts said.

"Why would a consumer bother using a PayPal card when all other cards in their wallet have been working just fine?" Carrington said. "Without a compelling reason to switch, consumers will default to existing, preferred payment products."

Kingsborough, though, said the PayPal card could replace all of the credit and debit cards in consumers' wallets. And over time as the technology for accepting mobile payments improve, the card could be phased out.

PayPal also will be marketing the flexibility of its digital wallet to store gift cards and coupons.

"It's all about everything being in the cloud and following you," Kingsborough said. "You'll also have the security of not having your personal data transmitted at the point of sale. It's a more secure way to pay."

And the end of exploding wallets.

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