Exploring the **payments value** chain

Von Vincent Roland

Von verschiedenen Seiten wird die Profitabilität der Marktteilnehmer im Kartengeschäft unter Druck gesetzt. analysiert Vincent Roland. Eine Konsolidierung stehe in allen Marktbereichen an oder sei, wie im Bereich der Terminals und der Kartenproduktion bereits erreicht. Für die Prozessoren prognostiziert er, dass Marktteilnehmer, die weniger als eine Milliarde Transaktionen jährlich abwickeln, im Sepa-Markt nur schwer überleben dürften. Red.

The payments value chain is going through significant changes. The pace of change will only increase as standardisation, higher compliance requirements and the need to drive scale continue the trend toward increasing industrialisation. There has been an unprecedented level of change in the European payments industry during the last five years and especially since the beginning of the financial crisis. The payments value chain has become increasingly industrialised, with back office processes increasingly automated and centralised.

Mergers and acquisitions have transformed the banking and payments industries while some previously domestic-only players are becoming more international with new business models for the Single Euro Payments Area (SEPA). Global standards such as EMV and Payment Card Industry Data Security Standards (PCI DSS) are driving standardisation and eliminating technological barriers to entry in national markets.

Up to now there has been far more domestic than international consolidation taking place. While most of the consolidation has been among established players, one should not underestimate the potential impact of new market entrants. For example, the market leaders in the internet payments world are very different to those who dominate physical world payments. It is safe to say that the well-established payment providers are not the ones responsible for the 29 percent increase in e-commerce transactions reported by Visa Europe in the second quarter 2009 compared to the same period in the previous year.

Consolidation in some parts of the value chain is almost complete. The POS terminal and cards manufacturing markets are almost fully consolidated, with the top three global players holding 70 percent or more of the market among them. At the same time, the top three European processors of both ACH and card transactions have 40 to 45 percent of the market share in both segments[1].

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Consolidation has started in Sepa

With the introduction of Sepa, scale and reach are becoming increasingly important. For example, the top six acquirers in Europe accounted for 50 percent of transactions in 2008.[2] Also, the infrastructure of the largest multi-national processors is now enabling the industrial processing of billions of transactions. The four largest European card processors each have volumes of over 2 billion transactions annually – some double this amount – and all are multi-national[2]. Organisations processing less than 1 billion transactions per year may find it difficult to survive in the Sepa market. Other than the large players, it is also worth mentioning that almost 100 percent of the volume of most processors is domestic transactions.

Consolidation has started in Sepa, but there is a long way to go yet. First Data research shows that some 21.4 percent of payment transactions in Europe are processed by multi-national organisations, with the rest processed by domestic players[3]. The consolidation of volumes by multi-national processors will accelerate, but the cost of migrating customers from legacy to new systems is a significant challenge in managing the consolidation. Investments of tens of millions of Euro are needed to develop pan-european applications and to migrate customers to them. In response to this trend, domestic players in several countries are merging to create bigger organisations capable of competing against multi-nationals.

Large issuers and aquirers are set to dominate

Sepa is creating several major challenges, especially scale, reach and compliance. Scale is needed to stimulate the industrialisation of payments and to reduce processing costs. Meanwhile reach becomes increasingly important to deliver multi-national solutions. Domestic processing companies will need to operate cross-border if they wish to increase their Sepa reach. At the same time, on-the-ground support will be needed in each market. The key will be to centralise what is possible and to localise certain services based on individual market needs.

Compliance is another major challenge – it is increasingly complex and costly. There is also a threat to incumbents from new market entrants, such as payment institutions, a new form of payment service provider created by the European Payment Services Directive. There is already considerable interest from many non-traditional payment services providers, such as retailers and telecom providers, in entering the payments industry by becoming payment institutions.

Many of the winners across the value chain are already known. Large issuers and acquirers that can generate scale and cost efficiencies are set to dominate, especially those that have the resources to enter new markets. Among the payment schemes, the increasing drive to standardisation means that the international card schemes are set to win at the expense of domestic schemes. However, as the telecoms industry has shown, it may be possible for some of the domestic schemes to survive if they can generate sufficient scale. However, providers across the value chain have to be best in class.

Meanwhile, multi-national processors that provide enhanced infrastructure and facilities backed by outstanding service and support are well-positioned to provide best value to customers. The other big winners will be service providers with a differentiated offering of business model. This could include organisations such as Paypal, some mobile operators, and organisations whose potential impact on payments is not yet clear, such as social media.

Not surprisingly, the financial crisis continues to have a major impact on payments. It is forcing players across the value change to re-assess strategies across their business. For example, banks are being challenged to get more value from existing customers. Meanwhile, the shift in consumer spending from credit to debit is creating a profitability gap for many issuers due to lower interchange on debit. Banks are also reviewing the pricing of products, especially loss-making payment instruments such as debit. At the same time, the subsidisation of merchant acquiring by other payment services provided to corporate customers is being questioned.

Regulatory uncertaining has reduced investment in innovation

Pressure on European payments is likely to continue and to come from a number of sources. In addition to the already heavy compliance burden, the industry can expect increased regulation as a result of the financial crisis. This regulatory uncertainty is also having a knock-on effect of holding back investment in technology. Investment in innovation has been radically reduced, with the emphasis now on short-term efficiency-focused projects. Competition from new market entrants and niche players is set to increase, while the continuing convergence of payment products and services will enable players to operate in different businesses. Finally, new business models will be needed to cope with the commoditisation of payments and downward pressure on revenues. Scale will be crucial to reduce costs.

Several trends are set to impact the future shape of the industry:

1) International growth will outpace domestic growth as consolidation increases.

2) Standardisation will continue to remove barriers to entry but also increase compliance costs.

3) Processing and merchant acquiring are becoming more pan-European.

4) The impact of new market entrants cannot be forecast but it will be felt by all incumbents.

5) Issuers and acquirers are looking for alternative ways to switch transactions.

Consolidation of the payments industry is going to continue and no part of the value chain will escape it. In some cases it will happen through major industrial players with large investment capacity acquiring assets from banks and other organisation. The profitability of both issuers and acquirers is under threat from different sources. Acquirers will be tested by the shift from credit to debit, while those servicing Sepa merchants will have to develop their geographic footprint and industrialise processes if they are to optimise costs. In both areas the trend to outsourcing will increase. Sepa and other market pressures have opened the box on European payments with the result that the industry's value chain is being fundamentally changed.

Footnotes

[1] Sources: Nilson Report, TowerGroup, SWIFT, gtnews.com, Frost & Sullivan

[2] Source for both statistics: Nilson Report

[3] Based on end-2007 data and volumes of the top five multi-national processors in Europe