



Innovative Business Strategies Chicago Federal Reserve Board

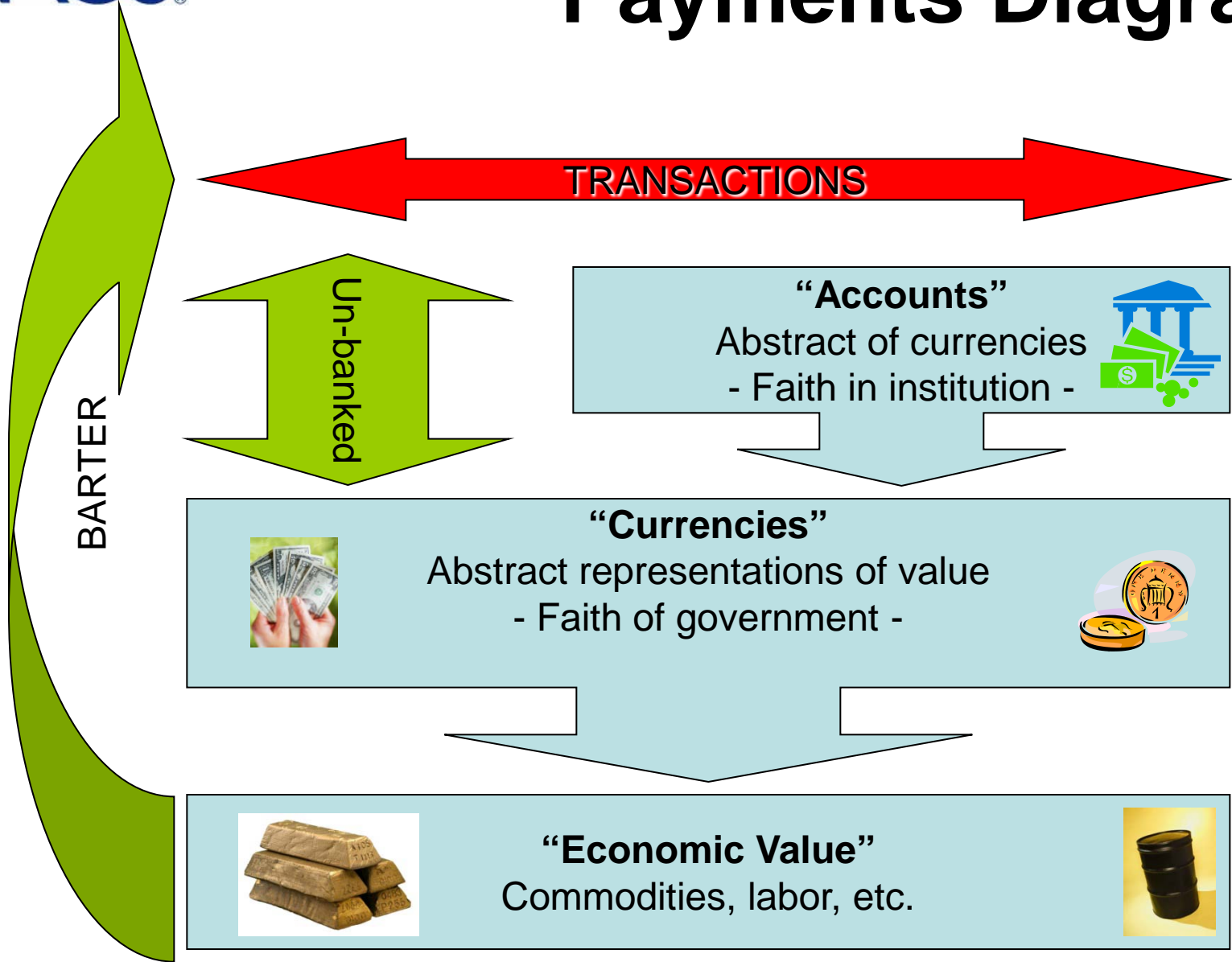


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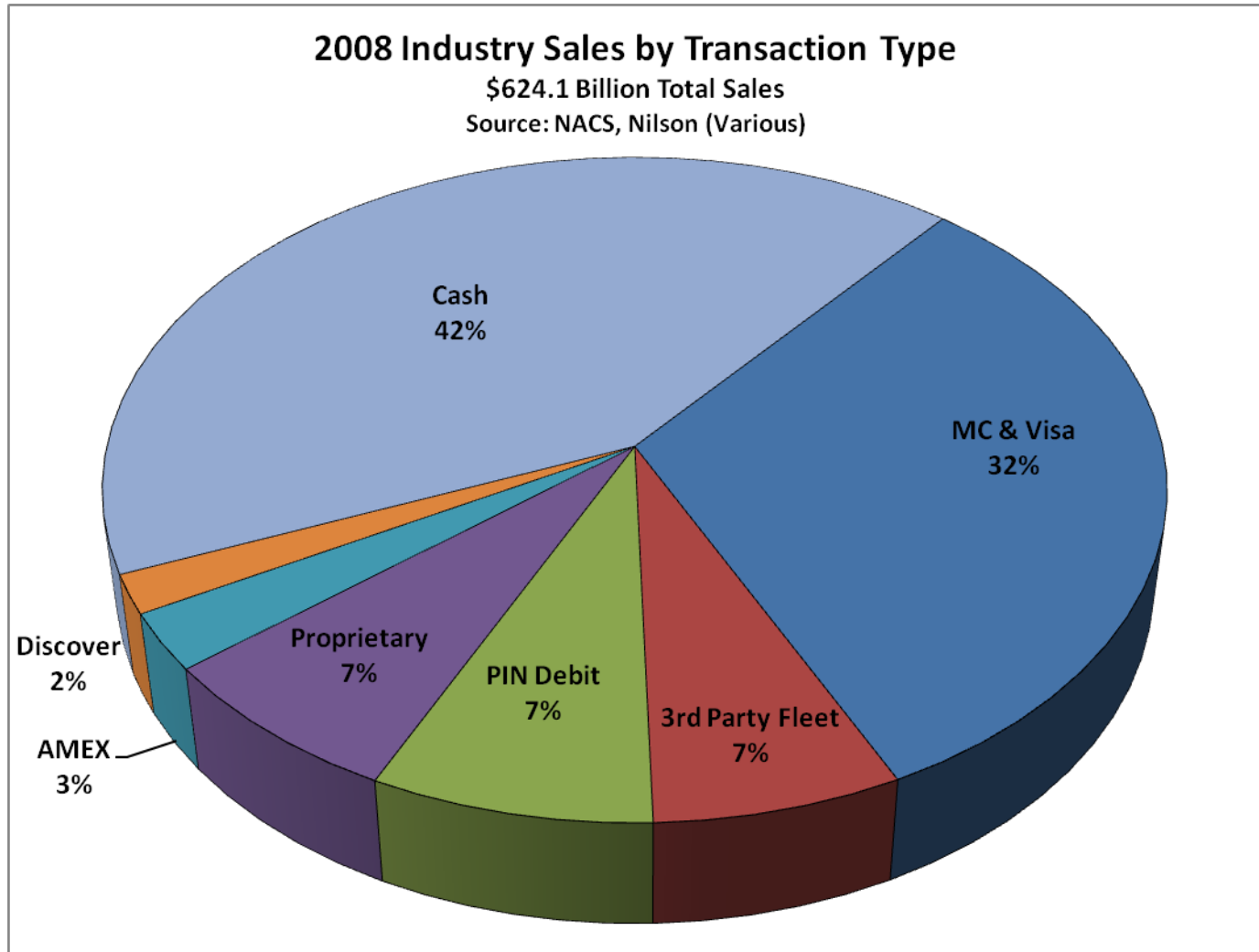
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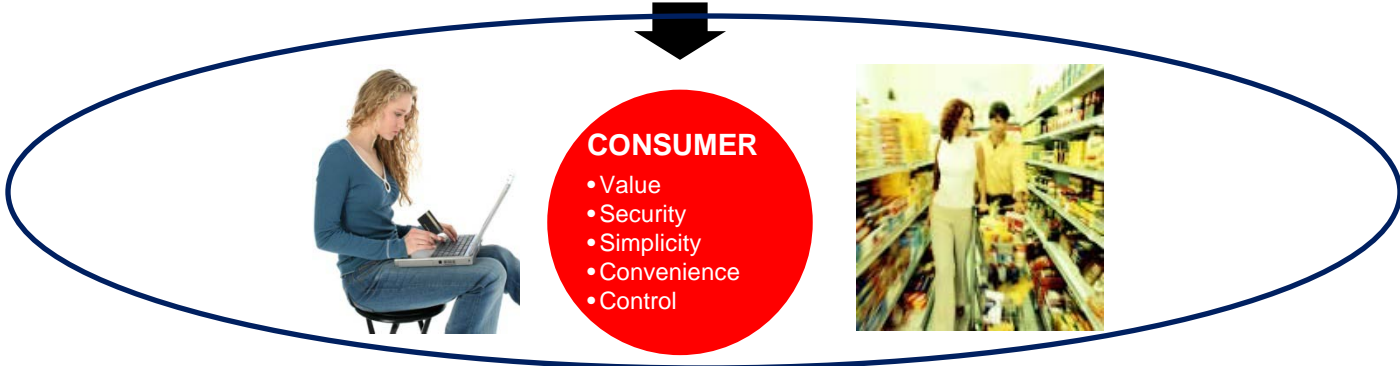
Payments Diagram



Current State of Abstraction: Convenience/Petroleum

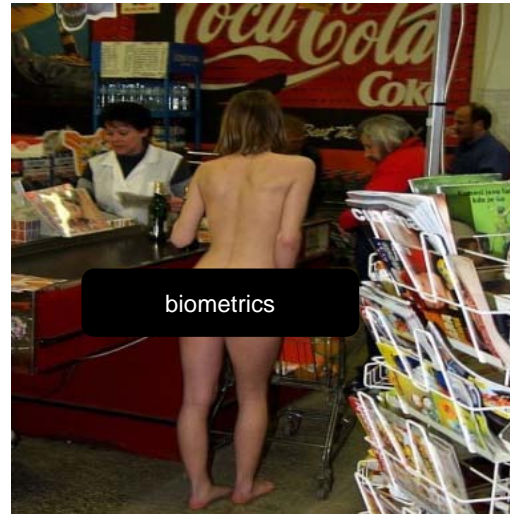


Innovation KFS



The Focus - Consumers

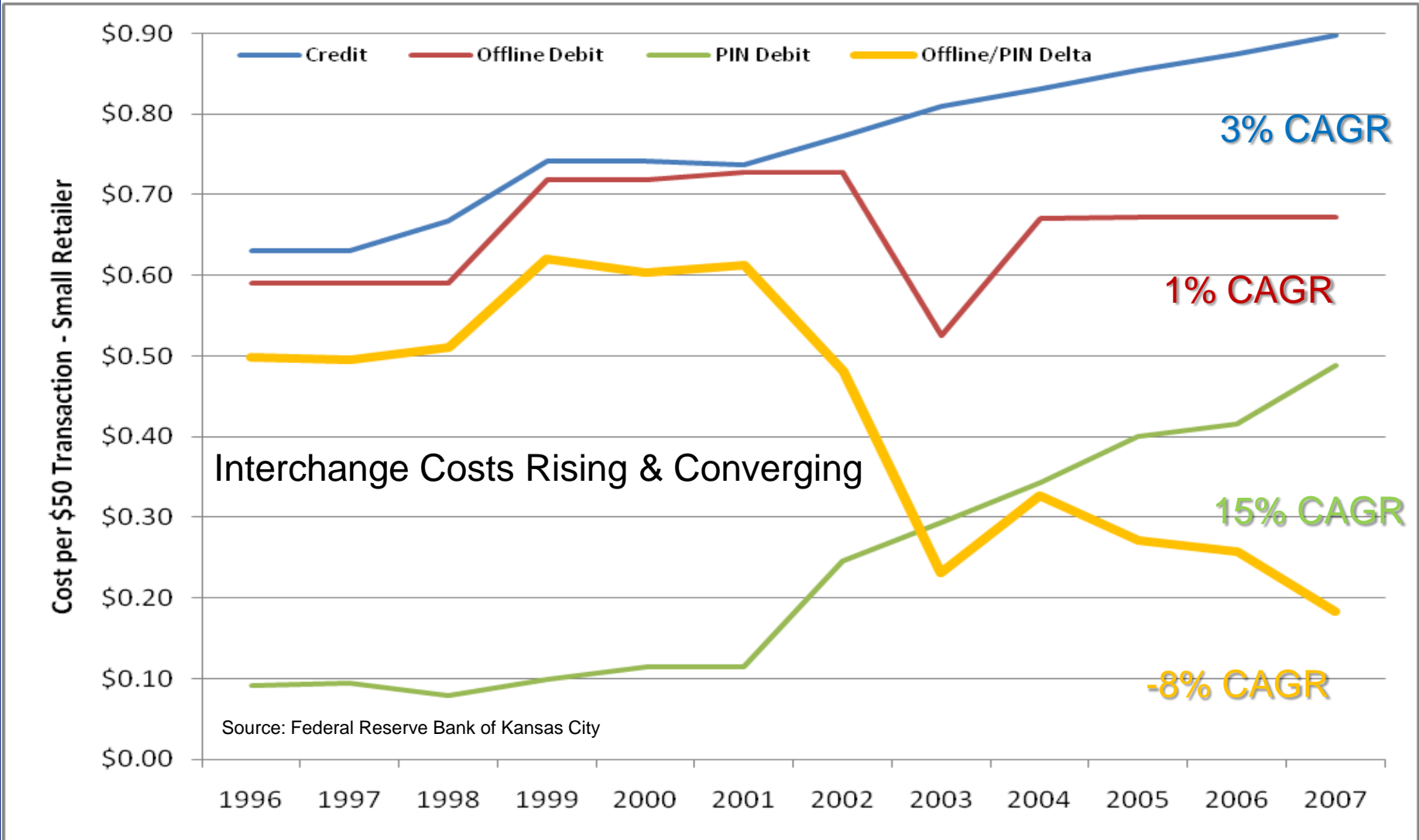
- Value
 - Costs
 - “Rewards”
 - Terms
- Simplicity
 - Ease of use
- Convenience
 - Ubiquity
- Security
 - Identity entire lifecycle
- Control
 - Payment type by purchase



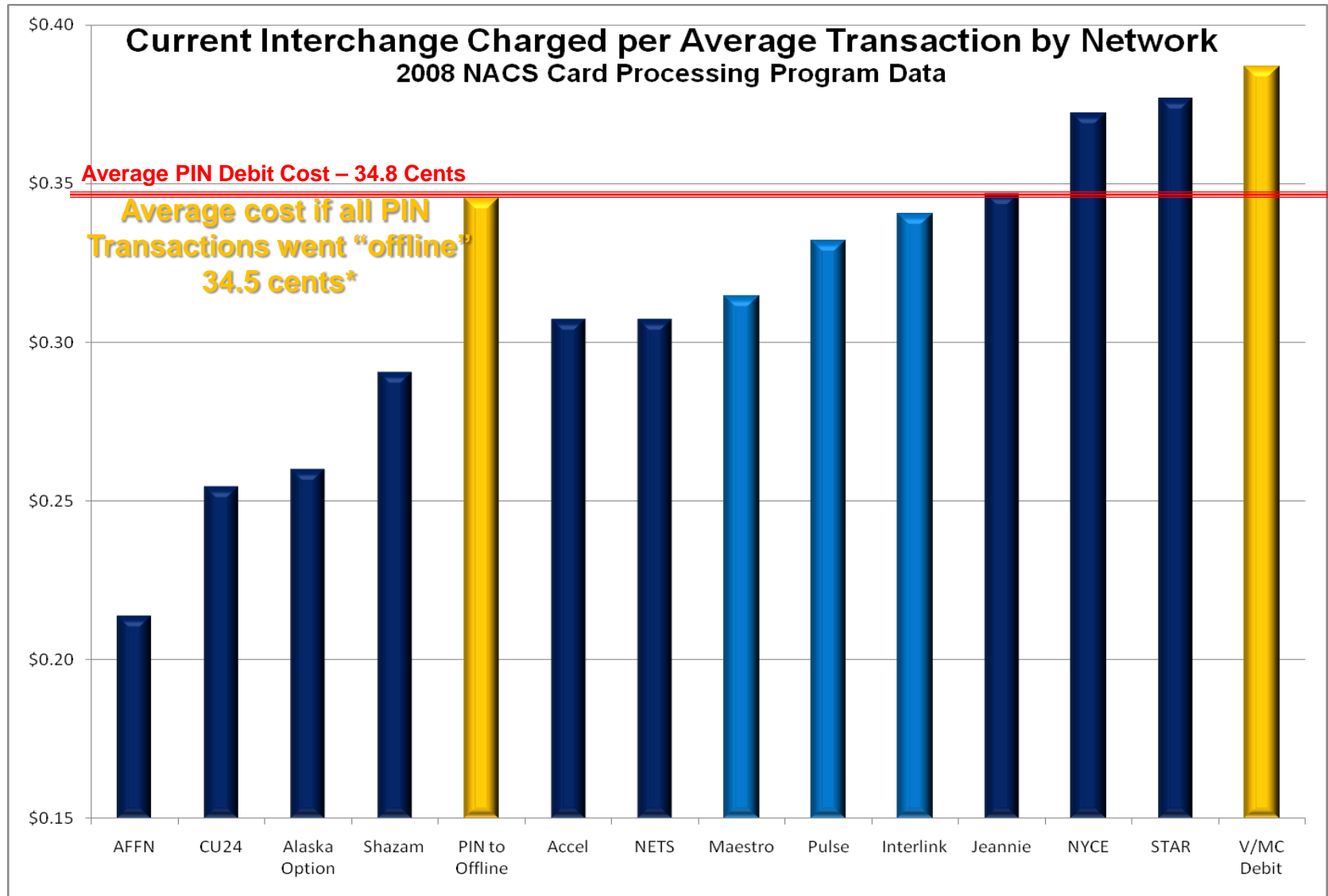
Barriers to Innovation - Consumer

- Value Distortion
 - Current absence of price discrimination
 - Transaction cost comparison is to “zero”
 - Rewards are tangible, transaction costs are not
- Security
 - Consumers are largely insulated from fraud
 - Higher security means lower convenience
- Control
 - No infrastructure ready for multi-homing
- Habits
- Current state of “incrementalism”

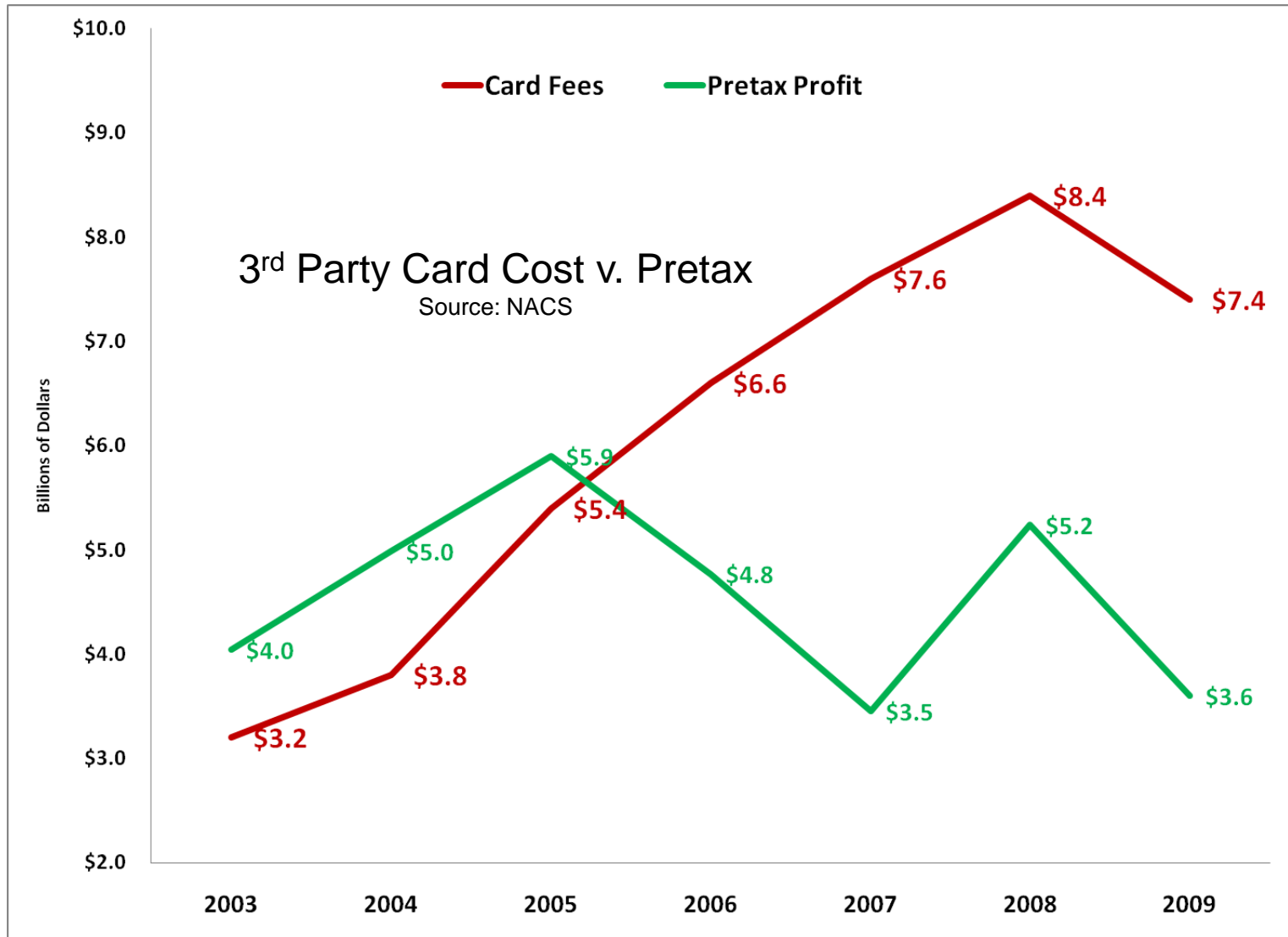
Catalyst – Retail Costs Increasing



PIN Debit & Signature Converged in '08

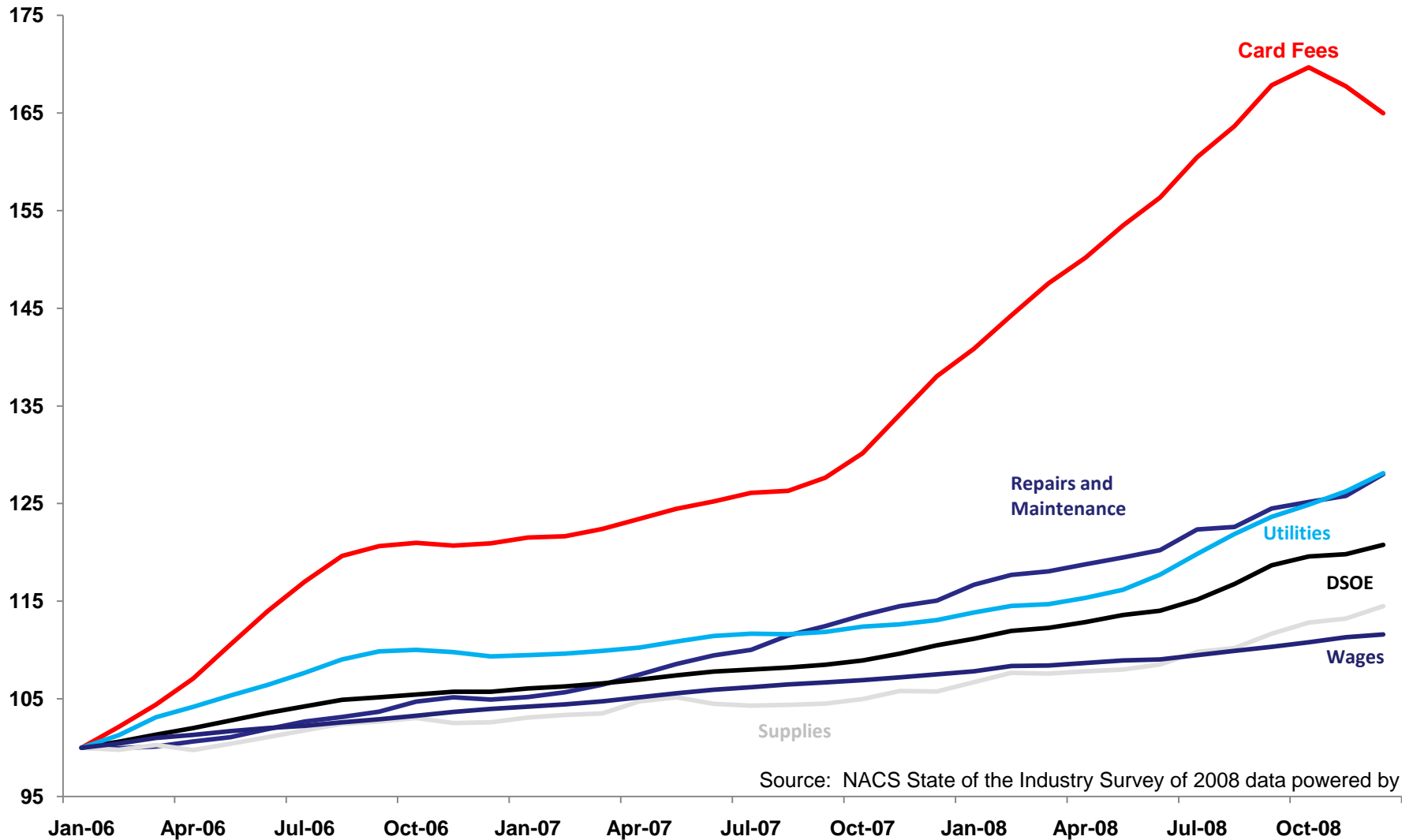


Catalyst – Retail Cost



Growth Rate of Key Expenses

2006 - 2008, 12 Month Moving Average



Source: NACS State of the Industry Survey of 2008 data powered by CSX

Cost-based Innovation

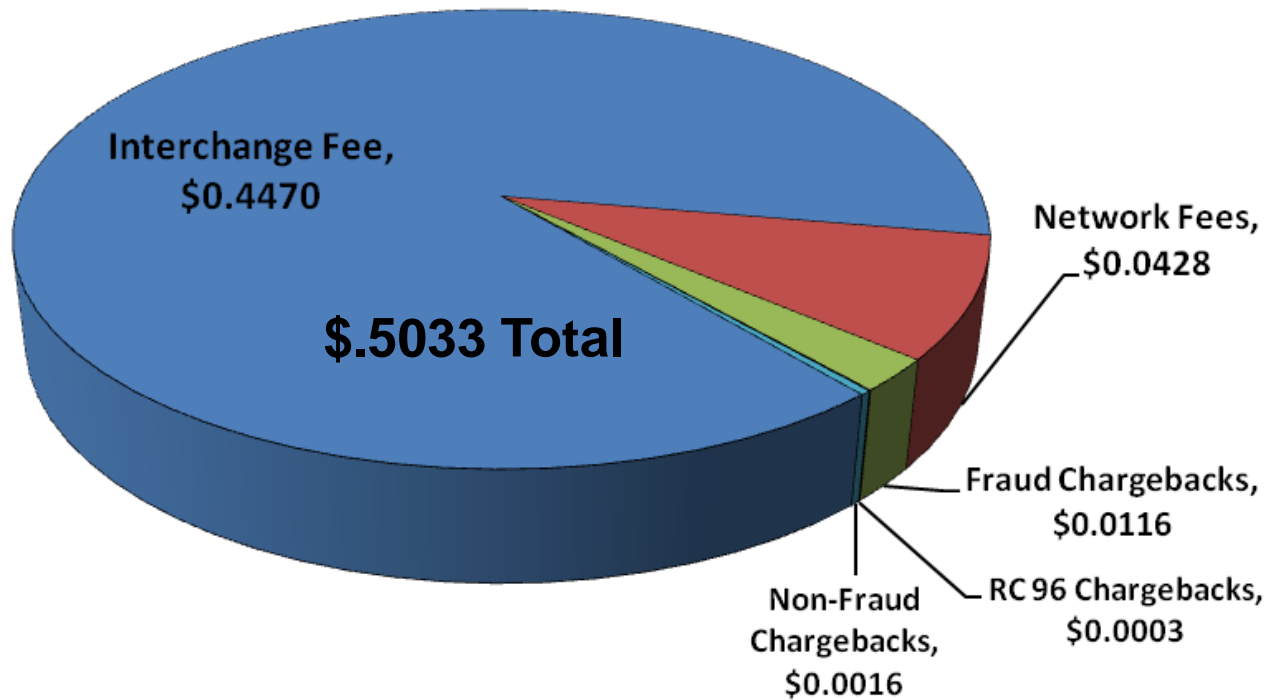
- Private Label
 - The least expensive strategy
 - Very difficult to implement in multi-homing economy
- ACH: “Electronic Checks”
 - Can be linked to Private Label
 - Fixed fee transactions < 18 cents guaranteed
 - Could address micro-payments
- Steering
 - Ineffectual in non-face to face
 - Pricing is hard to implement

Catalyst – Retail Fraud Cost

2009 Visa/MasterCard Transaction Cost Components

YTD \$23.28 average transaction

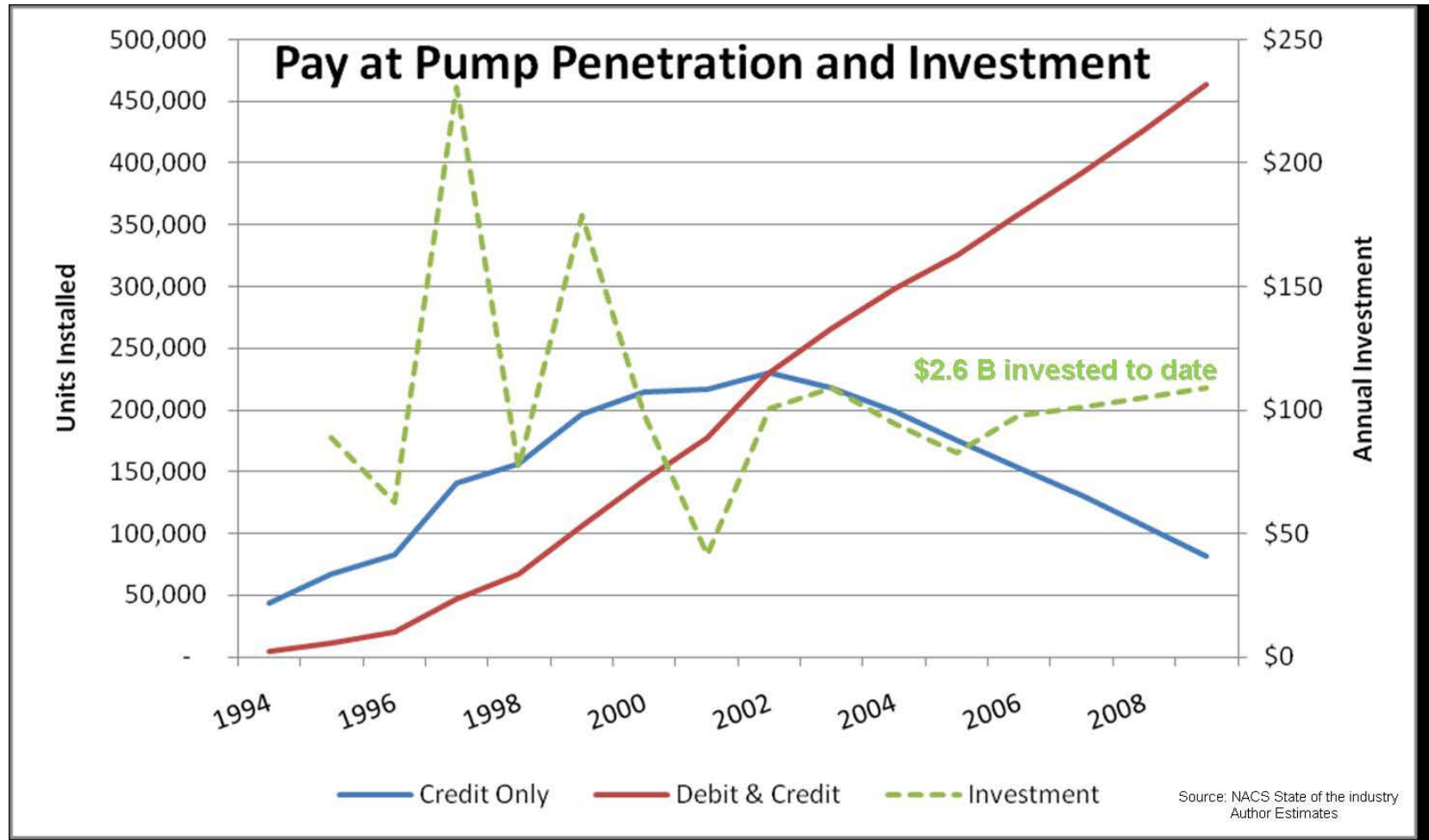
Source: NACS CPP (N=900)



Fraud-Based Innovation

- Authentication
 - Reduce fraud charge-backs
 - Verify card in possession
 - Authenticate cardholder (e.g. Zipcode/ID)
- Breach Risk Reduction
 - Reduce cost of PCI compliance
 - Point to point encryption
 - Tokenization

Catalyst – Retail Infrastructure



Infrastructure-based Innovation

- De-coupled Debit
 - ACH on ISO rails
 - Developing as multi-merchant
- NFC
 - Emulates MSR cards
 - First step to electronic wallet
- Transaction Routing
 - Least cost processor
 - Creates security risks

Retail economics are ripe for innovation

BUT

Retail Scorecard – 3rd Party Innovation

- Better
 - Reduce/eliminate fraud **X**
 - Eliminate cost of PCI compliance **X**
- Faster
 - Consumer adoption **X**
 - Checkout speed **0**
- Cheaper
 - Minimal infrastructure investment **-/0**
 - Reduced transaction costs **-/0**

Innovation Landscape: Some Final Thoughts

- Economic incentives between merchants and banks are at odds
- Banks have a problem
 - Revenue under pressure
 - Credit accounts/usage is falling
 - Debit usage increasing, but at lower revenue rate
 - Increasing regulatory oversight of debit costs
 - Security costs will rise
 - Chip and PIN close to zero sum game
- Consumers bored of incremental innovation